



BANK FOR INTERNATIONAL SETTLEMENTS  
RISK CONTROL

# Corporate Governance: Risk Control Framework

**Jens Ulrich, Risk Control, BIS**

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RISK CONTROL

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## Disclaimer

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The following is my personal view!



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## Agenda

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- Supervisors and Bank Risk Management
- Components of the Risk Management Process
- Organisation of Internal Controls
- Risk Control Framework of the BIS

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## Supervisors and Bank Risk Management

- “Core Principles for effective Banking Supervision”  
Basel Committee for Banking Supervision  
Basel September 1997



## Core Principles: Risk Management Process

- Principles 7-13 :

In summary: Banking supervisors must be satisfied that banks have in place a comprehensive risk management process (including appropriate board and senior management oversight) to identify, measure, monitor and control all material risks and, where appropriate, to hold capital against these risks.



## **Core Principles: Principles 7-13**

- Comprehensive risk management process (including board, senior management oversight)
- All material risks
  - Identify
  - Measure
  - Monitor
  - Control
- Where appropriate hold capital against risks.



## **Core Principles: Organisation of Internal Controls**

- Principle 14:

“Banking supervisors must determine that banks have in place internal controls that are adequate for the nature and scale of their business. These should include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding its assets; and appropriate independent internal or external audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.”



## **Core Principles: Principle 14**

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- Internal controls adequate for the nature and scale of business
- Clear arrangements for delegating authority and responsibility;
- Separation of the functions
  - Committing the bank
  - Paying away its funds
  - Accounting for its assets and liabilities
- Reconciliation of these processes;
- Safeguarding its assets;
- Independent internal or external audit and compliance functions



## **Agenda**

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- Supervisors and Bank Risk Management
- **Components of the Risk Management Process**
- Organisation of Internal Controls
- Risk Control Framework of the BIS



## Components of the Risk Management Process

- Risk Types
- Framework
- Activities
- Acting entities
- Attitudes



## Risk Types I

- Credit Risk
  - Default Risk/ Migration Risk
  - Transfer Risk
  - Settlement Risk
- Market Risk
  - Interest Rate Risk
  - Foreign Exchange Risk
  - Other Market Risks: Commodity, Equity, ...
- Liquidity Risk
- Operational Risk (Event Risk)



## **Risk Types II**

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- Legal Risk
- Reputational Risk
- Business Risk in general



## **Framework**

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- Mission
- Strategies
- Policies
- Rules
- Limits



## Activities

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- Framework
  - Define
  - Propose
  - Approve
  - Review
- Risks
  - Take (commit to)
  - Identify
  - Measure
  - Monitor
  - Control
  - Report



## Acting Entities

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- Board
- Senior Management
- Committees
- Risk Control
- Legal
- Finance
- Audit (internal/external)
- Risk Takers
- Compliance
- Operations





## Attitudes

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- High ethical and integrity standards
- Strong risk culture
  - Importance of internal controls
  - Understand role in the internal control process
  - Be fully engaged in the process

From: Principle 3, "Framework for Internal Control Systems in Banking Organisations", Basel Committee, Basel, September 1998



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## Organisation of Internal Controls

- “Framework for Internal Control Systems in Banking Organisations”, Basel Committee, Basel, September 1998; 13 Principles
- Management oversight and the control culture (pr. 1-3)
- Risk recognition and assessment (pr. 4)
- Control activities and segregation of duties (pr. 5,6)
- Information and communication (pr. 7-9)
- Monitoring activities and correcting deficiencies (pr. 10-12)
- Evaluation of internal control systems by supervisory authorities (pr. 13)



## Management oversight and the control culture

- **Board**
  - Ultimately responsible
  - Understand major risks
  - Approve and review strategies and significant policies
  - Approve organisational structure
  - Ensure appropriate senior management actions
- **Senior Management**
  - Implement strategies and policies set by board
  - Define and implement risk management process
  - Monitor adequacy and effectiveness of internal controls
  - Set clear responsibilities, authorities and reporting relationships
- **Both: promote ethics, integrity, risk control culture**



## **Risk recognition and assessment**

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- **Design Internal Control System**
  - Cover all material risks (see above: Risk types)
  - Recognise and continually assess (see above: Activities)
    - Identify
    - Measure
    - Monitor
    - Control
    - Report
- **Review and update Internal Control System**



## **Control activities and segregation of duties**

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- **Control activities**
  - Integral part of daily activities
  - Defined at every business level
  - Top level reviews
  - Activity controls in business units
  - Compliance check (limits), follow up on non-compliance
  - Approval and authorisation system
  - Verification and reconciliation system
- **Segregation of Duties**
  - No conflicting responsibilities
  - Conflicts of interest: identified, minimised, monitored



## Information and Communication

- **Adequate and comprehensive data**
  - Internal: financial, operational, compliance
  - External relevant for decision making
- **Information**
  - Reliable
  - Timely
  - Accessible
  - Consistent
- **Systems**
  - Secure
  - Monitored independently
  - Adequate contingency arrangements
- **Effective communication channels**
  - All staff understand and adhere to policies and procedures
  - Information is reaching the appropriate personnel



## Monitoring activities and correcting deficiencies

- **Monitoring of effectiveness of internal controls**
  - Monitoring of key risks part of daily activities
  - Periodic evaluations by business lines and internal audit
- **Internal audit function**
  - Effective, comprehensive audit of internal control system
  - Report to Senior Management and Board (Audit Committee)
- **Internal control deficiencies**
  - Timely reporting to management
  - Addressed promptly
  - Material deficiencies reported to senior management and Board

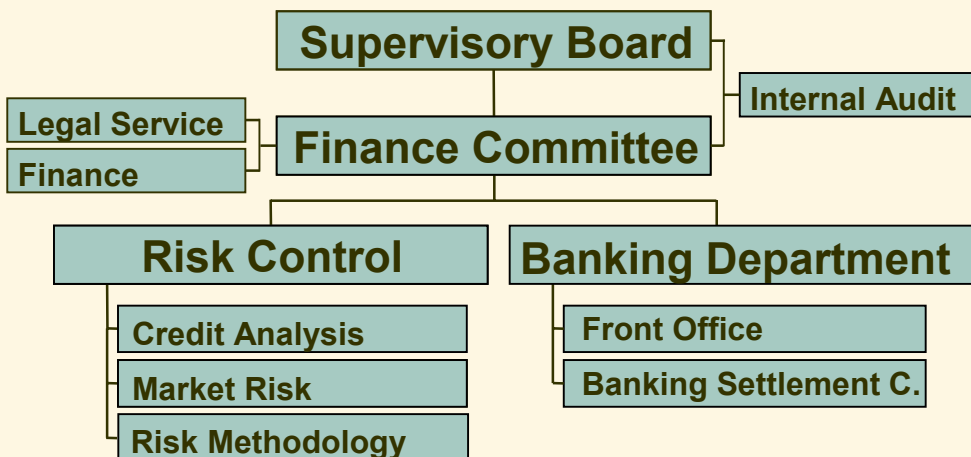


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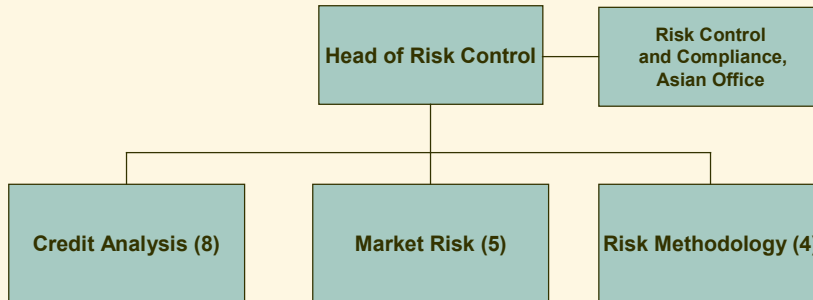
## Risk Control Framework





## Risk Control - Organisation

- Head of Risk Control reports to Deputy General Manager
- 3 Risk Control groups with own line management
- 19 staff + 1 report in Asian Office



## Risk Control - Challenges

- Strike adequate balance between supporting new business initiatives, best practice risk management and resource constraints
- Maintain high quality credit analysis and monitoring while diversifying investments
- Provide reliable and efficient performance measurement and reporting in co-operation with Finance
- Optimise provision of IT services to ensure efficient and reliable IT systems as critical success factor

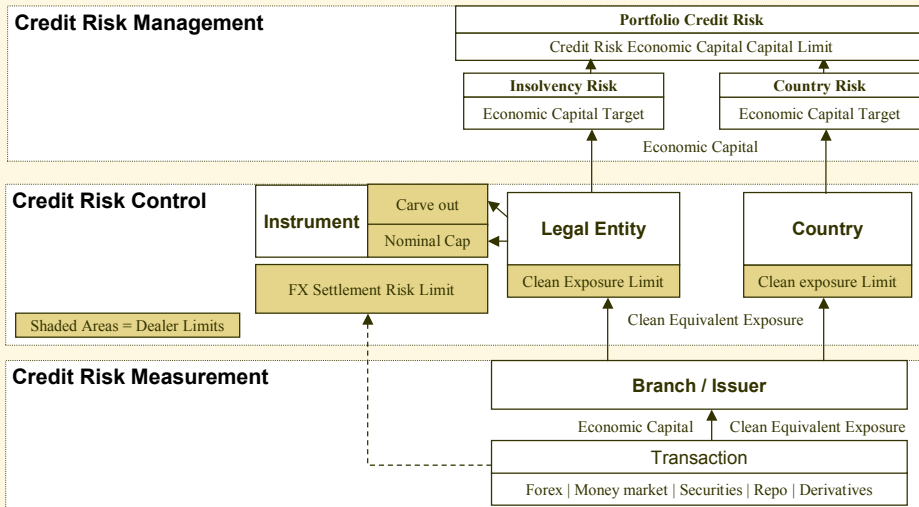


### Credit Analysis - Core Functions

- Development of credit strategy and policy
- Analysis of counterparty and country risk
- Management of risk within Board and FICO defined limits
- Definition of limit structures
- Monitoring of compliance with rules and limits
- Reporting of credit risk exposures and economic capital consumption



### Credit Risk Control Framework





## **Market Risk - Core Functions**

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- Development of market and liquidity risk policy and limit structure within Board and FICO defined limits
- Monitoring of compliance with rules and limits
- Market and liquidity risk measurement and reporting of exposures and market risk economic capital consumption
- Pricing and valuation
- Performance measurement and reporting



## **Risk Methodology - Core Functions**

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- Quantitative methods for risk measurement, valuation and performance measurement
  - New methods and systems
  - Review / redesign of existing methods and systems (e.g., the CRM Refinement Project)
- Ensure stable and reliable Risk Control IT
  - Development and maintenance of IT systems
  - Risk Control user support and training
  - Participation in the development of Bank-wide IT systems