

Operational Risk

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Consideration of external loss data and macro-economic factors in scenario building

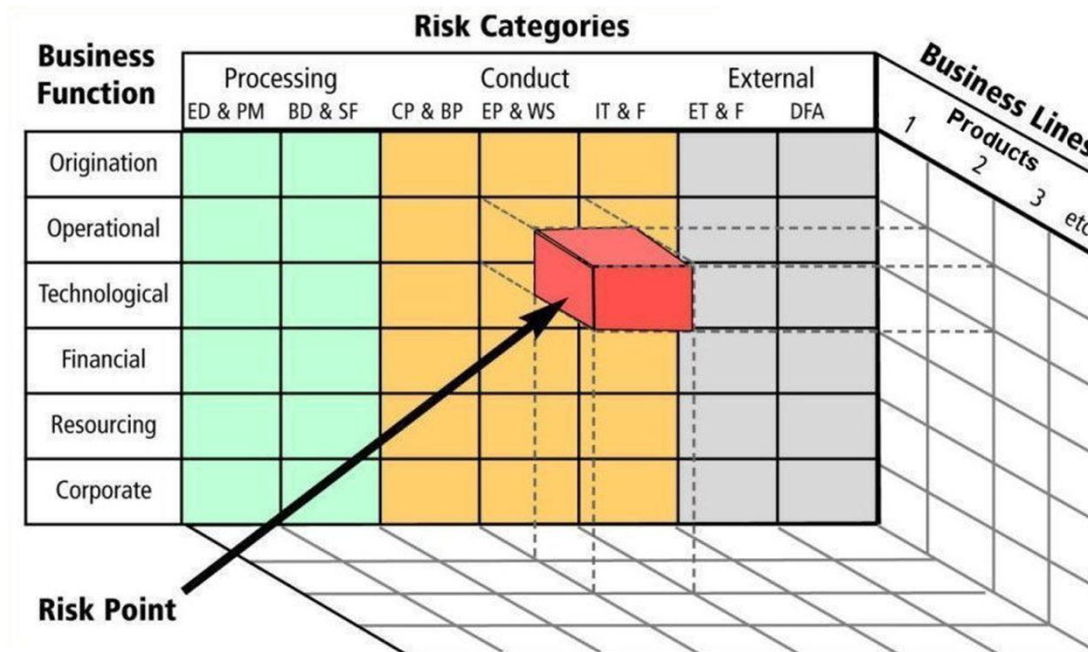
A very high or very low granularity may raise supervisory concerns

Models with a low granularity may not capture the real sources of operational risk and, therefore, the operational risk profile of the bank.

Therefore, banks that use models with low granularity and assume implicit zero correlations should demonstrate their right choice of granularity.

How to Select the Right Indicator?

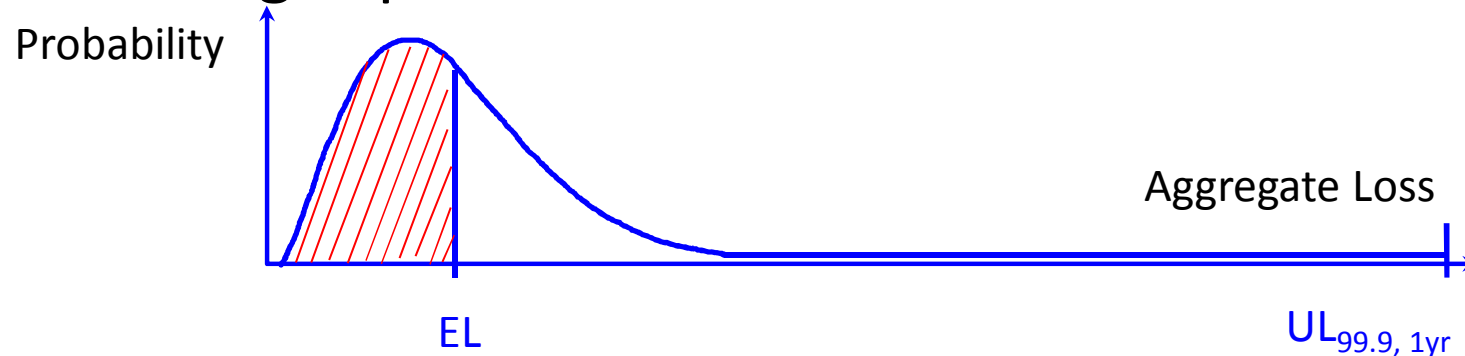
- Before selecting an indicator
 - analyze processes
 - analyze losses for causal factors
 - analyze near misses



- Test
 - usefulness
 - effectiveness
 - comparability
 - reliability
 - ease of use of the indicator

Internal Losses

- Collecting loss data for statistical purposes allows predicting expected losses



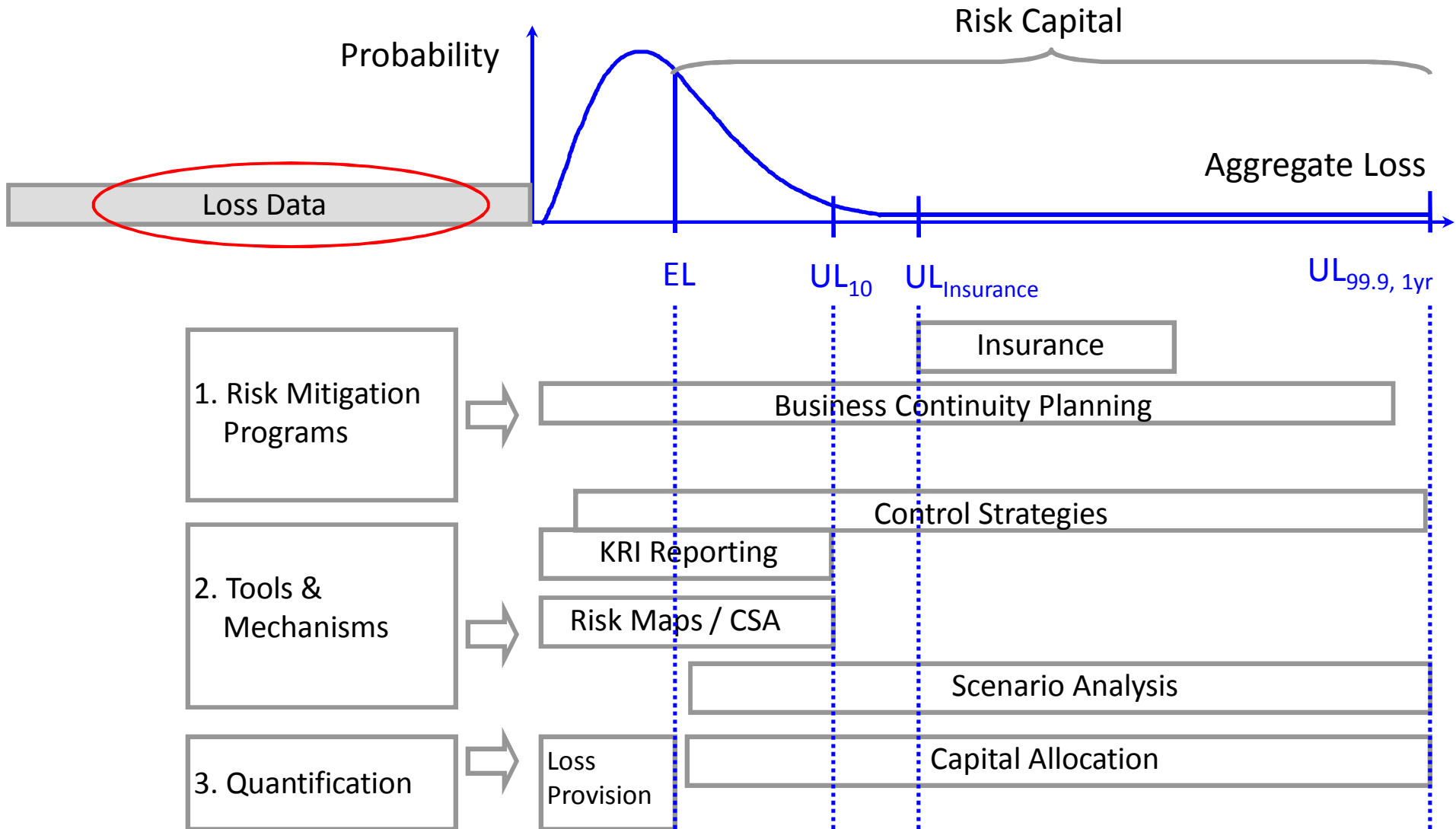
- Internal losses can never cover the whole curve
- Occasional data points in the UL area give but an indication of the shape of the curve

Source: RiskBusiness Scenario Workshop, New York

External Losses

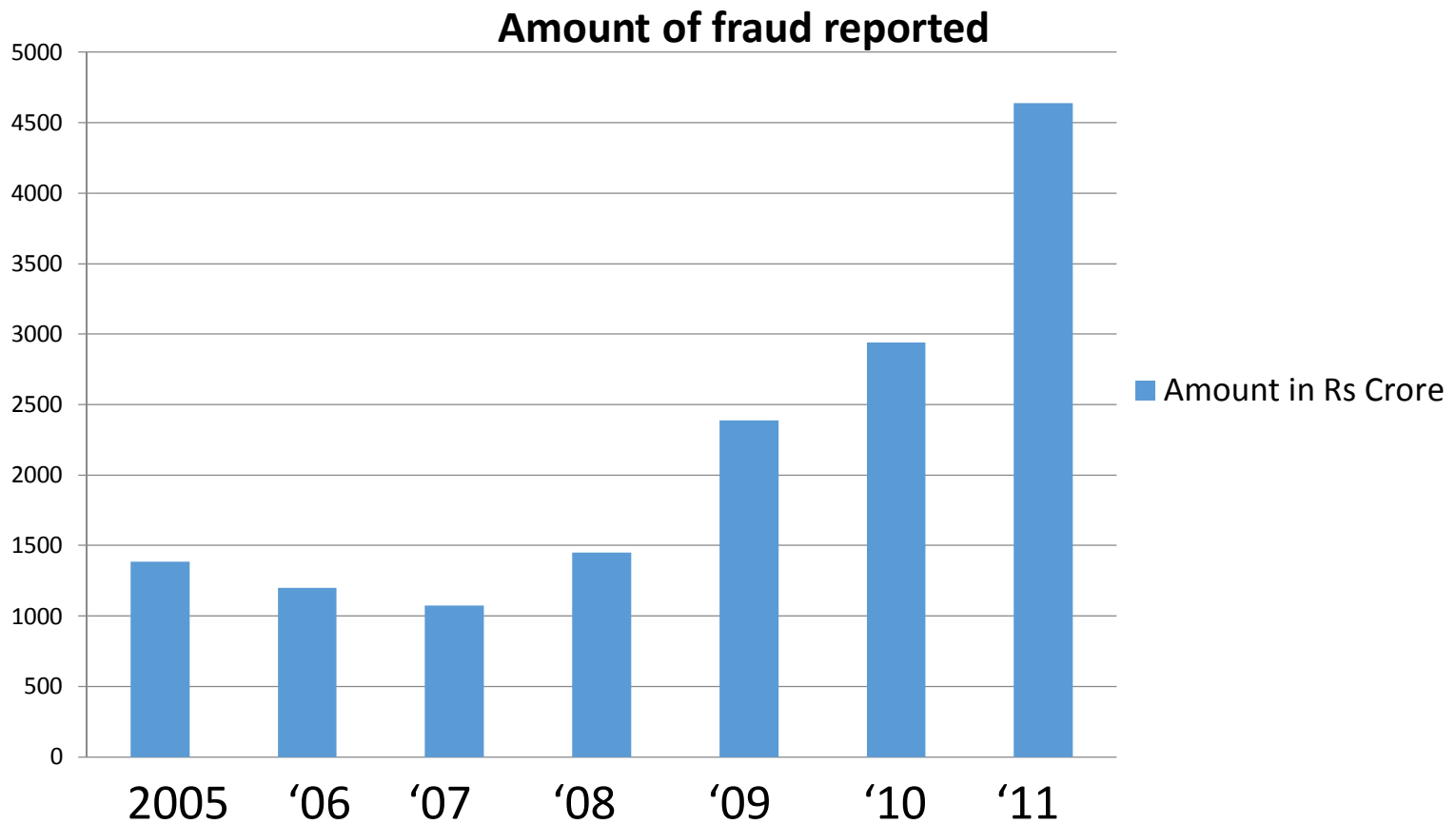
- Large loss events generally get reported in the press
- Often, the exact background is not known, but
 - the story can mostly be reconstructed
 - the approximate loss can be narrowed down
- Sources:
 - Newspapers
 - Public databases with qualitative case analyses
 - Industry talk
- Problems:
 - Reliability (different sources may vary)
 - Completeness of information

Loss Data as a Measure of Risk

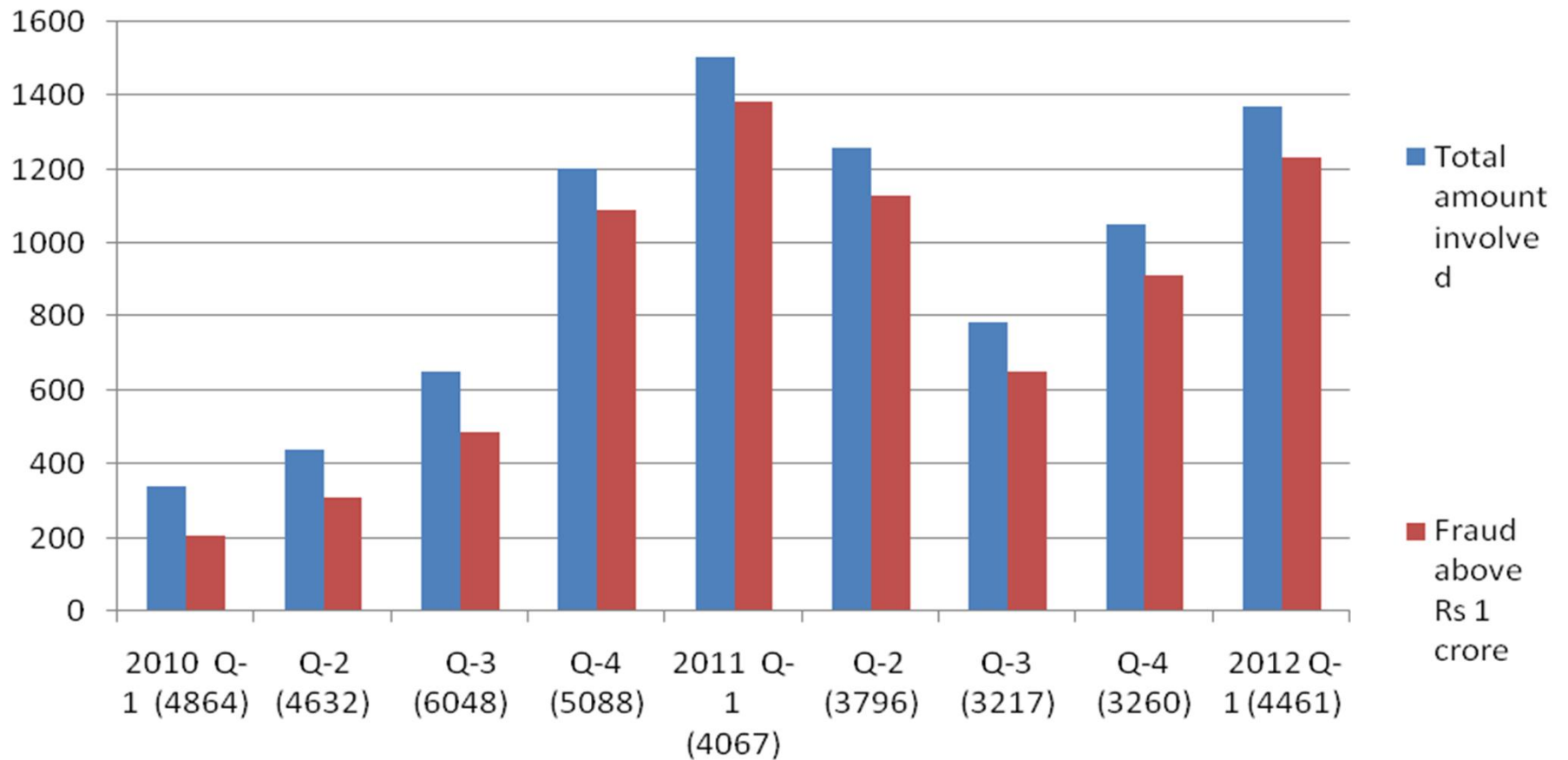


Source: RiskBusiness Scenario Workshop, New York

Trend in reported frauds



Trend in reported frauds



LC devolvement due to fraud

- L/C limit from 7 banks. L/C opened in favour of an intermediary for import of metal scrap. MCB of some banks not informed that it was for intermediary/ merchant trading.
- The contract for the export leg is usually backed by a tripartite contract entered into between M/s FRG Ltd, PYT Metals and the buyer. Goods are sold and payments are remitted promptly
- As per the contract, FRG was to receive advance payment for shipment from the buyers before the due dates under the import LCs. The original bills of lading were to be dispatched to PYT Metals/the buyers only after that.
- Contracts covered under the export leg was reneged by the buyers even though there was a back to back contract by the importing firm.
- devolvement of L/Cs to the extent of around USD 250 million.
- the fraud was detected when MC Metal (notify party) insisted on taking the cargo at lower than contracted rate on grounds of inferior quality of cargo
- Later revealed that the importing company and the buyer co. had common directors

Drivers for ICAAP

Network with peers

Exchange ideas, experiences and concerns

Create a forum to talk to regulators

Work together to create best practice:

- Using indicators

- Disclosure

- Benchmarking

Benchmark values of common interest

THANK YOU