

Response to BCBS of 10 Dec '10:
“Why no ref to ‘Risk *Dumping*’?”

Some Risk Identification insights

Presentation by:

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“For the avoidance of doubt, each statement in this Presentation is a statement either of opinion, or of a suggestion of opinion, unless it can be proved to be a statement of fact.”

Q: What has this got to do with Risk ID?

A: This is an example of Risk Termination!

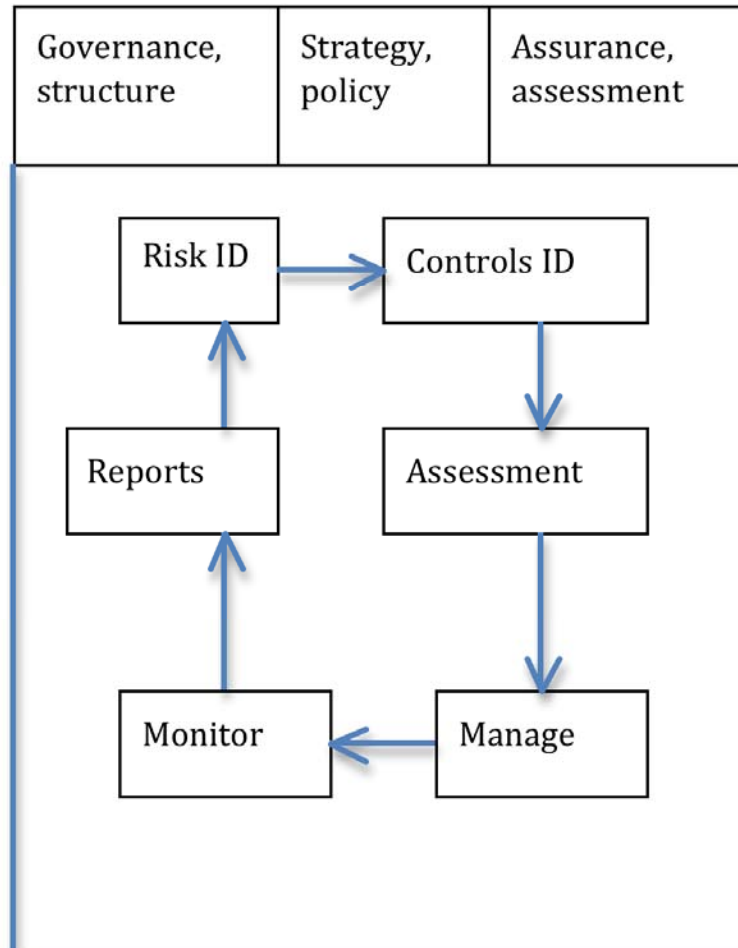
Risk Definitions

- Brit Std: *“Something that might happen and its effects on the achievement of objectives.”*
- Q: But where is risk in the chain of causality?
- CAUSE => EVENT => EFFECT => CONSEQUENCE
=>
- Basel Committee on Operational Risk:
- *“The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.”*

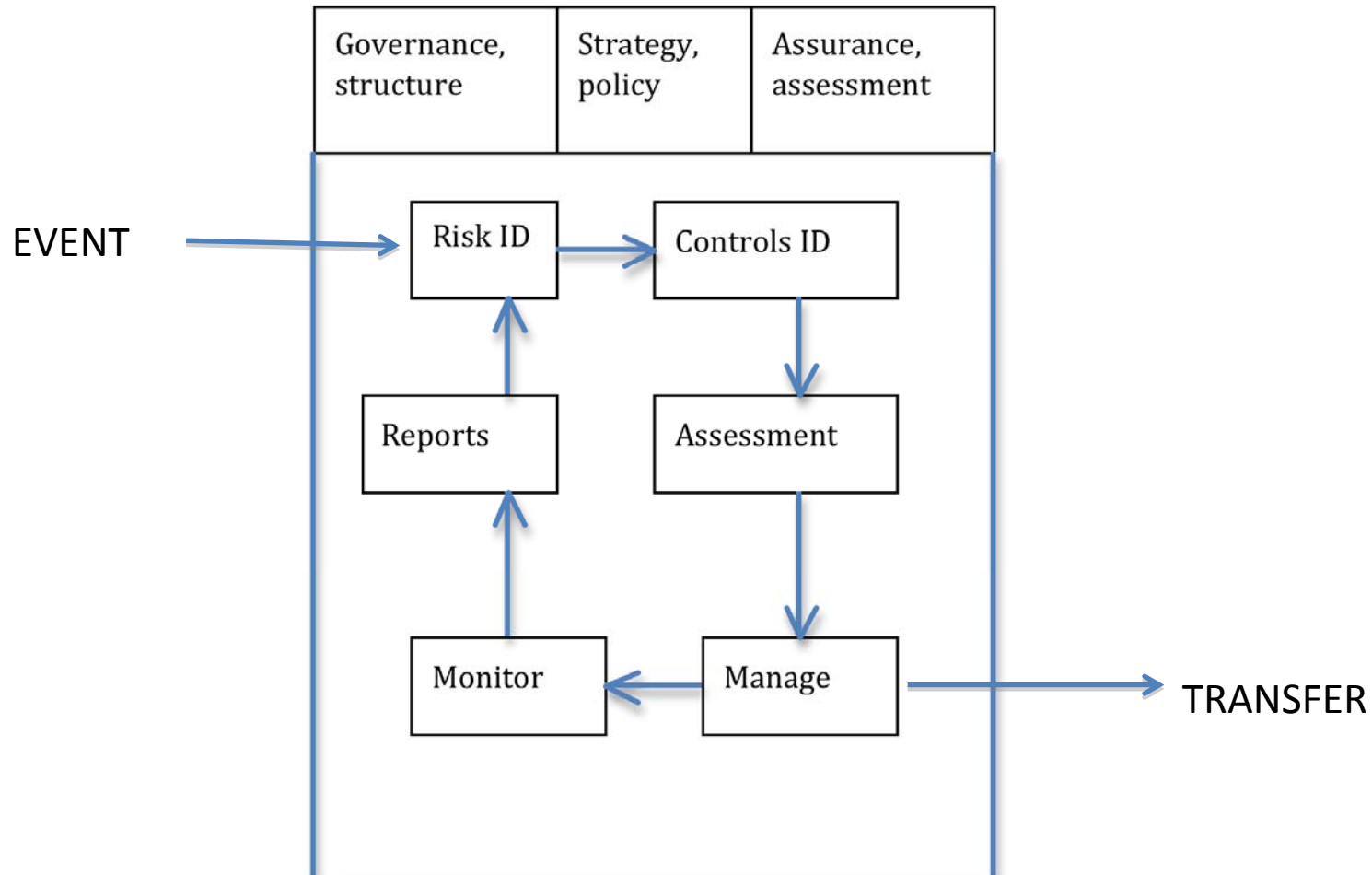
Box Ten Thesis

- Risk Management includes the 6Ts actions of:
- Terminate;
- Treat and/or Train;
- Trade (*e.g. Buy “Insurance” or Set up a formal “Risk Sharing” arrangement, etc.*);
- Transfer (*e.g. external “casual/surreptitious Risk Dispersion” or “deliberate Risk Dumping”*);
- Tolerate (*e.g. Pay as you go*).

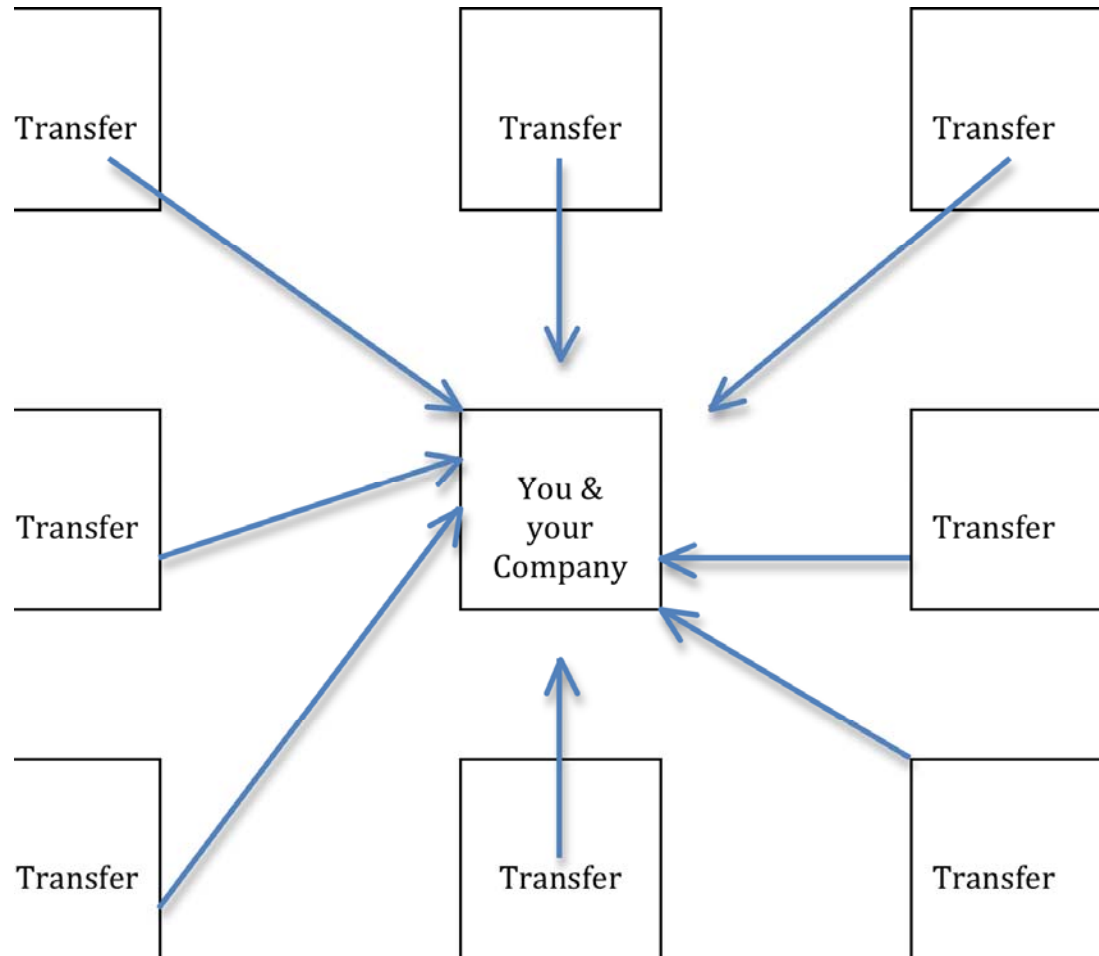
Risk Identification: INSIDE the box:



BUT unexpected risks may be OUTSIDE the box!



What if the Bank faces TRANSFERRED risks?



25 Sept 2002: Excerpts from “World Finance & Risk Management”, a Speech by A. Greenspan

- “The development of our paradigms for containing risk has emphasized, and will, of necessity, continue to emphasize dispersion of risk to those willing, and presumably able, to bear it.” (DS adds: and the concomitant **CUTS?**).
- And ... “If risk is properly dispersed, shocks to the overall economic system will be better absorbed and less likely to create cascading failures that could threaten financial stability.”

11 Jan 2011: Excerpts from “Competition & choice in banking: Financial regulation”, HoC Treasury S. C. -1

- Q523: Chair: “You do accept that the risks to the Senior [Barclays] Executives are limited, whereas the risks to the [UK] taxpayer are unlimited?”
- Bob Diamond: “YES, and we also agree that it’s not okay for taxpayers to have to bail out banks. Banks should be allowed to fail ...”
- [Later] The “period of remorse and apology” for banks needs to be over ...

11 Jan 2011: Excerpts from “Competition & choice in banking: Financial regulation”, HoC Treasury S. C. -2

- Q534: Mark Garnier: “If the IBC comes up & says you have to split, would that be a deal breaker?”
- Bob Diamond: “We are going to be here in the UK ... We need our banks willing to take risks ...”
- [Later] BUT Barclays prefers an “integrated universal” banking model ... *(DS 2nd thought Q: Is an “integrated universal” model also chosen to reduce/dump Corporation Tax risks by Transfer Pricing actions?)*
- *(DS Qs: Is Barclays a risk taker OR a risk maker? Do they transfer/dump risks on others? Same for failing banks?)*

10 Dec 2010: Excerpts from “Sound Practices for the Management and Supervision of Operational Risk”-1

- Page 9/para 33: “Senior management should ... maintain **accountability** ... to manage operational risk ... ”.
- *DS Response: “This (the key role that accountability should play in any Risk Management framework) is the heart of the matter, BUT it sadly seems un-emphasized by BCBS.*
- *“All too often the so-called ‘clever’ risk managers are those who can virtually eliminate risks by giving them to someone else!*
- *“How can it be a ‘sound practice’ if the decision makers know that the consequences of their poor ‘risk decisions’ will not be borne by them, but by local and national taxpayers via CUTS that may result in poverty?”*

10 Dec 2010: Excerpts from “Sound Practices for the Management and Supervision of Operational Risk”-2

- Page 9/para 34: “Senior management should ensure that staff responsible for managing operational risk ... co-ordinate and communicate effectively with staff responsible for ... the procurement of external services ... ”.
- *DS Response: “This (the key role that external events and their risk transfer should play in any Risk Management activity) is only just secondary to the heart of the matter, BUT again it sadly seems un-emphasized by BCBS.*
- *“All too often external events are the sources of the unexpected risks that overwhelm!*
- *“If a ‘sound practice’ of operational risk ignores the possibility of ‘risk dumping’ by ‘clever’ risk managers in vendors, then won’t recent history be repeated, via further CUTS?”*

What should BCBS do?

- Highlight the key role that accountability should play in any sound risk management framework; and
- Equally, BCBS should recognize the need to explicitly set out the dangers of deliberate risk dumping.
- NB: A solution to unexpected “risk dumping” may be found by requiring vendors to open up their risk management procedures to purchasers. This could result in banks being broken up, to avoid an “intrusive” risk of risk voyeurism.
- Actions speak louder than words, of course, and the banking response after Lehman's was to cease trading with other banks, i.e. to terminate the risk of “risk dumping”! Hence bullet 2 above.

Any Questions?

- Either now ... Just ask!
- Or perhaps later:
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