Comments

(by Ashish Dev)

on

The Market value Impact of Operational Risk Events for US Banks and Insurers

by David Cummins, Chris Lewis and Ran Wei

- Reported operational loss event has a significant negative impact on stock price (market value) on the institution both for banking and insurance industries.

- The size of market value loss of an institution is several times the operational loss reported by the institution. The effect is stronger for companies whose stock price reflects high levels of future growth.

- This provides justification for investments in time and resources on management of operational risk and likely prevention of operational losses.

- It also attracts the attention at the highest levels of the institution.

- A institution-specific analysis needs to be done and an implementation plan prepared to leverage off the attention. Then show that the cost of such an implementation is *small* in comparison with the expected market value erosion.

- It is not clear whether the erosion of market value is temporary (and may reverse itself over time).

- Financial institutions need to *signal* their effectiveness in operational risk management and control -- in order to minimize potential market value erosion when an operational event ends up happening unfortunately, even when operational risk management and effectiveness of controls are of high quality.

- Qualifying for *AMA* (Advanced Measurement Approaches of Basel II) is *one such signal*. It is likely to be an effective signal for institutions that are not required to be under Basel II (e.g. insurance companies, non-bank financial companies, medium-sized banks in the US).