

Compliance with Basel II and III Creating Corporate Assurance by Efficient Governance

“Correct risk governance, funding, control and reporting using a sophisticated integrated risk management solution”

This whitepaper explains an approach for banks that have to comply to Basel requirements and governance more effectively and efficiently, and incorporating such an approach into their daily operations. Focus is on easier managerial control, less internal effort, fewer costs to create company assurance and still comply with Basel II and III reviews, audits and the requirements of regulators and other stakeholders.

This document is composed of three parts. The first part focuses on the essence of the Basel regulations. In the second part, we illustrate a Basel compliance concept and the risk methodology on which it is based. The third part describes the implementation of such an integrated risk handling approach.

This article does not include other relevant aspects of Basel related business adjustments such as communication, expertise and change management to achieve the efficient embedding of this kind of supporting business software.

1. The Essence of Basel II and III*

Essentially, the Basel regulations created two main objectives to which banks are held accountable by their regulator.

These two main objectives are:

1. Sufficient funding of all the material risks to which banks are or could be exposed; in short, the ability of banks to live up to their financial obligations and liabilities.
2. Transparent standardized reporting to regulators and other public stakeholders, for example shareholders. Through standardized reporting, the objective is to create a level playing field in the European banking market and more accurately assess and compare banks.

To achieve this banks have implemented a more or less sophisticated risk management approach that takes care of managing all material risks and related funding on a daily basis over the years. This has affected all aspects of the business operation, from extending the expertise of actuaries and asset managers to new governance structures and procedures, additional new reporting and IT/data quality and security. Ultimately, all aspects should be supported by a risk-based approach on a continual basis. Implications of the regulations are far reaching. In some cases, walls have been raised between business silos, hindering transparency and sometimes even preventing the exchange of crucial data. As responsibilities have adjusted, more intense cooperation between departments is needed. Lastly, more detailed control and monitoring of risk related tasks in all relevant parts of the company is initiated.

Senior management, up to the board level and supervisory committees, has become more involved in the Basel risk governance of the enterprise. This has required increased awareness and even additional training for board and committee members.

It is fair to ask whether banks are ready in terms of maturity to effectively and efficiently implement and embed such an integrated risk governance structure and process for Basel III, given the silo based risk management approach of the bulk of banking organizations. Years of experience with Basel II has created learning curves for all involved. Now it is time to incorporate an integrated approach for Basel risk handling, so managerial control and assurance can be simplified and make Basel less of a burden for the entire organization. Additional benefits are that these effective and efficient adjustments simplify the procedure to honor Basel requirements and the reviews of regulators. In addition, the bank is much more secure and effectively prepared for Basel III.

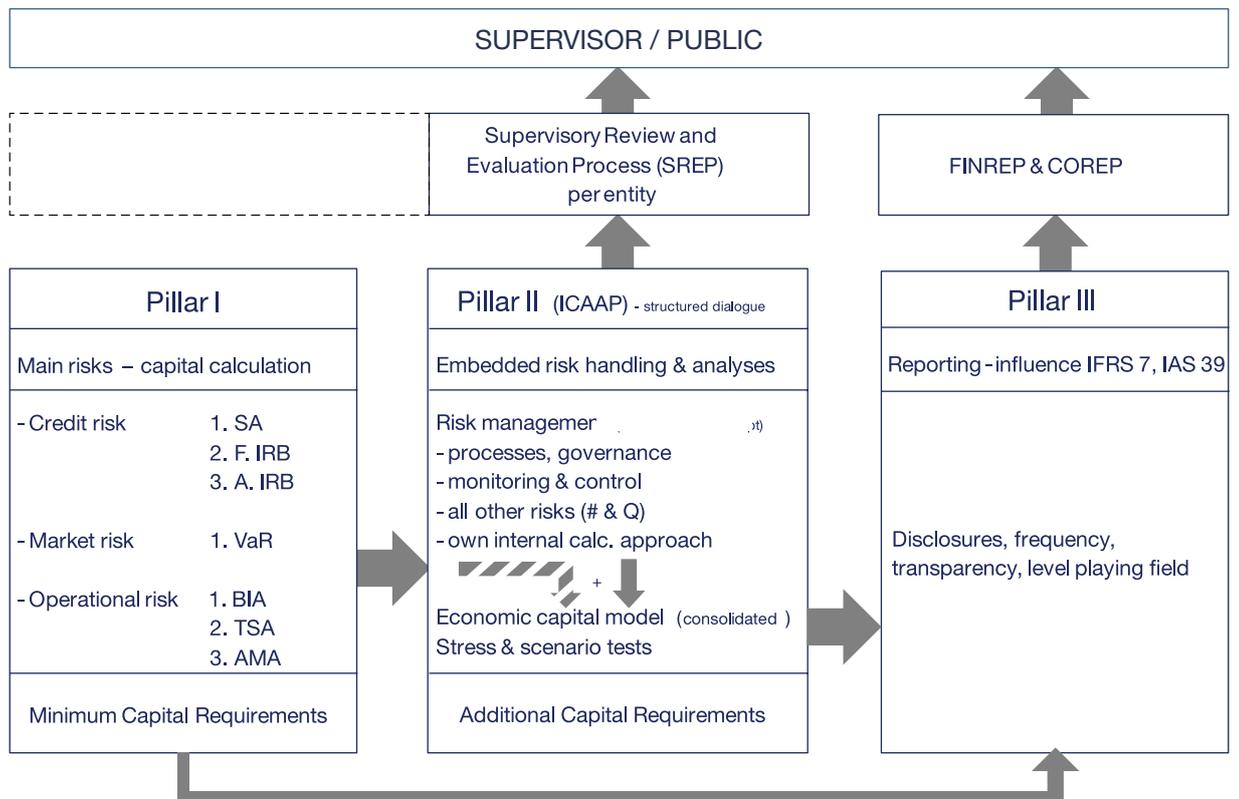
*This document is based on the following sources:

CEBS, EBA, FSA, Dutch Central Bank a.o.

2. Basel II/III - the concept

BWise created an overview which shows the interdependencies and relations between the pillars to create understanding of an integrated risk approach that could be developed (figure 1).

BASEL II => CEBS => now EBA - European Banking Authority => DNB: Basel II incorporated in Wft (art. 3:72, 3:77, 3:82)
 Fasing in so called CRD's - Capital Requirement Directive



* Internal Capital Adequacy Assessment Process: systems in place of assessing the adequacy of the bank's economic capital in relation to her risk profile and maintain an appropriate level of capital at all times

Figure 1. Basel II / III methodology

3. The BWise solution for Basel II/III compliance

BWise solutions focus on supporting and thereby creating managerial control and assurance on risks and compliance aspects of the total business operation.

The Basel Pillar 1 focus is very much centered on the specifics of the banking business and its expertise. The expertise concerning credit risk in Basel terms is bank specific, this is typically covered by the bank's own expert models. The BWise solution integrates with Pillar 1 solutions and fully supports the Pillar 2 governance and risk handling structure and

processes, including monitoring of key indicators from Pillar 1 (key risk data for credit, market and operational risks) and timely escalations to responsible management. Banks that use BWise are able to test, alert, remediate, monitor and so handle all material risks. By doing so the organization lives up to the Basel requirements. Since every action in the BWise solution is tracked and logged, every action in the software is also audit-traceable and documented. As a result, banks are able to support obliged internal as well as external reviews and audits by their own compliance and audit functions as well as by the supervisor (SREP - Supervisory Review & Evaluation Process).

The BWise Basel II and III solution is based on a single software platform that can be extended with other Governance, Risk and Compliance components such as Risk Management, Internal Control, Internal Audit, Compliance and Policy Management, Sustainability Performance Management and IT GRC.

The standard BWise software can be configured to accommodate each bank specific Basel II and III risk framework based on the company's processes and procedures. Mandatory documentation of essential management decisions and keeping track of the follow-up in the organization is also fully supported by the BWise solution. Relevant Basel data in the system and all kinds of generated reports, detailed reports or dashboards, can be used to support creating official required documents, such as for FINREP or COREP.

With documentation and risk monitoring in place, banks must have a system in place to manage any remaining risk; risk discrepancies of every kind can be managed, ideally by an integrated issue management system.

Banks already perform many of these actions, most often in disparate systems, loosely coupled or not integrated at all. Spreadsheets are used vastly, to collect data, and ultimately produce cumbersome reports. The true promise of an integrated system is to provide much better reporting. Better, because it is easier and faster to create, but moreover because the integrated and much more reliable data set enable analysis that is more detailed.

Flexible reporting features can support all kinds of dashboards, detailed analysis and reporting requirements.

The Implementation

As shown in figure 2 the implementation of BWise for Basel II and III consists of several phases, starting with the preparation phase. The next phase is the concept development phase, which includes the definition of the overall integrated governance system and fine-tuning of risk control data. In parallel, an IT project is initiated to investigate the incorporation of BWise into the current banking infrastructure and, if desired, includes the interfacing of different systems or databases with BWise for Continuous Monitoring purposes. Based on the results of the preparation and the concept development phase, the BWise solution to support the overall risk handling for Basel II and III, can be configured and implemented.

The Preparation Phase

The preparation phase includes the capture of current risk handling and monitoring, including risk assessments, preferably process based, and supporting IT systems, next to the current basic set up of its governance structure. For a valuable understanding of the entire operation, it is advised to model the most important business processes: the banking and investment processes that incorporate the biggest capitalized risks. This can be done very

efficiently in so called integrated workshops in which key employees define these primary business processes, no more than three levels deep, and at the same time perform risk assessments. During these workshops, reports and information requirements can also be defined. See figure 2 for some details.

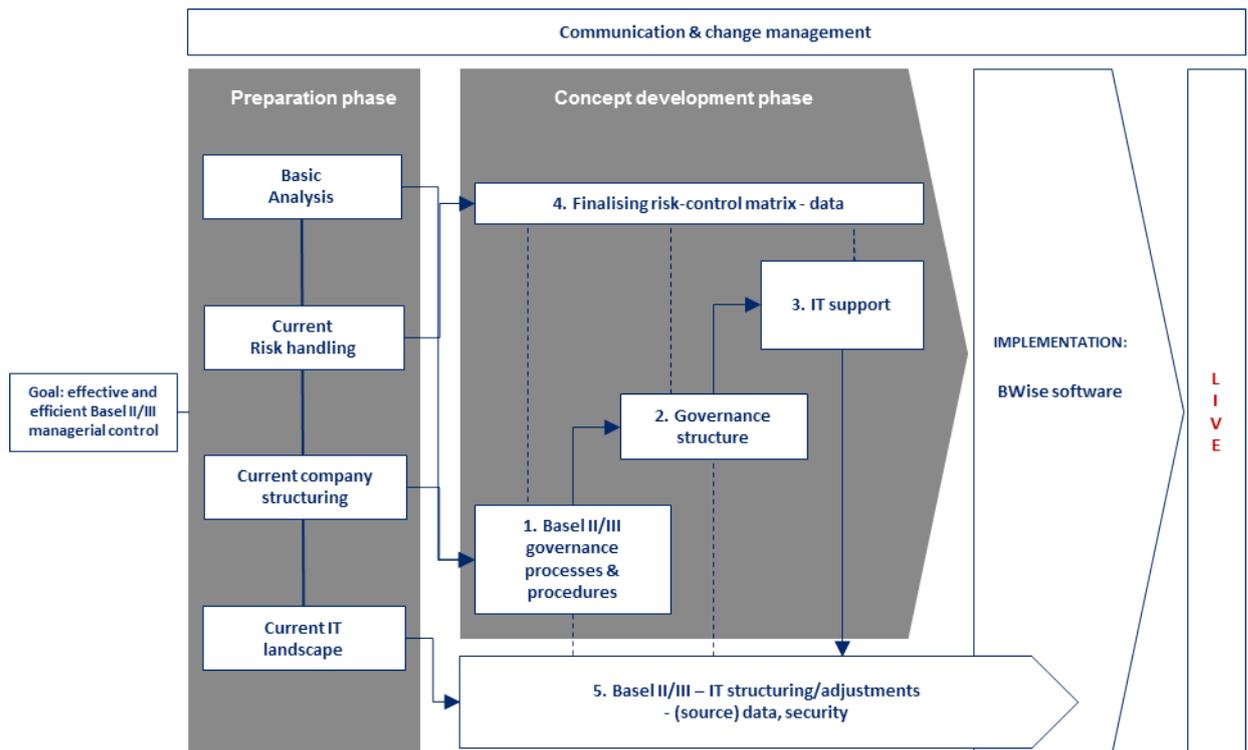


Figure 2. Basel II/III project implementation

The next step: Concept Development Phase

The following topics must be covered in this concept development or design phase in order to implement and embed an integrated governance structure in the organization to stay compliant with the Basel II and III requirements. The numbers refer to the figure.

- Definition and documentation of the necessary governance processes and procedures (1). Based on an integrated approach define how the Basel II and III governance control should be executed by the organization. For instance, including the definition of alerting and escalating procedures, decision making, signing off and monitoring of all relevant issues;
- Based on the approved governance processes and procedures define or fine tune the governance structure (2) including allocation of tasks, responsibilities, authorizations (all captured and embedded in adjusted or new job descriptions) for handling all related risks in the company at all levels in the organization. Including operational, compliancy and audit functions. Everything documented and also captured in a hierarchical chart;
- The results and related information requirements of the Preparation phase and the designed governance control (1 and 2) will be confronted with the current IT supporting infrastructure. Necessary IT adjustments (3) should be defined as input for the IT project part (5).

After the Preparation and Concept Development phase have been concluded the BWise software platform can be implemented and deployed. The organizational changes and IT adjustments can be managed simultaneously.

Based on hundreds of risk management and compliance implementations around the globe BWise has developed a successful standardized implementation methodology. This approach includes best practices and secures an effective and efficient control of this kind of project.

The BWise software solution helps banking organizations to comply with Basel II and III and could be extended to other GRC subjects. The benefit of this approach is that by using BWise, an integrated platform using a single risk framework and taxonomy is used to effectively and efficiently identify, assess, monitor and manage risks throughout the company. This results in substantially lower effort and costs than working with a silo-based approach.

Many financial institutions have implemented and deployed BWise for operational risk management, various kinds of other GRC subjects and now in Europe also for Basel II and III compliance. The business consultants and project managers of BWise have developed an unrivalled collective intelligence of best practices that ensure the smoothest possible implementation in the shortest possible time.

About BWise

BWise, a NASDAQ OMX company, is a global leader in Enterprise Governance, Risk Management and Compliance (GRC) software. Based on a strong heritage in business process management, the BWise® GRC platform provides companies with highly-rated, proven software solutions for Risk Management, Internal Control, Internal Audit, Compliance & Policy Management, IT GRC and Sustainability Performance Management.

BWise's end-to-end solutions support an organization's ability to understand, track, measure, and manage key organizational risks. BWise helps companies truly be in control by balancing performance with their financial and reputational risks, improving corporate accountability, increasing financial, strategic and operating efficiencies. Using BWise, organizations are able to efficiently comply with anti-corruption regulations like FCPA and the UK Bribery Act, the Sarbanes-Oxley Act, European Corporate Governance Codes, ISAE3402/SAS-70, PCI-DSS, Solvency II, Basel II and III, Dodd-Frank, ISO-standards, and many more.

BWise sales, service and support offices around the globe provide for the GRC needs of hundreds of clients, including: adidas, AEGON, Ahold, AngloGold Ashanti, Connexion, Health Alliance Plan (HAP) of Michigan, LeapFrog, Liebherr, Marathon Oil, Southern Company, Swiss Life, and Transcontinental. For more information, visit www.bwise.com.

BWise® GRC Platform

BWise offers multiple role-based software solutions for Risk Management, Internal Control, Internal Audit, Compliance & Policy Management, IT GRC and Sustainability Performance Management. Each solution derived from the BWise integrated Governance, Risk management, and Compliance Platform supports the end-to-end process of a given role.

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