



Marco Onado
Gli insegnamenti della crisi e le regole future

**I controlli interni:
fallimenti del passato e regole del futuro
Convegno Adam Smith Society
20 aprile 2009**



Agenda

- **I controlli interni e la corporate governance al centro dell'attenzione**
- **La crisi ha dimostrato l'esistenza di molti punti deboli all'interno delle banche**
- **Le autorità di tutti i paesi stanno lanciando messaggi chiari e forti su quello che le banche dovranno fare nell'immediato futuro**
- **Le banche sono giustamente impegnate ad affrontare l'emergenza, ma ormai è tempo di pensare a risolvere i problemi di fondo**

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Activist investors

Fight of the locusts

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Will the retreat of activist investors give industrial bosses more leeway to manage?

Illustration by David Simonds



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Audit committees
By Jennifer Hughes
Published: February 3...

Economist.com

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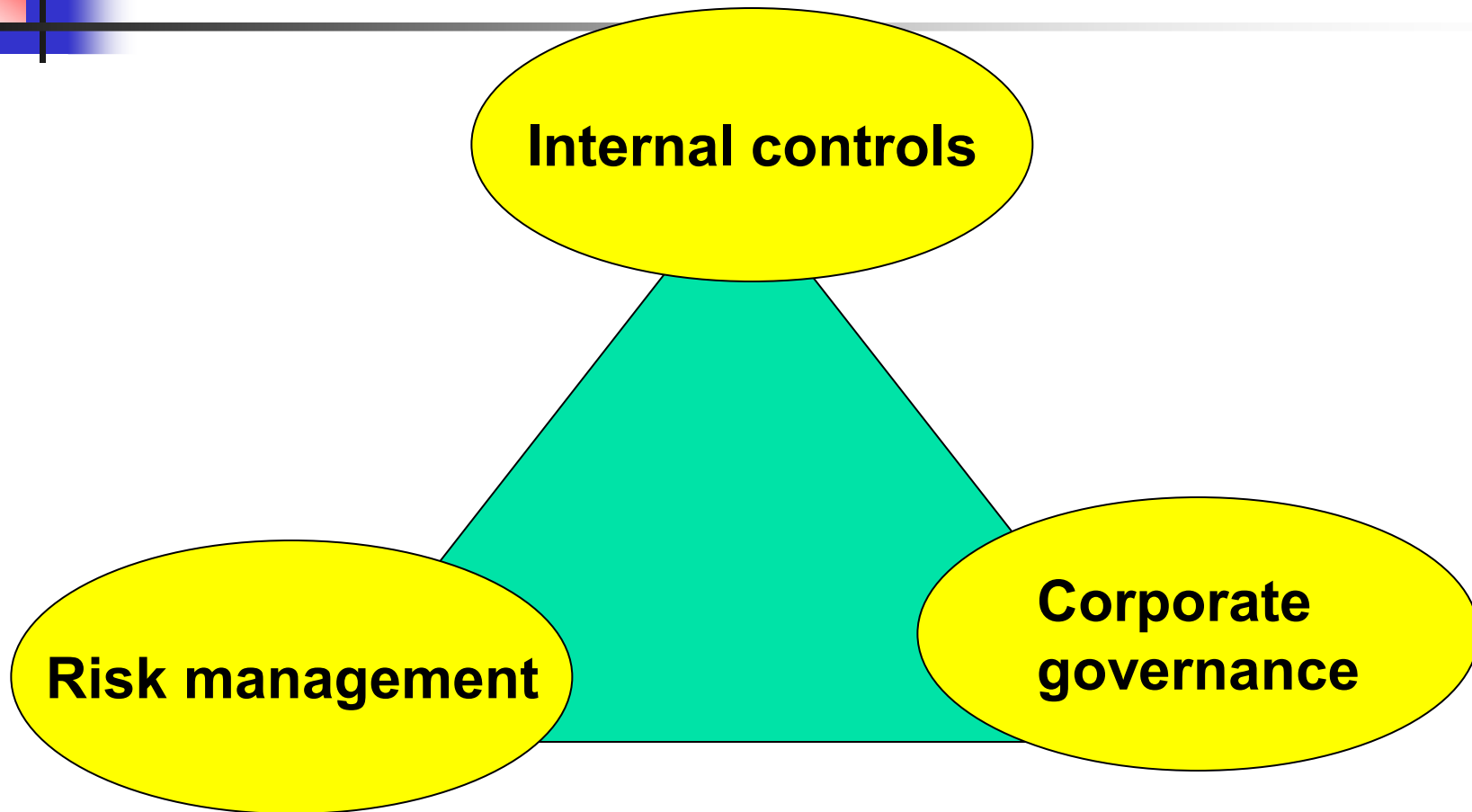
Called to account

Feb 26th 2009
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Basel Committee on Banking Supervision

SENIOR SUPERVISORS GROUP

Observations on Risk Management Practices
during the Recent Market Turbulence

March 6, 2008



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FOR ECONOMIC
CO-OPERATION
AND DEVELOPMENT



For a stronger, cleaner, fairer world economy

Supervisory guidance for assessing banks' financial instrument fair value practices

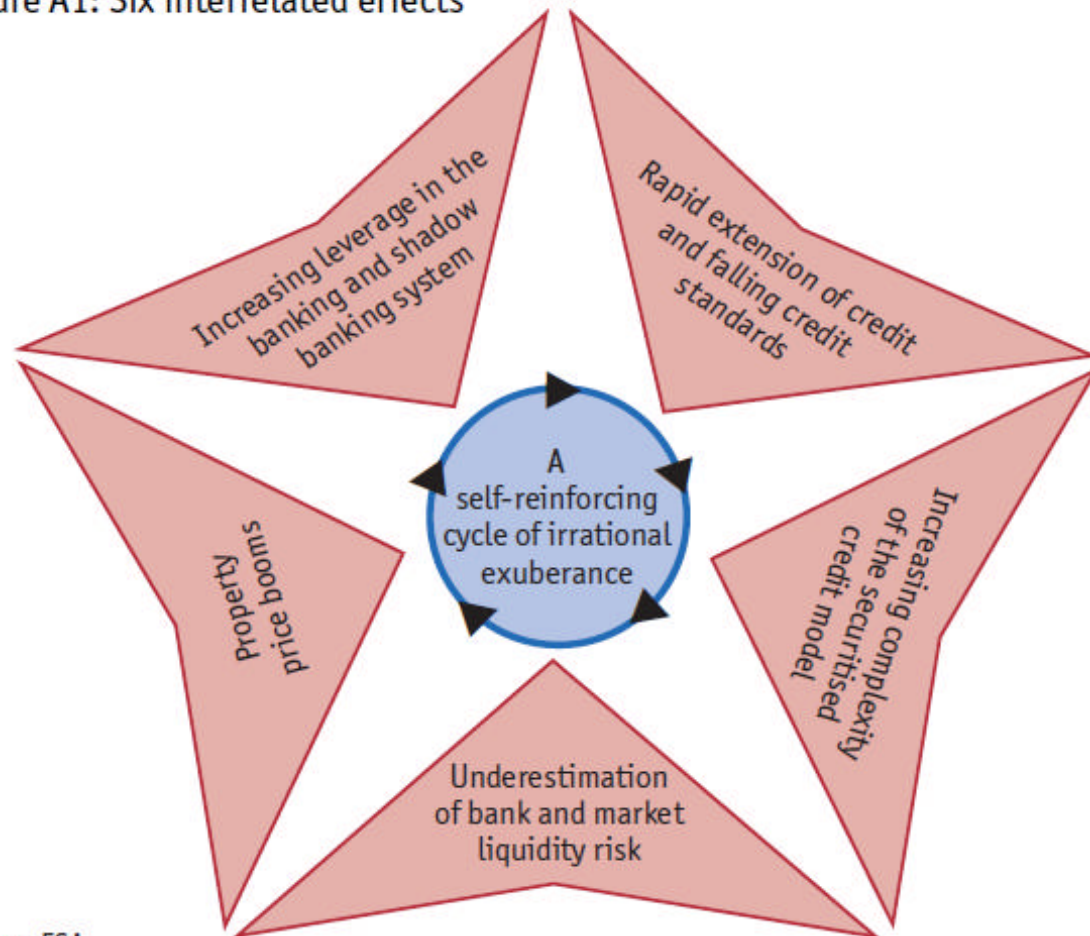


FINANCE, COMPETITION AND GOVERNANCE:
STRATEGIES TO PHASE OUT EMERGENCY MEASURES*



Cosa non ha funzionato secondo la Fsa

Figure A1: Six interrelated effects



Source: FSA



Cosa non ha funzionato secondo il Group of Thirty

- **...weak credit appraisal and underwriting standards; extreme and sometimes unrealized credit concentrations; misjudged maturity mismatches; wildly excessive use of leverage on and off balance sheets, often imbedded in little-understood financial products; and unwarranted and unsustainable confidence in uninterrupted market liquidity. Gaps in regulatory oversight, accounting, and risk management practices that exaggerated cycles, a flawed system of credit ratings, and weakness in governance also need attention.**



... segue Group of Thirty

- To some degree, these factors have been evident in other, less damaging periods of financial crises.
- Two unique features have worked together to help account for the extent of the current market breakdown. **Highly aggressive and unbalanced compensation practices** have strongly encouraged risk taking over prudence. At the same time, **highly engineered financial instruments, in their complexity, obscured the risk and uncertainties inherent in those instruments**, giving rise to false confidence and heavy use of leverage to enhance profits, as asset prices rose.



... segue Group of Thirty

- To be effective and sustainable, **improvements in governance and risk management must be driven by leadership in private sector firms incorporated into a business culture that promotes discipline and a focus on long-run performance.**
- Direction for that must start at the top, with boards of directors that are engaged and up to the task of overseeing the complexities of modern financial risk management. **Complexities cannot be an excuse for poorly prepared and informed boards.** In the first instance, senior management has responsibility for providing boards with timely information, and, if necessary, the training necessary to use it. In turn, boards must be populated with sufficient expertise to absorb such information and act on it, if need be with the benefit of independent outside advice. If these criteria cannot be met, the argument for reducing the size and complexity of these organizations becomes relevant



Fsa: risk management failures

- Recent events have highlighted the shortcomings and **limitations of quantitative risk models and revealed the importance of disciplined risk management processes.**
- Structured product credit ratings based largely on **quantitative credit risk models and inadequate data have proved misleading.**
- Risk management based purely on such external ratings has failed for instance where, banks buying highly rated high-yielding structured products with sufficient risk management resources to **independently understand and assess the risks.** **Banks need to have strong risk management,** combining the insights of models, intuitive and prudent decision-making by experienced risk professionals.



Larosière Report

- Failures in risk assessment and risk management were aggravated by the fact that the **checks and balances of corporate governance also failed**. Many boards and senior managements of financial firms neither understood the characteristics of the new, highly complex financial products they were dealing with, nor were they aware of the aggregate exposure of their companies, thus seriously underestimating the risks they were running.
- Many board members did not provide the necessary oversight or control of management.
- Nor did the owners of these companies – the shareholders.



La Fsa: tagliate tutto tranne i controlli interni

- **Lower levels of new business could place firms under significant pressure. Despite these pressures, firms need to ensure that they continue to treat customers fairly and not cut important resources in a bid to retain capital.**
- **For example, some firms may reduce their resource devoted to complaints handling, which in the long run could reduce the likelihood of firms taking appropriate corrective action. Similarly, the resource devoted to key control activities should not be reduced to a level where the effectiveness of those controls is compromised.**



Fsa: A strategic shift

- To survive adverse conditions, banks need a strategic shift away from short-term profit maximisation towards ensuring medium-term survival and sustainable growth.
- Banks need to base their strategies **around ample liquidity, robust capitalisation, prudent risk management and sustainable business models.** Prudent risk management also needs to be supported by compatible **incentive structures** in remuneration policies and compensation practices.



Oecd

- In the post-Enron years it appears that there has been a strong focus on internal controls for the purpose of financial reporting, together with having the internal and external auditors report to the Audit committee.
- **Risk management in financial institutions deserves the same emphasis**



The ECB on risk management

- The downfall of large financial institutions can ultimately be attributed, in one way or another, to **the failings of risk management.**
- On the other hand, for those firms that have weathered the storm more or less unscathed, good risk management practices can be seen as the **main variable explaining their good performance.**



Best practices nel risk management secondo la Bce

- **Firm-wide communication systems**
- **Independent and rigorous valuation practices**
- **Effective management of funding liquidity, capital and the balance sheet**
- **Risk measurement and management reporting**
- **practices**



Firm-wide communication systems

- Firms that did well “**generally shared quantitative and qualitative information more effectively across the organisation.**”
- This allowed the firms to anticipate potential problems in the markets for asset-backed securities (ABSs) well in advance, giving them the necessary time to implement plans to mitigate, reduce or completely shed risks while this was still possible and not overly expensive.



Independent and rigorous valuation practices

- Firms that performed well had established a **disciplined approach for the valuation of complex or potentially illiquid securities**.
- This implied a **strong risk management culture**, in which a critical and sceptical attitude existed to challenge the valuation input assumptions used by the front office.
- **Independent assessments of the credit quality of assets backing complex securities were conducted to identify the intrinsic value of those securities**.
- Valuation estimates were sometimes “tested” by **selling a small proportion of illiquid assets** to observe actual prices, or collateral disputes were monitored for clues to inconsistency



Risk measurement and management reporting practices

- Firms that managed to avoid major problems tended to have management information systems that were **more adaptive and could rapidly incorporate altered assumptions** as the market environment changed.
- Risk management in those firms **relied on a wide range of measures of risk,**



CRO, Chief Risk Officer

- Another important element of a good corporate governance framework **is the need to have a strong organisational structure for risk management.** Firms should assign operational responsibility for risk management to a senior officer, the Chief Risk Officer (CRO), who should have sufficient seniority and independence from business line management.
- The CRO should have the ability and capacity to influence key decisions of the firm, with the objective of making sure that the level of risk taken by the firm is consistent with the agreed levels of risk appetite and that an integrated view of the



No alla “banca nella banca”

- Large and complex financial institutions should, from a pragmatic point of view, **rely on a number of high-level “institution-wide committees**, to facilitate communication, coordination, and, in some instances, consensus-based decision making.
- The CRMPG III report also stresses the importance of committee structures as a way to foster firm-wide cooperation and communication so as to **help reduce the temptation of promoting a silo-mentality in isolated business lines** that could bring down the entire firm in bad times.



Risk measurement and integration of risk management areas

- **Risk management should be implemented in a comprehensive, firm-wide fashion.** The accurate measurement and monitoring of risks is essential, but it is, unfortunately, not enough to achieve a successful implementation of an effective risk management function.
- Ultimately, good risk management and monitoring reduces to the basics of **producing accurate information, at the right time, to the right people,** such that those people can make the most informed decisions possible



Prodotti trasparenti, please

- It has been also recommended that, whenever possible, **firms should use transparent and liquid instruments, rather than bespoke products**. To promote this practice, firms should consider imposing internal charges against profit and loss accounts for hard-to-value or illiquid transactions or other methods such as higher capital charges, limits or higher haircuts when the collateral received in a collateralised transaction has low market liquidity. In addition, firms should ensure, to the greatest extent possible, that whenever the same instrument is held by different business units, that instrument is marked at the same



The responsibilities of the senior managers (and the Board)

- Promoting a corporate governance framework in which risk management can operate effectively.
- Senior managers are the ultimate guarantors for an adequate risk culture to permeate into all parts of the institution.
- They should be directly involved in risk management decision-making so as to ensure that the institution's agreed risk tolerance is respected and maintained.
- This is important as, far too often, **senior managers at large financial institutions did not heed the advice of risk managers prior to the start of the crisis.** It is therefore not surprising that those firms that did relatively well were run by executives that were directly involved in risk management and, therefore, had direct knowledge of the market issues that were developing.