

Leonardo B3: Business Vs Basel II

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“Basel II” & Operational Risk: lessons to learn
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Basilea 2: Surfing the Net

- Summer 2003: I had some difficulties to find right contents/news on Basel II, searching “Basilea 2” (Basel 2, in Italian) through Google
 - ▀ The first obtained document was entitled
 - ▀ “Basilea 2 – Spartak Praga 0”
- In Autumn 2004, already:
 - ▀ Searching “Basilea 2” by Google we may found more than 15.000 documents, simply searching “Basel 2” we may found more than 110.000

Impact

- ➔ Basel II is a fundamental (maybe, today, the most important) source of change for Banks, Enterprise and Relationship:
 - ▀ Credit is always strategic
 - ▀ Basel II impact is connected to a *general* (medium-term & world – wide) *mood*: the so-called *culture of stability*
 - ▀ On the background of the Basel II favorite processes you may found that culture of continuous improvement focused by Total Quality

One years ago ...

	"Basilea 2"	"Basilea 2" & "Rischio Operativo"	"Basilea 2" & "Risorse umane"	"Basilea 2" & "Competenze"	"Basilea 2" & "Rating"	"Basilea 2" & "PMI"
19-apr-04	14.200	298	590	1.130	1.840	2.620
16-feb-05	41.300	538	3.800	4.410	11.000	13.000
3-set-07	480.000	13.300	48.800	81.000	109.000	101.000
% difference (in less than 30 months !)	1062%	2372%	1184%	1737%	891%	677%

Today (4 July 2008) you'll find:
 (Searching by Google "Basilea 2" OR "Basilea II" OR "Basel II" OR Basel 2")
1.280.000 Documents

Two source of innovation

➤ Credit Risk <-> Rating

- ▶ From States to SMEs
- ▶ Involving:
 - ✓ Government
 - ✓ Processes
 - ✓ Human Resource

➤ Operational Risk

- ▶ *The risk of loss resulting from inadequate or failed internal process, people and systems or from external events*
- ▶ Bank of International Settlements¹ has:
 - ✓ Analyzed around Fifty Thousand Events of Loss
 - Nearly Eight Billion of euros
 - Nearly Twelve Million of person-years
 - ✓ Produced guides and suggestions to avoid them.

¹ "The 2002 Loss Data Collection Exercise for Operational Risk: Summary of the Data Collected" - www.bis.org - March 2003

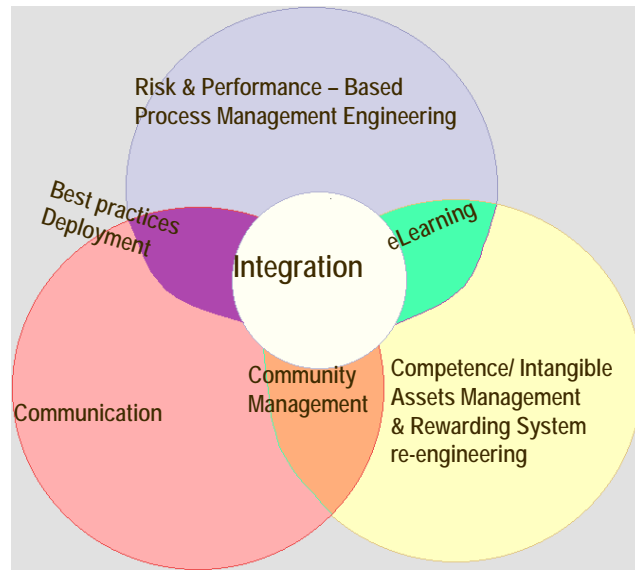
Facing Basel II Credit Market: Six golden rules

➤ European Commission has recently published a guide for SMEs in order to facilitate the access to the Credit

- ▶ Rule 1: Ask for information
- ▶ Rule 2: Deliver clear, complete, and timely documentation
- ▶ Rule 3: Check terms and conditions
- ▶ Rule 4: Manage your rating actively
- ▶ Rule 5: Make sure you hold on to your loan
- ▶ Rule 6: Consider the alternatives

The guide (how to deal with the new culture of rating) may be freely download, in different languages, from European Union website (<http://europa.eu>)

Impact areas



Basel II – Operational Risk

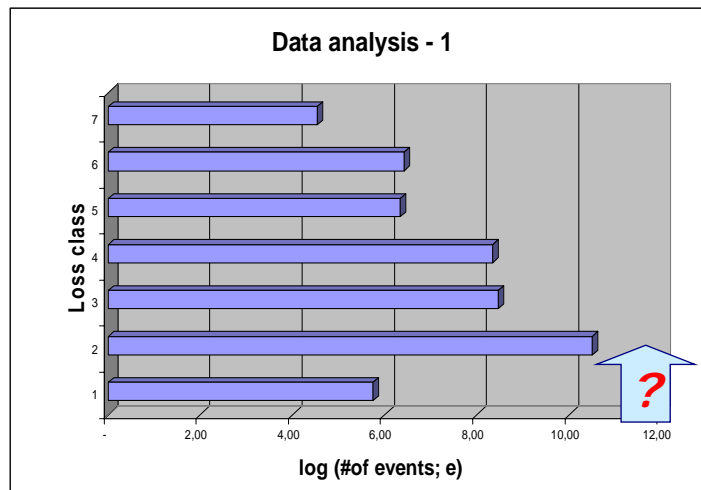
- Three levels:
 - ▶ Seven "event-type category" (Level 1)
 - ▶ Twenty "categories" (Level 2)
 - ▶ Seventy "Activity examples" (Level 3)
- The seven event-type categories are:
 - ▶ Internal fraud
 - ▶ External fraud
 - ▶ Employment Practices and Workplace Safety
 - ▶ Clients, Products & Business Practices
 - ▶ Damage to Physical Assets
 - ▶ Business disruption and system failure
 - ▶ Execution, Delivery & Process Management

Basel II – Operational Risk
Events of loss

Loss value (€)	Number off loss (BRI 2002 statistic - 89 Banks)	Average value	Global value (€)	Value %
<10.000	313	€ 6.185	€ 1.936.000	0,02%
>10.000 - <50.000	36.745	€ 19.608	€ 720.489.000	9,24%
>50.000 - < 100.000	4.719	€ 68.825	€ 324.783.000	4,17%
>100.000 - <500.000	4.217	€ 201.007	€ 847.645.000	10,87%
>500.000 - < 1.000.000	563	€ 688.842	€ 387.818.000	4,97%
>1.000.000 - <10.000.000	619	€ 2.825.124	€ 1.748.752.000	22,43%
>10.000.000	93	€ 40.474.237	€ 3.764.104.000	48,29%
Totale / media complessiva	47.269	€ 164.918	€ 7.795.527.000	100,00%

Source
 "The 2002 Loss Data Collection Exercise for Operational Risk: Summary of the Data Collected"
 -March 2003 - www.bis.org "

Data Analysis



Data Analysis

Events off loss and average value of lossess (thousand of euros)		Categorie (livello 1)							TOTAL
		FI - Internal Fraud	FE - External Fraud	RI - Employment practices	BP: Clients, Products &	Danni - Damage to Physical Assets	Sistemi: "business disruption & System failure"	PM: Execution, Delivery & Process Management	
Corporate finance	# of events	17	20	73	73	16	8	214	421
	Average loss	2.905,9	250,0	2.163,0	109,6	31,3	6.200,0	2,8	643,7
Trading & Sales	# of events	47	95	101	108	33	137	4.603	5.124
	Average loss	1.266,0	425,3	641,6	1.790,7	2.663,6	128,5	151,7	226,8
Retail Banking	# of events	1.268	17.107	2.063	2.125	520	163	5.289	28.535
	Average loss	261,8	46,0	164,8	119,6	168,3	162,6	80,3	78,9
Commercial Banking	# of events	84	1.799	82	308	50	47	1.012	3.382
	Average loss	252,4	180,6	248,8	507,8	21.458,0	387,2	809,7	719,5
Payment & Settlement	# of events	23	332	54	25	9	82	1.334	1.859
	Average loss	1.000,0	63,3	214,8	420,0	1.666,7	958,5	70,1	136,2
Agency services	# of events	3	15	19	27	8	32	1.381	1.485
	Average loss	66,7	260,0	400,0	185,2	12.500,0	1.253,7	126,1	222,8
Asset Management	# of events	28	44	39	131	6	16	837	1.101
	Average loss	228,6	104,5	261,5	587,8	383,3	143,8	135,2	196,2
Retail Brokerage	# of events	59	20	794	539	7	50	1.773	3.242
	Average loss	1.042,4	60,0	63,9	294,2	73.314,3	560,0	54,8	280,8
Totale	# of events	1.529	19.432	3.225	3.336	649	535	16.443	45.149
	Average loss	361,7	61,1	205,6	258,7	2.895,7	487,7	147,2	173,4

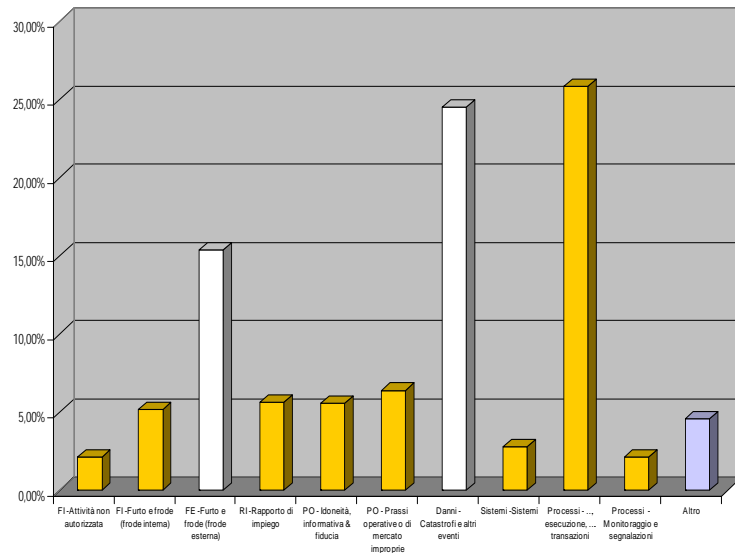
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"Top ten"

Level 1	Level 2	% (Value)
Damage to Physical Assets	Disaster & Other Events	24,21%
Execution, Delivery & Process Management	Transaction Capture, Execution & Maintenance	22,08%
External Fraud	Theft & Fraud	14,49%
Employment Practices & WP Safety	Employee Relations	5,49%
Clients, Products & Business Practices	Improper Business or Market Practices	5,32%
Clients, Products & Business Practices	Suitability, Disclosure & Fiduciary	4,63%
Internal Fraud	Theft & Fraud	2,86%
Business Disruption & System Failure	Systems	2,70%
Execution, Delivery & Process Management	Monitoring & Reporting	1,80%
Internal Fraud	Unauthorized Activity	1,54%

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So, what?



Elaborazione dell'autore su dati BRI

Sound Practices for the Management Supervision of OR

- ➔ Basel committee focused 10 principles, grouped into 4 areas,
 - ▀ Developing an Appropriate Risk Management Environment
 - ▀ Risk Management: Identification, Assessment, Monitoring and Mitigation/Control
 - ▀ Role of Supervision
 - ▀ Role of Disclosure
- ➔ We state that that's principles may be also migrated from Bank to Enterprise
- ➔ We state that that's principles paint competencies' enhancements' needs

Migrated principles

- ➔ The Entrepreneur and the CEO should be aware of the major aspect of the Enterprise Operational Risk, as a distinct risk category
- ➔ The Entrepreneur have to state an effective, comprehensive and powered Operational Risk Management Framework, and an independent Internal Audit on that Framework
- ➔ All the management should have responsibility on implementing Operational Risk Framework

From principles to competencies

Behaviors/processes

- ➔ Awareness on O.R. role in entrepreneurship
- ➔ O.R. framework planning and O.R. – related structures definition
- ➔ Integration of +Performance & -Risk actions

Competencies' enhancements' needs

- ➔ Awareness on risk role in business success
- ➔ Integrated Planning and Organization Development
- ➔ Integrated management: performance implementation and risks mitigation

**Education & training
needs****Competencies'
enhancements' needs**

- Awareness on risk role in business success
- Integrated Planning and Organization Development
- Integrated management: performance implementation and risks mitigation

Educational contents needs

- OR and Event of Loss
- Relationship between business planning and organizational development
- Why KPI and KRI are "two side of the same coin". What are the business and organizational consequences of this concept

Migrated principles

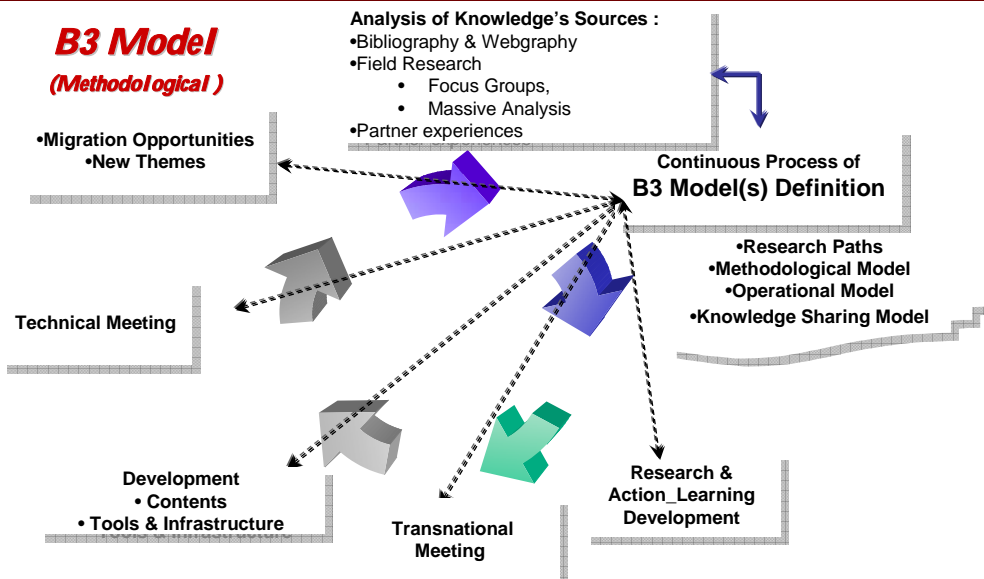
Enterprise, according with it's dimension and complexity but independently with it's branch, should

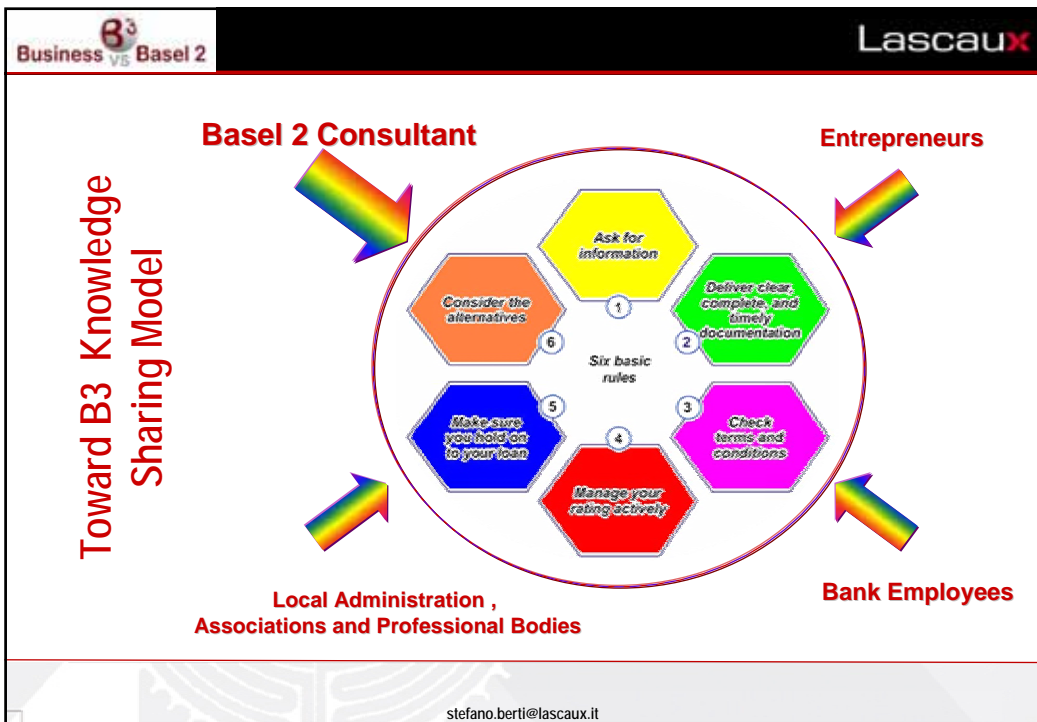
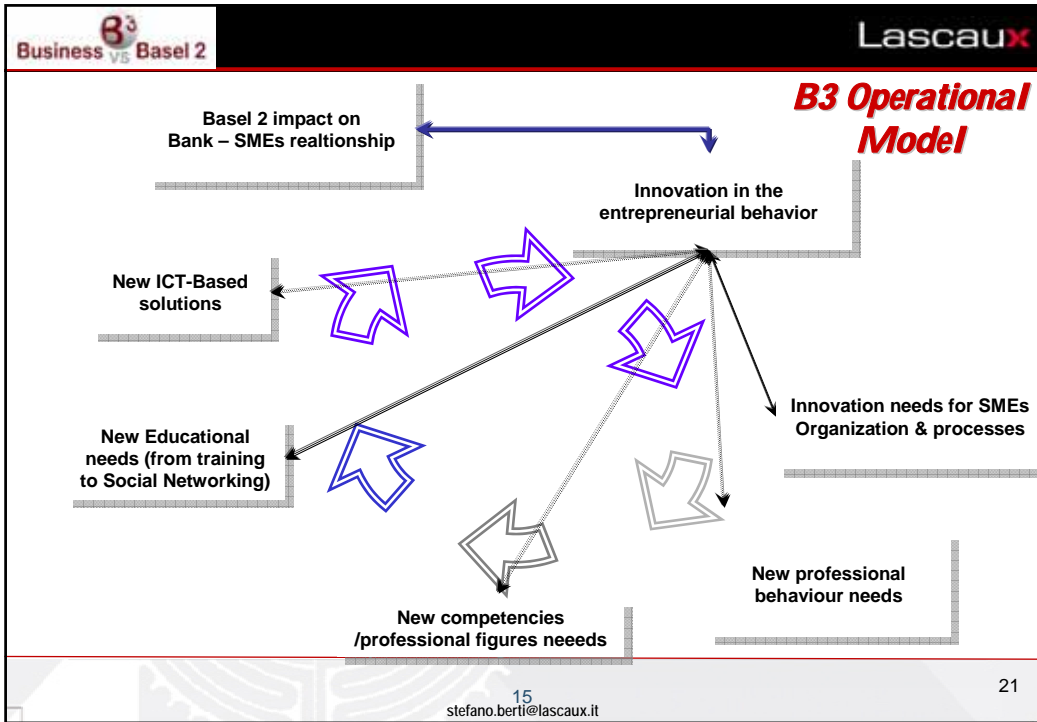
- Identify and assess the operational risk inherent in all material, product, activities, processes and systems
- Implement a process to regularly monitor operational risk profiles
- Have policies, processes and procedures to control and/or mitigate operational risk

Migrated principles

- ➔ Authority should require that all the enterprise have an effective operational risk framework
- ➔ Authority should conduct, directly or indirectly, regular evaluation of enterprise policies & practices concerning Operational Risk
- ➔ Enterprise should make sufficient public disclosure to allow market participants to assess their approach to operational risk management

B3 Model
(Methodological)





Thank you for your kind attention ...

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