# Scenario Library

"… scenarios that are to accurately reflect risk require a willingness to think expansively about linkages, and cannot be artificially constrained by a desire to minimize capital." "Even with improvements in scenario analysis, there will be significant judgment involved in the exercise.  As behavioral economics has highlighted, it can be very difficult to elicit accurate qualitative information from managers.  Generating scenario data that are predictive (that is, forward looking) requires calculated rigor."
*Eric Rosengren, Risk Management Lessons from Recent Financial Turmoil, Conference on New Challenges for OR Measurement and Management , Federal Reserve Bank of Boston, Boston, May 14, 2008*

Many organisations create their own scenarios, using different methods to assist in identifying possible scenarios, such as expert opinion, public loss data sources and brainstorming techniques. But merely identifying a possible scenario is just the starting point – how can we be sure we have covered all the possible types of risks we may face? How do we classify or categorise our scenarios? How do we cross-reference our scenarios to our loss data, risk and control assessments, KRIs and to consortium or public loss data? How do we know that the parameters we are using are both realistic and in line with our industry peers?

Risk*Business* defines a scenario as an outline, description or model of a sequence of unexpected or adverse events. Scenarios vary in detail according to the level of the organisation at which they are researched and focussed, but are generally made up of similar components. Scenarios are described using scenario (risk category or loss event) types and describe the typical causes and potential impacts of the event, should it actually crystallise. Generically, information from all aspects of an operational risk framework should be included in a scenario or scenario analysis: a description of the event, an inventory of relevant risks and controls, along with their effectiveness if applicable, a summary of relevant internal and external loss data, a list of key risk indicators that are expected to describe or even predict the scenario event to some extent, as well as a costing or parameterisation of the scenario for risk capital calculation purposes. Scenario assessment will usually include a causal analysis, along with expected direct and indirect impacts, particularly those of a reputational nature. Firms usually also analyse the expected timeline over which an adverse event would play out, along with the mitigating actions that could be taken to minimise the scenario's severity.

Scenario's are usually either considered "top-down" by senior management, as is the case for scenarios used in the capital estimation process or for business continuity planning, or "bottom-up" by line management and the business for the purposes of extreme or unusual risk or exposure assessment and vulnerability estimation. Scenario's may also consist of a single standardised scenario event or may be created by grouping a number of standardised events to create custom, multi-variant scenarios deemed possible of occurring.

The Risk*Business* Scenario Library is an online subscription-based database containing both individual scenario events and consolidations of scenario events into complete scenarios of adverse and unexpected events which may impact negatively on an organisation. Subscribing firms can browse the different categories of scenario, select those they feel could apply to them and then download the scenario for their own internal use and evaluation, while adding their own scenario events or entire scenarios if they wish to.

# Risk Content

The Scenario Library contains:

- A taxonomy of standard scenario types, cross-referenced to the Risk*Business* Taxonomy, the Basel II loss event types and to other industry recognised taxonomies;
- A library of standardised scenarios of each scenario type, linked to risk points derived from the Risk*Business* Taxonomy and which can be supplemented by public loss events through the Risk*Business* Newsflashes Service; and
- A sub-library of independent scenario events, linked to risk points derived from the Risk*Business* Taxonomy, which can be used to create your own unique multi-variant scenarios.
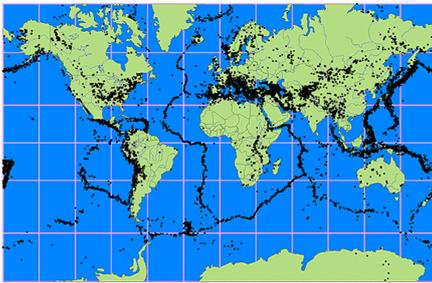
As a subscriber to the Scenario Library, you can select those scenarios and scenario events which you use and flag these – in the same manner, on an anonymous basis, you can see which other scenarios and scenario events have been selected by other subscribers and how often each scenario or scenario event has been selected. You can also add your own scenarios and propose new scenarios for inclusion into the Scenario Library.

Of equal importance to the availability of an exhaustive set of quality scenarios for evaluation is the approach to scenario assessment. Scenarios fill a very specific position within the overall suite of operational risk management tools and care is required to focus scenario analysis on that aspect of the exposure curve to which it applies. This requires a clear policy on scenario usage and estimation – Risk*Business* provides advisory services to our clients, both in conjunction with the Scenario Library and independent thereof. The approach must also focus on the reduction of bias and gaming and should accept the difference in the use of scenarios for risk quantification versus risk management.
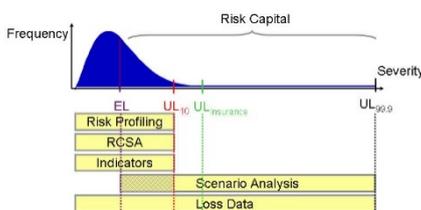
To support the Scenario Library, Risk*Business* also provides its Scenario Assessment Service, an online tool to collect scenario parameters for scenarios selected from the Scenario Library, to process these parameters and facilitate the eventual agreement on the overall frequency and impact to the firm. This then allows for the scenario parameters to be incorporated into a capital estimation process or to be pooled with other interested firms to achieve anonymised scenario benchmarking, under the Risk*Business* Benchmarking Service.

Risk*Business* also facilitates regular scenario discussion groups on selected topics amongst subscribers to the Scenario Library, with emerging areas of exposure concern being subjected to group assessment to derive suitable scenario events for inclusion into the Scenario Library.

For more information on the Scenario Library, please contact Risk*Business* Services Limited through our website or email us at info@Risk*Business*.com.

What is our exposure to earthquake?

# Risk**Content**