Insights

ECS Private Limited

Managing Operational Risk in Banking

Banks on a caution note…

Operational Risk is one of the important arms of the risk management triangle – the other two being Credit Risk and Market (Treasury) Risk. Traditionally Operational Risk has been captured in credit and market risk. Nevertheless, recent events in many countries indicate that if due attention is not paid to Operational Risk Management, often a very large amount of loss may have to be sustained by a bank. Key reasons for increasing focus on Operational Risk Management are:

- Competitive pressures due to financial deregulation and globalization
- Increased leverage of technology resulting in new and sometimes unknown risks
- Managing outsourced processing
- Growing complexity of services and products
- Last but not the least Basel II mandates capital allocation for operational risks

Basel II defines operational risk as:
"The risk of loss resulting from inadequate or failed internal processes, people & systems or from external events"

These developments have made Operational Risk Management architecture an area of leadership focus for banks across the globe

Operational Risk review at a large private sector bank

The bank offered a wide range of transaction banking products, cross border payment and receipt options and capital market products to a large number of customers. Over a period of time, the delivery processes had undergone changes in order to meet business and customer requirements. Given the nature of transactions and the high volume, the operational risks in the bank's processes were fairly high.

In this scenario, the leadership felt the need for an independent assessment of the Operational Risk across business lines. The initiative involved building an 'Operational Risk Register' for chosen areas. The risk register enabled comparison of operational risks across business lines against a common platform

Benefits

- Culture of risk awareness coupled with accountability across levels
- Risk mitigation and risk based deployment of funds ensures improved profitability
- Documented risk scorecard, policies and flow charts provide comfort to management in meeting accountability obligations
- Framework for meeting the disclosure requirements under Basel II

Snapshot of some of key risks observed:

- Lack of adequate management oversight and accountability.
- Inadequate recognition/assessment of the risks of certain activities.
- Gaps in key control structures and activities, such as segregation of duties, approvals, and verifications.
- Delayed reconciliation
- Ineffective audit programs, monitoring activity.

ECS's approach

The project involved mapping of all processes, identifying risks, existing controls and calibrating the same. The risk identification is based on a hybrid of ECS domain knowledge and self-audit by the process owners. All categories of operational risks defined by Basel II were covered; this included:

- Internal fraud
- External fraud
- Employment practices and workplace safety
- Clients, Products and Business practices
- Damage to Physical Assets
- Business Disruption and System Failures

Risk and control owners were defined with clear accountabilities. The risks and controls were rated based on select parameters, as follows:

- Risk rating (Frequency and Severity)
- Control rating (Control Design & Control Effectiveness)
- Risk Index and Health Index analysis

These were translated into an Operational Risk Dashboard

Operational Risk Dashboard

Risk Rating Matrix	Low likelyhood	High likelyhood
High impact	**Medium Risk** Create Risk Management Plan & Share the Risk (insure)	**High Risk** Create detailed Risk Management Plan and Mitigation
Low impact	**Low Risk** Accept / Ignore the risk	**Medium Risk** Create Risk Management Plan & Pass the Risk (outsource)

Subsequently, actionable risk mitigates were identified and implemented for key open risks. These in turn helped improve the Health Index. Based on the review, internal audit and concurrent audit checklists were updated to facilitate future review.

Contact for details

Harsh Bisht - Vice President
harsh_bisht@ecs-limited.com

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Offices:

Mumbai office

2 A, Wing A, 8th Floor, Prism Towers, Mindspace,
Goregaon (West),
Mumbai – 400 062
Tel : 022- 40074600 / 40033400 - 1 Fax : 022- 40074700

Delhi office

804, Signature Towers
Tower A, South City
Gurgaon, Haryana – 122001
Tel: 0124-2383301/02, 2383297 Fax: 0124-2383295

Bangalore office

Tel: 080 – 40794128

Chennai Office

1st Floor, Mootha Centre
9/3 Kodambakkam High Road
Nungambakkam, Chennai – 600 034
Tel: 044- 42122190 / 42123471/81Fax: 044-42122190

Web site: www.ecs-limited.com