

Banking Supervision Instructions
No. 17 dated 13 February 2005

Instructions for
Operational Risks

Issued by The Monetary and Credit Council through Decision No. (106/M.C.C/S4)
dated 13 February 2005, and accredited by the Prime Minister

Syrian Arab Republic
The Monetary and Credit Council

The Monetary and Credit Council Decision (106/M.C.C/S4)

The Monetary and Credit Council, pursuant to the provisions of the paragraphs **/2.C/** and **/2.E/** of **/Article 1/** and paragraph **/5/** of **/Article 118/** of the Central Bank of Syria Law and the Basic Monetary System No. **/23/** dated 17 March 2002, and in reference to the “Sound Practices for the Management and Supervision of Operational Risks” issued by the Basel Committee on Banking Supervision in February 2003, and following the Basic Principles for Effective Banking Supervision issued by the same committee in September 1997, notably **/Principle 13/**, and based on its memorandum in the session held on 13 February 2005,

decides the following:

Article 1: The adoption of the attached instructions on operational risks and requesting the banks operating in the Syrian Arab Republic to apply and implement the contents thereof.

Article 2: This decision shall be communicated to whom it may concern for implementation.

Damascus on 13 February 2005

Chairperson of The Monetary and Credit Council
Dr. Adeeb Mayyaleh

Accredited by the Prime Minister
Eng. Muhammed Naji Itry

Secretary of The Monetary and Credit Council
Hana’a Audeh

Based on of paragraphs /2.C/ and /2. E/ of /Article 1/ and paragraph /5/ of /Article 118/ of the Central Bank of Syria Law No. /23/ dated 17 March 2002, and in reference to the “Sound Practices for the Management and Supervision of Operational Risks” issued by the Basel Committee on Banking Supervision in February 2003, and following the Basic Principles for Effective Banking Supervision issued by the same committee in September 1997, notably /Principle 13/, banks are requested to work on:

First: Managing Operational Risks:

Given the development and complexity of financial and banking services and the banks’ increased reliance on electronic and advanced technological services, and considering the extensive use of services provided by external entities, and in anticipation of facing operational risks that may arise from these activities represented by the failure and inadequacy of internal processes and systems, and the losses that may result from dealing with individuals or due to external events, banks must manage these risks as follows:

Responsibilities of the Board of Directors:

Article 1: A bank’s board of directors must be aware and knowledgeable of the significant operational risks facing the bank, considering them as risks that require attention and precaution. It is also their responsibility to ratify the operational risk management system established by the bank’s general management, review it periodically, and include any new risks that may arise through the bank’s operations. This system must identify and define operational risks and set standards for how to identify, assess, monitor, follow up, and mitigate them.

Article 2: The board of directors must ensure that the bank’s operational risks are subject to comprehensive and effective internal control conducted by trained and competent individuals who are independent of the operations that generate these risks or their management.

Responsibilities of the General Management:

Article 3: A bank’s general management must establish an operational risk management system approved by the board of directors, and ensure that all units and departments of the bank implement this system. It must also ensure that all levels of employees in the bank understand their responsibilities regarding operational risk management by defining these risks and the potential effects on the bank if they occur.

Article 4: A bank’s general management is responsible for developing policies, procedures, and means related to managing operational risks arising from the activities the bank intends to undertake and the new tools it wishes to deal with.

Identifying, Assessing, Monitoring, and Mitigating Operational Risks:

Article 5: A bank must be able to identify and assess the operational risks inherent in the activities, operations, and systems it conducts or deals with.

In this regard, the concerned bank may resort to the following procedures to identify and assess operational risks:

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| A. Self-assessment of risks: | By evaluating the susceptibility of the operations and activities it conducts to potential operational risks, which is done by preparing workshops and creating lists that indicate the strength or weakness of the operational risk environment inherent in its operations and activities. |
| B. Aggregating risks by type: | By categorizing the operations conducted by the bank and identifying the units and departments facing operational risks according to the type of risks they are exposed to. This procedure helps reveal weaknesses in the operational risk management system and assists in prioritizing the steps to be taken to address these risks. |
| C. Key risk indicators: | These may be financial or statistical indicators such as employee turnover rate, the frequency of hazards and negligence in their treatment, or the number of operations that failed upon execution, etc. These indicators require periodic review and adjustment according to any new operational risk indicators that may emerge. |
| D. Scorecards: | These cards help convert the qualitative assessment of operational risks into a quantitative measure for various types of risks. These cards should indicate the factors inherent in operational risks and ways to mitigate them. The general management must be able to assign weights to each type of these operational |

risks and establish a basis for the quantitative measurement of each of the indicators mentioned above.

E. Operational risk limits:

By setting boundaries and limits for the key operational risk indicators that can be tolerated and should not be exceeded.

F. Measurement:

By using historical statistical information, where previously realized losses resulting from operational risks are cataloged and used in the future to develop policies for monitoring and mitigating these risks. This statistical information should include the frequency and severity of operational risks.

Article 6: The Risk Management Committee or the Risk Management Division in the concerned bank must conduct periodic monitoring of aspects surrounding operational risks and ascertain the bank's material exposure to losses, and then periodically inform the Board of Directors and the general management about the information related to these risks.

Active periodic monitoring of operational risks is essential for managing these risks, as this process helps to quickly identify and discover risks before they occur and assists in mitigating their effects in case they do occur and works to correct their causes. This requires identifying **Early Warning Indicators** of operational risks such as rapid growth in certain activities, adopting a new activity, using a new financial instrument, having a high employee turnover, or facing breakdowns in the information systems, etc., and linking all these indicators to the set limits that the bank can tolerate or absorb.

The reports prepared by the regulatory authority, the auditor, the internal controller, the internal audit division, or the bank's risk management division greatly assist in identifying operational risks, and therefore, the bank's Board of Directors and general management should draw on these reports and work on addressing and managing the factors causing these risks. This requires the bank to ensure a system for rapid periodic reporting that reaches the relevant parties in a timely manner.

Article 7: The bank must work on developing policies and procedures for monitoring significant operational risks and mitigating the effects resulting from their occurrence, as well as estimating the need for alternative risk limits and working on monitoring and adjusting these limits by adopting appropriate strategies in light of its capacity and readiness to face these risks.

Regarding the risks that can be controlled and managed, the bank must decide on the appropriate supervisory measures and technical means it wishes to follow to confront these risks and the limits of losses it can bear. As for the risks that cannot be controlled, the bank must decide whether to accept them or withdraw from the activities associated with them. For this purpose, it must establish policies and procedures specific to operational risk management, which include:

- Reviewing the progress made towards the objectives set for operational risks.
- Verifying compliance with instructions and set limits.
- Identifying the authorities and approvals required for each management level related to operational risks.
- Separating tasks among employees, and not assigning tasks that create a conflict with their personal interests.
- Identifying tasks where conflicts of interest exist and working to mitigate and closely monitor them.
- Providing adequate protection for the bank's assets and records.
- Conducting reconciliations and periodic verification of operations and accounts.
- Providing procedures and internal control systems for any new activity or new financial instrument.
- Mitigating operational risks that have a low probability of occurrence but could result in significant losses if they do occur, by resorting to insurance against such risks, such as loss of securities, embezzlement, natural disasters, etc.
- Establishing procedures and policies related to transferring risks to others, such as having insurance on the bank's assets or conducting certain operations through other institutions. In such a case, the bank must make sure that these entities comply with the contracts signed with them and the applicable laws, understand the size of the remaining losses, and how to treat and manage them.

In all cases, the bank should not rely solely on mitigating the effects of risks by insuring against them but should also work on establishing procedures and internal control systems that allow for the detection of these risks before they occur or help to avoid them.

Article 8: The bank must establish emergency plans and alternative action plans to ensure its ability to continue operating and mitigate losses in the event of severe malfunctions, such as communication device failures, cessation of the operating system in informational and technological devices, or damage to the physical infrastructure of its assets, with the aim of avoiding the risks that such malfunctions may cause to its payment systems.

If the bank relies on an external entity to provide certain services, it must ensure that this entity is capable of continuing to provide these services and at the same time work on finding another entity or entities that can replace it in case of failure. In all cases, it is necessary to review,

amend, and evaluate these plans periodically in light of the changes that occur through the bank's activity and work to make these plans more suitable when any damage occurs.

Article 9: The bank must disclose the significant operational risks it faces to its clients in addition to the methods it follows in addressing and mitigating these risks, and it must document all information related to the operational risk management system.

Second: Measuring Operational Risks:

A bank can adopt one of the following methods for measuring operational risks as determined by the "Basel II Accord" on capital adequacy issued by the Basel Committee on Banking Supervision in June 2004.

- A. The Basic Indicator Approach.
- B. The Standardized Approach.

It should be noted that the bank is not allowed to change the methodology it follows to measure operational risks without obtaining prior approval from the Banking Supervision Department for this change.

1. The Basic Indicator Approach:

Following this approach, a bank's own funds must, at a minimum, cover a fixed percentage of 15% of the average total revenue over the previous three years, without calculating any year in which the total income is negative and replacing it with the positive total income of the preceding year, as this process aims at facing operational risks. This percentage is considered a burden on capital when calculating the adequacy rate of own funds.

The total revenue includes several elements of the income statement (Form No. 4) for the general rules for preparing periodic financial statements for banking conditions issued by the Prime Minister's decree No. (4844) dated 5 August 2004:

Account No. 40500 – Net interest and commissions received.

Account No. 41000 – Revenues from financial investments with volatile interests.

Account No. 41700 – Net other operating revenues.

2. The Standardized Approach:

- A. According to this method, banking activities are distributed into eight **Lines of Business** where capital charges are calculated against operational risks for each line based on the following weights determined by the Basel Committee on Banking Supervision under the "Basel II Accord" on capital adequacy issued in June 2004:

<u>Line of Business</u>	<u>Relative Weight (%)</u>
1. Corporate Finance	18
2. Trading and Sales	18
3. Retail Banking	12
4. Commercial Banking	15
5. Payment and Settlement	18
6. Agency Services	15
7. Asset Management	12
8. Retail Brokerage	12

- B. The above lines of business and the nature of each line's activities are distributed according to the **"Mapping of the Lines of Business"** shown in the annex attached to these instructions.
- C. If a bank adopts the standardized approach for measuring operational risks, this approach must be approved by the Board of Directors and periodically reviewed by an independent party within the bank, in addition to being reviewed by the external auditor (external control commissioner).
- D. The total capital charges for operational risks are calculated according to the standardized approach by multiplying the average total income generated by each of the lines of business specified in paragraph (A) above for the last three years by the weight determined for it and then adding up the amounts resulting from these calculations.
- E. The total income referred to in paragraph (D) above includes net interest and commissions received from each of the bank's dealing lines as previously defined, as shown in account number 40500, deducting net interest and commissions received from the income statement (Form No. 4) for the general rules for preparing periodic financial statements for banking conditions mentioned above.

Damascus on 27 February 2005

Annex

Mapping of the Lines of Business

Lines of business		Weight Against Line of Business (%)	Area of Activity
Level 1	Level 2		
1. Corporate Finance	Corporate Finance	18	- Mergers and Acquisitions - Underwriting - Privatizations - Securitization - Research - Debt (Government, High Yield) - Equity and Syndications
	Municipal/Government		
	Finance		
	Merchant Banking		
2. Trading and Sales	Sales	18	- Fixed Income - Equity - Foreign Exchanges - Commodities - Credit - Funding - Own Position Securities - Lending and Repurchase or Resale Operations (Repo) - Brokerage - Debt - Prime Brokerage
	Market Making		
	Proprietary Positions		
	Treasury		
3. Retail Banking	Retail Banking	12	- Retail Lending and Deposits - Banking Services - Trust and estates

	Private Banking		- Private Lending and Deposits - Banking Services - Trust and estates
	Card Services		- Merchants - Commercial Operations - Corporate Cards - Private labels and Retail
4. Commercial Banking	Commercial Banking	15	- Project Finance - Real Estate - Export Finance - Trade Finance - Leasing - Credit - Guarantees
5. Payment and Settlement	External Clients	18	- Payments and Collections - Funds Transfer - Clearing and Settlement
6. Agency Services	Custody	15	- Escrow - Depository Receipts - Securities lending (Customers) - Corporate actions
	Corporate Agency		- Issuer and paying agents
	Corporate Trust		
7. Asset Management	Discretionary Fund Management	12	- Pooled - Segregated - Retail - Institutional - Closed - Open - Private - Equity
	Non-Discretionary Fund Management		- Pooled - Segregated - Retail - Institutional - Closed - Open
8. Retail Brokerage	Retail Brokerage	12	- Execution and full service