Workshop 9

Managing Operational Risk:

Turkey Case

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Outline

- The Treasury and the Reform Program
- Operational Risk Management (ORM)
- Setting up the ORM Framework in Turkey
Organizational Chart of Treasury
Functions of the Treasury

- Debt and cash management
- Foreign economic relations
- Assisting government in economic policy design
- Regulation of the insurance market
- Formulation of government investment incentives scheme
- Regulating foreign direct investment
Functions of the Directorate General of Public Finance

- Cash management of the central government
- Executing the domestic borrowing of the government
- Domestic and external debt service
- Management of statistics and accounting of the Treasury transactions
- Risk management of central government debt
- Management of Treasury receivables
Public Administration Reform-1

  - Addresses long running problems of the Turkish financial administration
  - Introduces modern financial administration concepts
  - Mandates all public institutions to prepare three year strategic plans
  - Introduces performance budgeting
  - Requires all public institutions to establish an internal control framework.
Public Administration Reform-2

  - Defines the Treasury as the sole borrowing authority
  - Introduces changes in the debt management organisation
    - Debt and Risk Management Committee
    - Middle Office
  - Determines the main principles and procedures for debt and receivables management and guarantee issuance.
Debt & Risk Management Committee (DRMC)

- Minister of State
- The Undersecretary
- Deputy Undersecretaries
- Directorate General of Public Finance
- Directorate General of Foreign Economic Relations
- Directorate General of Economic Research

- Deputy General Directorate of Public Finance
  - Deputy General Directorate of Cash and Domestic Debt Management (Front Office)
  - Deputy General Directorate of Risk Management (Middle Office)
  - Deputy General Directorate of Debt Transactions (Back Office)

- Directorate General of Foreign Economic Relations
  - Finance of Program Project (Front Office)
Functions of the Directorate General of Public Finance

- Offering Criteria
- Offering Guarantee Limit

Debt and Risk Management Committee
- Setting Strategic Benchmarks
- Offering Guarantee Limit

DGPF
- Annual Financing Program
- Monthly Risk Bulletin
- Monthly Public Debt Management Report

Law on Regulating Public Finance & Debt Management (No:4749/2003)
- PARLIAMENT
  - Borrowing Limit
  - Guarantee Limit
Risk Management

- Liquidity Risk
- Interest Rate Risk
- Exchange Rate Risk
- Credit Risk

Market Risk
Risk Management

Main Exposures

Contingent Liabilities

- Credit Risk
- Liquidity Risk
- Operational Risk

Direct Liabilities

- Market Risk
- Liquidity Risk
- Operational Risk
- Refinancing Risk
Stages of Operational Risk Management

Turkish Treasury is supported by

EU-OECD SIGMA Peer Collaboration Internal Control Mechanisms

- 2007 - ORM / Pilot Project
  - GD of Public Finance – Back Office Practices

- 2008 - ORM / Project
  - GD of Public Finance – Front Office Practices
  - GD of Public Finance – Middle Office Practices
  - GD of Public Finance – Support Units Practices

- 2009 - ORM / Project
  - Combination of Risk Profile Tables

- 2010 - ORM / Project
  - ORM Information System
What is Operational Risk?

Operational Risk (OR) is

- The risk of direct or indirect loss resulting from inadequate or failed internal processes, people, systems or from external events

Operational Risk Management (ORM) is

- Defined as a continual cyclic process resulting in acceptance, avoidance, transfer or mitigation of risk
Why Managing OR is important for a DMU?

- The sums involved are very large, a failure of a transaction system or process may have a direct, substantial cost.

- Errors in policy and process that lead to wrong decisions which may result increase in cost.
Some distinguishing features of OR

- It is endogenous to the institution and it is linked to the nature and the complexity of the activities.
- It cannot be captured and measured as easily as credit or market risk.
- It flows from many sources; include a lack of discipline, poorly designed procedures, inertia, change, greed, inadequate knowledge, and overconfidence.
How Operational Risks are Managed?

Identifying Operational Risks

- Strategy
- Objective
- Risk Appetite

Developing Appropriate New Control Mechanisms

Measuring

- Likelihood
- Impact
- Risk Matrix

Risk Profile Table

OPERATIONAL RISK MANAGEMENT

Monitoring Reports

Incident Reports

Risk Bulletin

Monitoring and Reporting

New Control Mechanisms
Flow Chart of ORM

1. List all activity areas
2. Design aims of activity
3. Define risks and sources of risks
4. Determine current control mechanisms
5. Measure probability level of risk
6. Measure impact of risk
7. Set the high level risks
8. Develop new control mechanisms
9. Are there any changes in risks and source of risks?
10. Current Controls = New Controls
11. Error Report
12. Monitoring Report
13. Risk Bulletin
14. Are controls effected?
Setting up the ORM Framework in Turkey
Organisational Arrangements

- The first step was an analysis of the current ORM arrangements
- This work identified poor risk awareness and lack of OR systems
- As a result an action plan and a timetable was developed
- A new organisational structure was formed
Process within Organisation

- The RC led and coordinated the whole process
- The CC met regularly once a week throughout and executed the action plan in line with the timetable
- MC met regularly once a month to oversee the process and ensure that it was kept to timetable
- Working groups applied the decisions
- These arrangements ensured the harmony at all levels
- RC and ORMU met with the Sigma team from time to time to review and revise the procedures
Building the Risk Profile-1

- ORMU provided training to whole staff on both the concept of ORM and the process to be followed
- Workshops were conducted by working groups to identify activities, activity purposes, associated risks and current controls
- RC, ORMU and line managers attended these workshops to ensure a consistent approach
Once risks were identified, they were measured according to their impact and likelihood.

Qualitative measures were used taking into account the nature of the work of a DMU.

This work was done in workshops in which all working groups (and in some cases the Sigma consultant) participated under the RC’s coordination.

Collective workshops were followed up by workshops in each unit.

Common understanding of how to measure risks was established.
Risk Exposure Matrix-1

- Likelihood was scored in five levels from very low to very high
- Impact also in five levels from insignificant to catastrophic.
- After scoring all risks, a risk exposure matrix was formed
- The matrix was used to prioritise the risks and craft new control mechanisms to mitigate the high level risks
Risk Exposure Matrix-2

- The darker colours (the “heat map”) indicated the higher priority areas.
- Those in area 3, 4 and 5 in Figure were identified for early action.
Monitoring and Reporting Operational Risks

- Monitoring ORs
  - Error reports (Users)
  - Monitoring reports (Heads of Department)

- Reporting ORs
  - Monthly Operational Risk Bulletin (to Heads of Department)
  - Quarterly Operational Risk Bulletin (to Debt and Risk Management Committee)
Error Reports

- “Error” is defined broadly to include all incidents, including those that are system-related.
- Error reporting formats were developed and staff was trained.
- Staff encouraged to report errors as soon as they were encountered.
- Error reports are received and monitored by the ORMU.
- This process:
  - enabled efficient assessment of the risk sources or changes in the risk profile.
  - contributed to improved risk awareness among the staff.
  - provided better understanding of the linkage between risks and controls.
Monitoring reports

- Line managers are required to fill in monitoring reports on the errors
- This ensures that managers are notified about errors and also adds a management level perspective
- Managers are asked to report the measures taken, make suggestions for future prevention, and give their opinion on the how the risk in their area are evolving, whether they are decreasing or increasing
Operational Risk Bulletins

- Prepared by ORMU
- Includes analysis and information on the risk profile table
- Errors of the previous quarter are summarised
- Encourages senior managers’ involvement in the ORM process who closely monitor changes in the risk profile
- The bulletins are discussed in DRC and new control mechanisms or other mitigation strategies developed
- The focus is on the highly-scored risk exposures
Looking Forward

- DGPF staff will continue to produce error or incident reports which will enable the RC to test the risk exposures and concentrations identified in the risk profile table.
- Line managers will complete quarterly monitoring reports.
- RC will present the Risk Bulletin to the DRC.
- The implementation of controls, as well as their impact on risks, will be closely monitored.
- Risk matrix will be updated involving staff at all levels.
Thank You

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