Financial institutions face an increasingly complex regulatory and economic environment. The heightened expectations from Basel III as well as the macroprudential regulatory oversight required by the Dodd-Frank Act after the financial crisis have created a period of material change across the industry.

All business activities are impacted, but a number of common themes have emerged: pressure on profitability, increased capital requirements, stricter rules around leverage and liquidity, and increasing requirements for risk management and measurement.

Banks between small and mid-sized banks are having to balance the need to comply with complex new regulatory requirements with managing day-to-day activities and achieving growth targets. Meanwhile, for larger banks, the CCAR process has introduced a high bar for paying dividends to shareholders, further reducing the attractiveness and return on bank equity investment.

**CCAR and DFAST modeling**

The annual stress testing cycle has increased the regulatory focus on risk management and risk measurement techniques. Aon helps clients to:

- Project operational risk losses, using a variety of quantitative modeling approaches that identify and isolate the macroeconomic effects on operational risk.
- Develop and facilitate scenario analysis workshops that identify the macroeconomic and idiosyncratic risks faced by the institution.
- Build internal loss data collection systems and processes that ensure management can have confidence in the output from stress test models.

**Operational risk capital modeling**

More and more small and mid-sized banks are developing economic capital models using techniques applied at AMA banks to quantify their exposure to operational risk. Aon helps clients to:

- Conduct exploratory data analysis on their internal and external loss data.
- Design a unit of measure structure with sufficient granularity to support risk management, while maintaining enough data in each unit to accurately model the risk.
- Build and code a flexible infrastructure to fit and select frequency and severity distributions, and perform Monte Carlo simulation of losses.
- Model the dependence structures between units of measure to identify the appropriate level of diversification.

We’re here to empower results:

Contact a member of Aon’s Financial Institutions practice to learn more.

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Scenario analysis

Many institutions face challenges in developing a robust scenario analysis framework with complete coverage of all key risks. A well-designed scenario analysis framework helps an institution to understand its risk exposures, and provides an essential input into the DFAST and CCAR stress testing processes. Aon helps clients to:

- Develop a scenario analysis framework that identifies the macroeconomic and idiosyncratic risks an institution faces. Such scenarios are a required element of the CCAR process.
- Provide a forward-looking element to their operational risk capital modeling methodology, with a comprehensive scenario analysis library across all units of measure.
- Gain insight into their risk profile by estimating their quantitative (loss frequency and severity), as well as qualitative risk exposure.

Model validation and model risk management

Aon has extensive experience in supporting clients through Credit and Operational Risk model reviews and formal model validation, targeted at compliance with SR 11-7. Thorough model validation increases management and regulatory confidence in the results of models, enabling their use as important business management tools. Aon helps clients to:

- Review and validate existing models for statistical soundness, compliance with relevant regulation and adherence with existing and emerging industry best-practice.
- Produce model development plans designed to address gaps found during validation process.

Insurance program review and optimization

- Insurance is one of the primary methods of operational risk loss mitigation, particularly against large and unexpected losses. Aon works with clients to design optimal insurance solutions that tailor coverage to the institution’s underlying risk exposure and risk appetite.
- With Aon’s unique combination of modeling and insurance brokerage expertise, we are able to help clients balance premium cost against effective risk mitigation.

Operational risk management frameworks

The operational risk management framework is a cornerstone of an institution’s risk management infrastructure. A well-designed framework helps to ensure that management understands the risks inherent to the organization, and have actively accepted or mitigated the risk. Further, while regulatory requirements may change and advance, a strong framework allows a firm to meet requirements without recreating itself. Aon helps clients to:

- Establish a comprehensive risk taxonomy.
- Set up an internal loss data collection system.
- Implement a risk and control self-assessment (RCSA) program.
- Design and implement a library of key risk indicators and key control indicators.
- Review existing frameworks and produce development plans to address identified gaps.
- Put in place a comprehensive plan to ensure readiness for regulatory expectations relative for the size and complexity of your institution.