

# Operation Risk Management

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# Definition

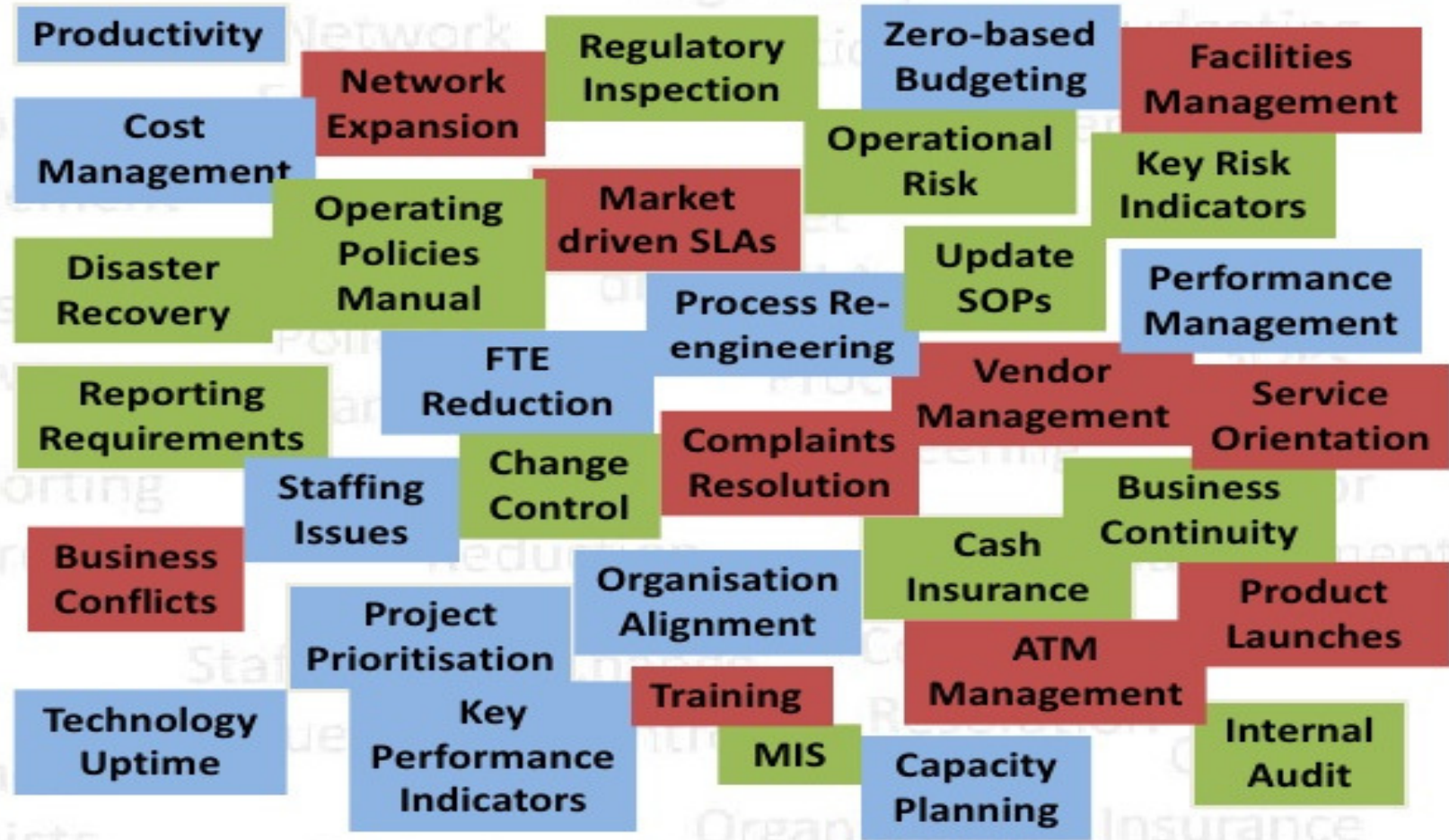
## Operation Risk

“Probabilities of losses due to inadequate or failed:

- Internal Processes,
- People,
- Systems and
- External Factors



## Operations Areas...



## Types of Operation Risks

1. Internal Fraud
2. External Fraud
3. Employment Practices and Workplace Safety
4. Clients, Products and Business Practices
5. Damage to Physical Assets
6. Business Disruption and System Failures
7. Execution, Delivery and Process Management





# Specialty of Operation Risk

Not Directly related with the return for the Expected Reward or Benefits

## Operation Risk



## Credit Risk



## Why Operation Risk receiving increased attention?

1. Growing complexity in Banking Industry
  - Products, Services, Globalization
2. Several and widely publicized Operational Losses,
3. Rapid pace of Innovation and Automation
4. Increasing Non Face-to-Face Transactions
5. Changing Regulatory and Internal Process
6. Growing Competitive Market
7. Outsourcing
8. Merger, Acquisitions and Consolidations
9. Market Challenges



## Causes of Operation Risk

1. Inadequate Segregation of Duties
2. Insufficient Training
3. Lack of Management Supervision
4. Inadequate Compliance, Risk and Audit Procedures
5. Inadequate Security Measures
6. Inadequate Internal Control System
7. Poor System Design
8. Poor HR Policies



## Highly Risk Prone areas in Banking

1. IT Security
2. Compliances and Corporate Governance
3. Fake Account Opening
4. Fake Credit Supporting Documents
5. Outsourcing Services
6. Use of Cards [Debit or Credit]
7. E-Transfer or Wire-Transaction
8. Anti Money Laundering and Know Your Customer
9. Core Banking Loopholes and Data Manipulation
10. Misuse of staffs by External Parties
11. Customer Security and Services
12. Staffs Engagements





## Key Contributing Factors

1. Lack of **OVERSIGHT** of Supervisors
2. Business **PRESSURE** to meet target
3. Difficult/Competitive Business Scenarios
4. Weak **Fraud/Risk Management** & control practices-Freedom
5. **New Technologies & Innovations**
6. Over **DEPEDENCY, CONFIDENCE** and smartness of staffs
7. Compromise on Compliance and Corporate Governance
8. Poor understanding of Works, Risks and Implications
9. Lack of tools to Identify High-Risk patterns and transactions
10. New Business Strategy without proper Orientation/Execution plan
11. Outsourcing services with full dependency
12. Weak Team & Work- **Willful Blindness**



## Risk Measurement Basis- examples

1. Total number of Risk Events
2. Total Financial Reversal
3. Net Financial Impact
4. Total number of Customer Complains and Paid Out
5. System Failures/Shutdown Trends
6. Increasing Audit Remarks
7. Performance Scenarios/Trends Analysis
8. Market Information
9. Increasing TTR and Suspicious Transaction
10. Security Unusualness



## Risk Management Tools

### 1. Key Performance Indicators (KPI)

Monitoring Operational Efficiency, Performance Targets

### 2. Key Risk Indicators (KRIs)/EWS

Risk Tracking based upon the KPIs an KCIs.

### 3. Key Control Self Assessments (KCSA)

Effectiveness of Controls- Variance, Security Lapses, audit comments etc.



# KRIs- Examples

1. Number of complaints
2. Staff turnover
3. Number of errors/reversals
4. Instances of system errors
5. Number of expired accounts
6. Increasing number of expired insurances
7. Number of cash short/over
8. Increasing number of Audit comments
9. Pending reconciliation items
10. Number/amount of interest payment delay
11. Increasing Watch List accounts/NPAs
12. Number of loan account with missing documents
13. Frequent issues of security unusualness
14. Increasing number of incident reports
15. Frequent late cash closing/settlement in Teller/Vault
16. Frequent hangover or control lapses on CBS or IT
17. Calculation errors on customer accounts on CBS
18. High or frequent transaction on staff account
19. Staffs showing high financial attitude not matching to its usual regular earning
20. PASSWORD sharing



## KPIs- Some Examples

1. Per cheque payments- 5 Minutes
2. TAT for Loan- 5 Days
3. Cheque Issue- 30 Minutes
4. Interest Suspense- NIL; NPL- Below 0.5%
5. Budget Variance- below 10%
6. Operating Expenses to Total Business Ratio
7. Per Staff Business, Per Staff Profit, Per Staff Expenses etc.
8. Fixed level of Cash Hold on Vault
9. CCD at 79.5%, Liquidity at 25%,
10. Credit portfolio mix and sectoral mix management
11. Fee Based Income per Business Volume
12. Many more.....





# General Operational Risk Issues



## Customer Account Maintenance

1. Breach of confidentiality
2. Statements, balance certificates issued without request; and to unauthorized persons
3. Recipient's ID card not obtained in third party delivery
4. Cheques delivered to unauthorized person
5. Account closed without minute, request
6. Signature change without valid request
7. Incomplete account coding like: risk, sector etc



## Teller & Vault Cash Management

1. Multiple hands on Teller Cash
2. Open cash drawer while teller unattended
3. Single entry into vault room
4. Vault key with one person while record shows another
5. Teller cash excess than the prescribed limit
6. Cash out from Vault on Day Start at 11/12 noon



## Signature & Other Documents Verification

1. Customer's documents not verified with original
2. Issues of wrong signature verification
3. Duplicate documents on account operation
4. No signature verification on request of customers like: stop payments, cheque cancellations etc
5. Signature specimen and photo are not uploaded in CBS in large numbers



## Revenue Losses

1. Deviations of charges than STC
2. No recording of recoverable charges from customers like: blacklisting, cheque bounce etc
3. Instances of Fine or No rebate on utility bill payments
4. Errors on applying Interest rate on Loan and FD account. No dual control.





## Cash Over/Short

1. Differences on denomination and total cheque amount
2. Most errors on cash receipt- Note Counting
3. Uncontrolled movement on teller area and uses of cash by others
4. Mismanagement at Rush Time.
5. Weak CCTV quality to identify the note
6. Increasing cases of cash short at ATM



## ATM Card & Cheque Handling

1. Control of both ATM card and PIN in same person
2. Signature not verified or even obtained on delivery of Card/Cheque receiver not obtained
3. Cheque handed over to unauthorized person
4. Long pending/uncollected cheques/ATMs under weak control/not destroyed



## Cheque/Withdrawal Slips Payments

1. Problems on signature verification
2. Post dated cheque paid
3. Wrong account withdrawal slip issue
4. Denomination errors on cheque payment
5. Cheque bounce errors & no record



# Reporting/MIS

1. Irregular Reporting. No giving priority on reporting.
2. Questions on data integrity. Stale information.
3. Duplication on reporting and time consuming on reporting



## Other General Issues..

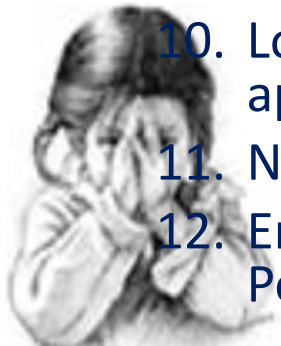
1. Large number of expired insurance, drawing power etc.
2. Irregular functioning of Security Guard
3. Message alteration/fishing on Swift and e-mails
4. Post dated cheque payments
5. ATM Cash short and ATM malfunctioning
6. Customer complaints
7. Account coding errors and mis reporting
8. Account block- but no remarks
9. No update of signature/image
10. Late or single opening of vault
11. Loss of Vault/ATM Keys
12. Staff Attendance- frequent late
13. Commission not taken or forget to take
14. Generator or vehicle consuming abnormally high fuel
15. Security guards do not check the visitors seriously
16. Vehicle log book not maintained





## Credit Operations

1. Loss of security documents or Inappropriate Documentations
2. Uncontrolled Movements of Documents
3. Non supportive or Invalid Loan applications, board decisions or Other Documents
4. Single control on security documents and intentional misuse
5. Credit Request (Amt, Type) is different than the approved
6. Large number of uncollected or irregular Stocks or Receivables
7. No Insurance or Expired Insurance
8. Fake Documents
9. Misplaces of Credit Documents
10. Loan disbursement/renewals prior to approval or in deviation of approvals
11. No tracking of pending documents
12. Errors on Software Inputs like: Interest, Expiry Date, Installments Amt, Posting Frequency etc.



## Op. Risk Control Measures

**Common Sense Banking through  
Knowledge updates**



**Dual Control-  
Maker & Checker**



**Strong Supervisory Role**



**Controlled Deviations and  
Risk Monitoring.  
'Take Risk if You Understand'**

Incomplete KYC-	73
Pending Inspection-	18
Due Revaluations-	30
Pending Basel Grade-	2
PAN Dues-	12
Bills Pending-	5

**Proper Handling of  
Customers' Complaints and  
Internal Audit Comments**



**KRI Identifications and  
Incidents Recording**



**Market Information**



**ZERO Tolerance on Compliance**



**Events Socialization Practices**



## Major Operation Risk/Fraud

Bank	Fraud Amount	Area
Agriculture Dev Bank	49.10 Mio	Inter-branch Clearing
Gurkha Dev Bank	130 Mio	Credit
United Dev	270 Mio	Credit/Staff Exp
Nepal Share Market	2.51 Bio	Deposit& Credit
H&B Dev	1.09 Bio	Good For Payments
Kist Bank	8 Mio	Fund Transfer
General Finance	151.5 Mio	Credit
Crysal Finance	501 Mio	Credit
Mega Bank	40 Mio	Cheque
Kailash Dev Bank	30.2 Mio	Cash embezzlement
Bangladesh Bank (Bangladesh)	\$ 81 Mio	System Security





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## Common Tools of Identifying Events of Risk

1. Transaction Monitoring/Checking
2. Key Risk Indicators
3. Supervisory monitoring of subordinates function on desk
4. Customers' Complaints and Feed Back
5. Audit and Inspection Report
6. Head Office Feedback
7. Incidents/Loss Data recording and reporting
8. Scenarios/Trends Analysis
9. Market Information
10. TTR and Suspicious Transaction



## Unearthing Fraud

Mechanisms	% of Unearthing
By Customer Complaints	21%
Internal Whistleblower/anonymous complaint	18%
During account audit/reconciliation	18%
Through automated data analysis or transaction monitoring	16%
At the point of transaction	10%
Through a third party notification	7%
By accident	6%
Review by a Law enforcement agency	4%



*Thank You*

