Internal Loss Data

- Setting up a comprehensive system and process for ensuring completeness
- Treatment of specific issues(recoveries, accounting losses, legal provisions, fixed assets write-offs, various dates)

Presentation by
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Definition of Operational Risk

- Defined by some as Variance in net earnings not caused by credit and market risk

But generally accepted definition and as defined by Basle or RBI is

- Risk of loss resulting from inadequate or failed internal processes, people and systems or from external events

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Primary requirements for AMA approach

- Developing a Qualitative/ Quantitative Framework on Operational Risk for the Bank.
- Studying the Organization Structure, IT Systems, External Suppliers, Interdependencies, Policies, Processes & Products.
- Developing a risk profile by identifying, classifying risks based on their frequency & severity and monitoring them over a period of time.
- Accumulating Loss Data (Business Unit-wise/ Event-wise) across the Bank over a period of 5 years.
- Developing Key Risk Indicators from risks and loss data, collecting information on these KRI(s) at periodic intervals from all Units and escalating them to the Top Management based on the criticality of the issues.

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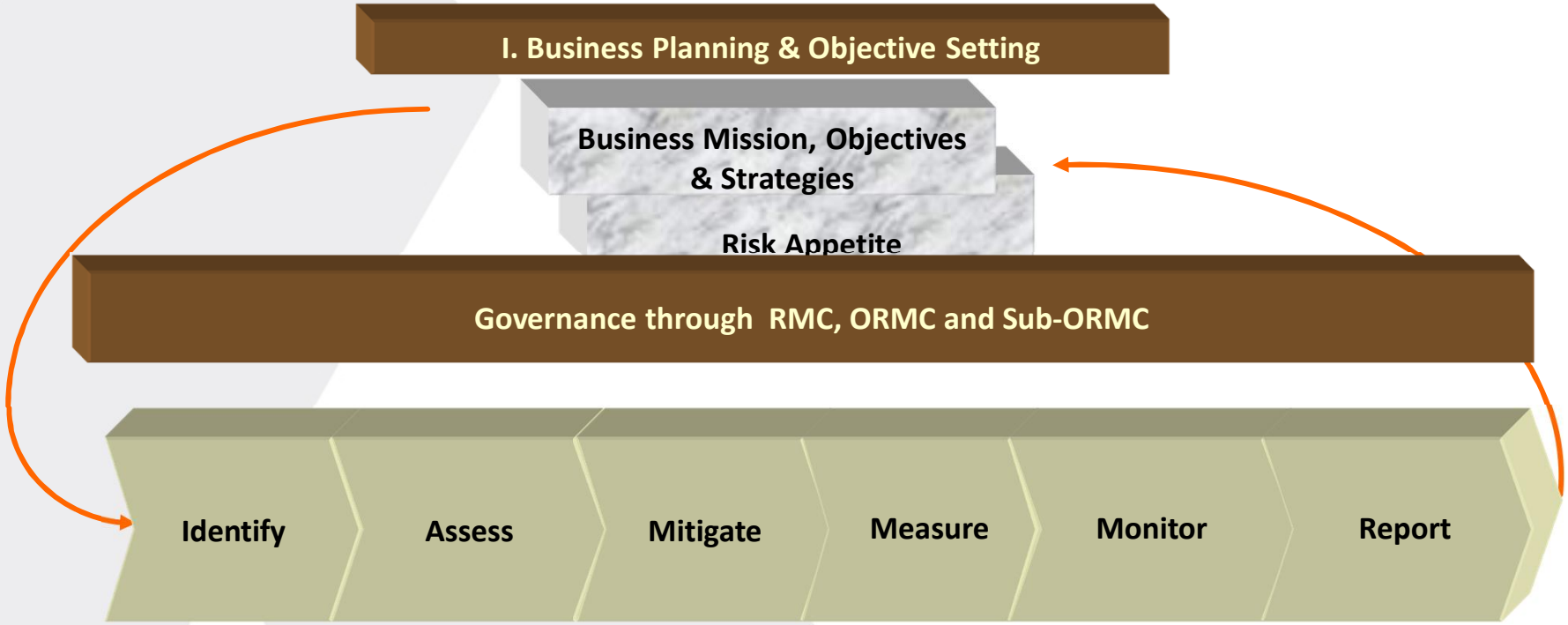
Operational Risk Management Cycle



- External Events
- Incident Reporting
- Internal Audit Reports
- Frauds
- Complaints
- COSMOS

- Risk Assessments
- Control Assessments

Proactive Measures
- PMC / CMC
- Outsourcing Committee
- IT Security Committee
- Software Evaluation Committee

- Internal Loss Database
- External Loss Database
- Scenario
- Capital Calculation Modeling

Key risk indicators

- MIS
- Dashboard

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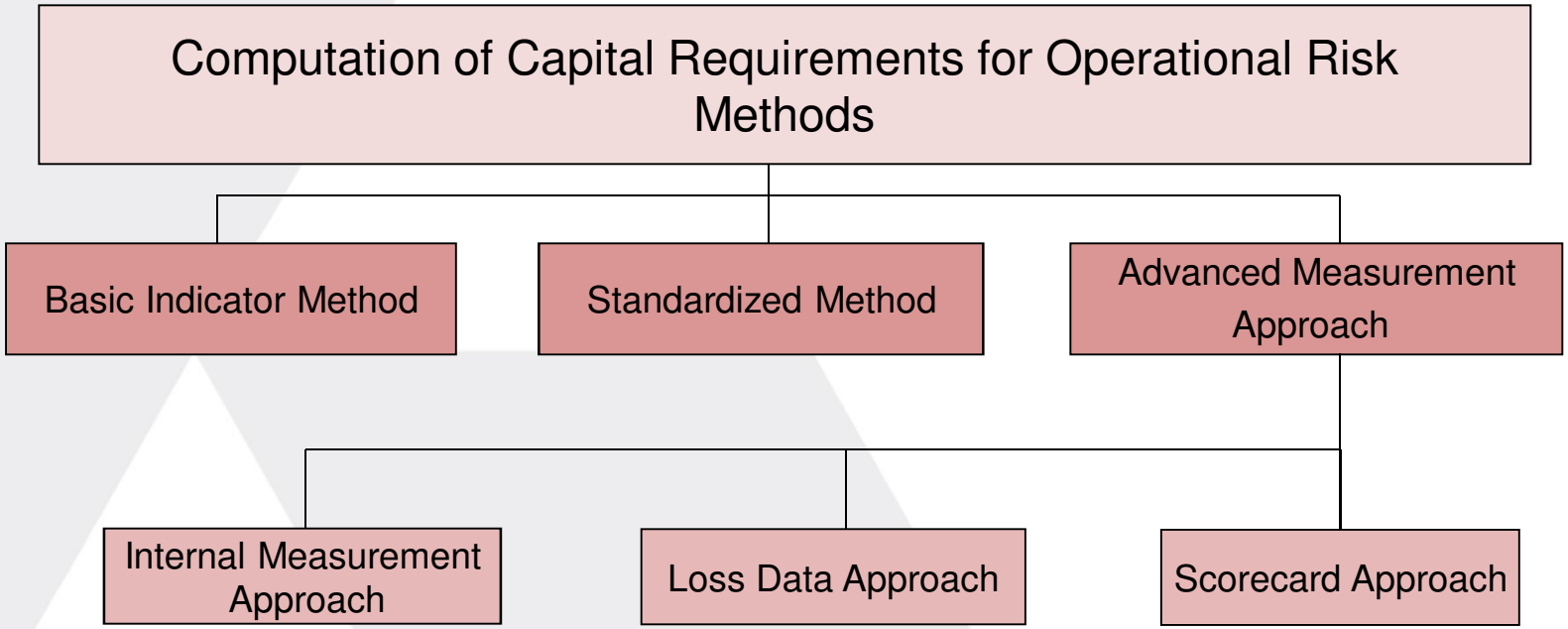
Approaches for Operational Risk



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OpRisk Approaches under Basel II

APPROACH	GROSS INCOME	LOSS DATA Internal	LOSS DATA External	SELF-ASSESSMENT	KRI
BIA	Across The Bank	-	-	-	-
STA	Per Standard Business Line	YES	-	YES	RECOMMENDED
ASA	Per Standard Business Line	YES	-	YES	RECOMMENDED
LDA	Per Standard Business Line	YES	YES	YES	RECOMMENDED

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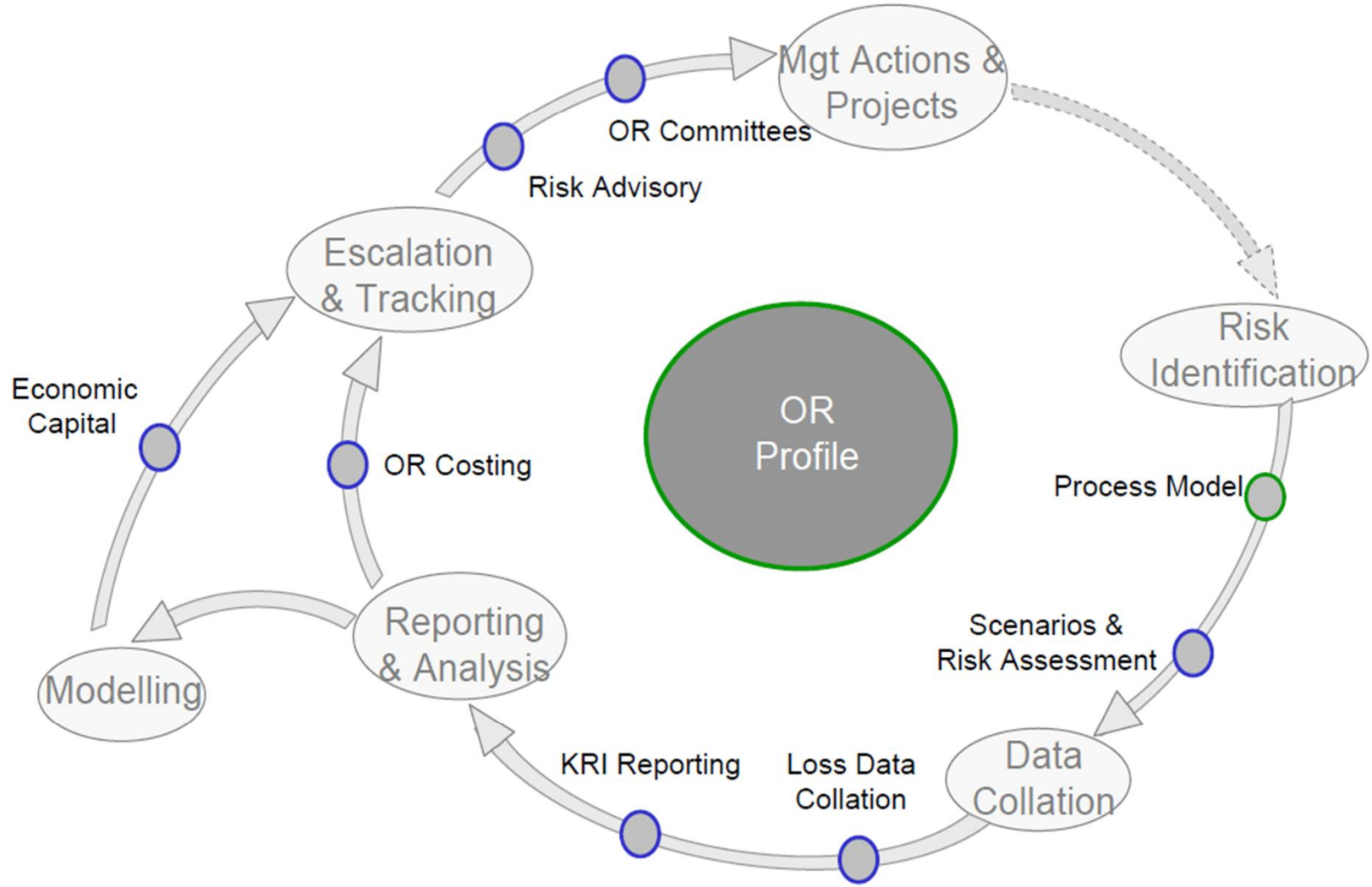
Ops Risk Management Process



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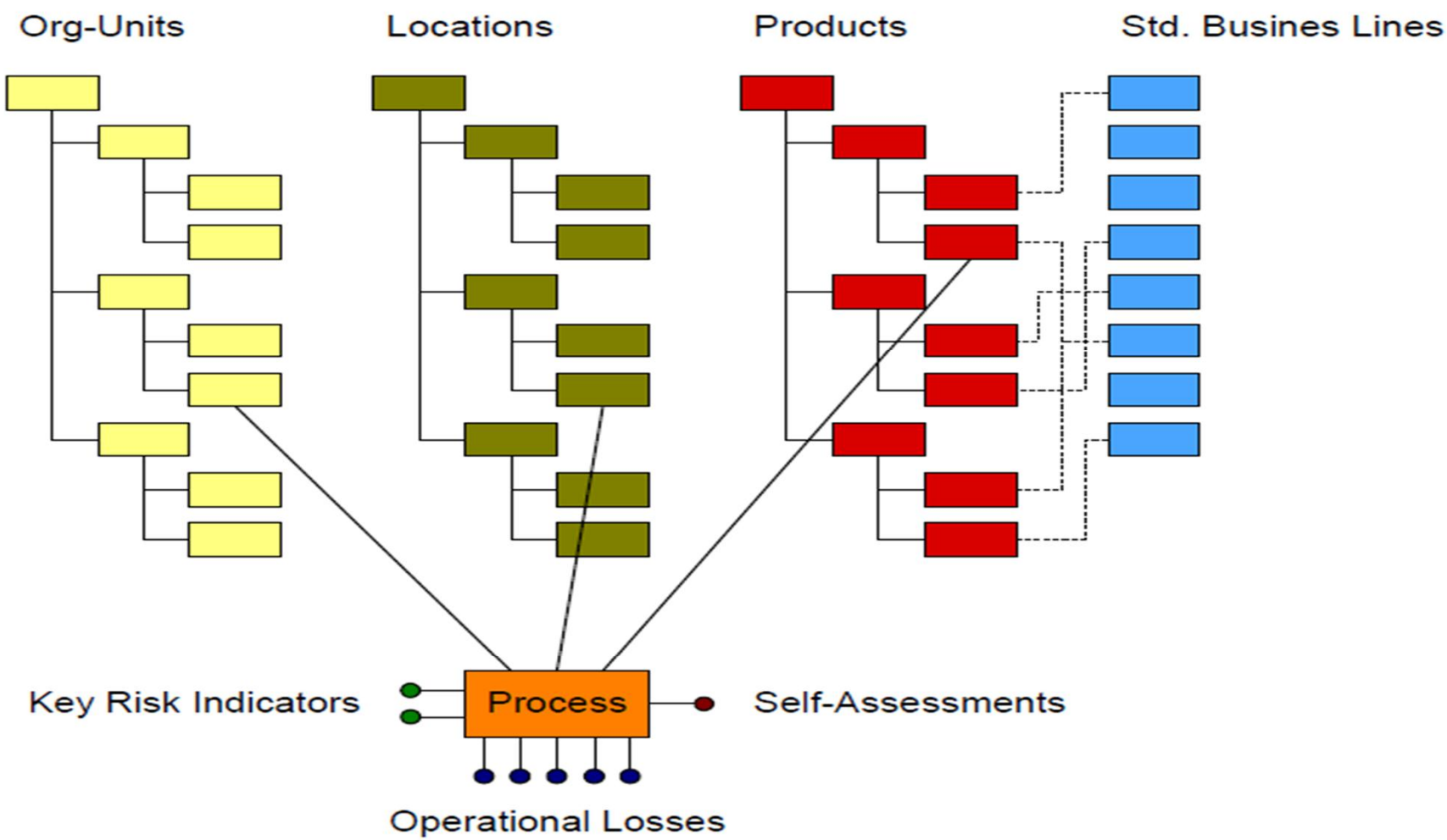
Process Allocation and Risk Loss indicator comparison



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Internal Loss data

What is it?

Collection of Operational Losses (Financial/Non financial impacts including Penalties) in business processes and projects, structured by risk categories, such as technology, human resources, organization, external factor.

Why do we need it?

- To Analyze organizational weaknesses per product/Process, organizational unit and/or location
- To Analyze weaknesses in Outsourcing arrangements
- To identify and prioritize need for management action or attention
- To validate economic capital

How does it work?

- Identify loss booking procedures and accounts
- Identify responsible people
- Replace existing manual procedures with loss collection workflow
- Coordinate with Internal Audit, Insurance and Compliance

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Risk Categorised Causal factors

People

- Attrition
- Adequacy
- Competency

Process

- Adhoc
- Granular Completeness

System (IT Operations)

- Enablements
- Validations
- Access Control(Login id/password compromise)

External Events

- Floods
- Earthquakes
- Riots/Vandalism

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Loss Matrix (8 X 7)

Operational Risk is broken down into event types as they cut across business lines

Event Type / Business Line	TSA %	Internal fraud	External fraud	Employment Practices And Workplace Safety	Clients, Products & Business Practices	Damage to Physical Assets	Business Disruption and systems failures	Execution, Delivery & Process Management
Corporate Finance	18							
Trading & Sales	18							
Retail Banking	12							
Commercial Banking	15							
Payment and Settlements	18							
Agency Services	15							
Asset Management	12							
Retail Brokerage	12							

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The internal business lines and events matrix for collection of loss data

Event Type / Internal Business Line	Internal fraud	External fraud	Employment Practices And Workplace Safety	Clients, Products & Business Practices	Damage to Physical Assets	Business Disruption and systems failures	Execution, Delivery & Process Management
Consumer Lending, Cards & Acquiring							
Retail Liabilities, Investment Products & Channels							
Rural & Inclusive Banking							
SME							
Mid Corporate							
Large Corporate							
Infrastructure							
Business Banking							
Treasury							
Investment Banking							

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Risk Event Types (RET)

Risk Event Types	Examples of Risk Event Types
Internal Fraud	Losses due to acts of a type intended to defraud, misappropriate property or circumvent regulations, the law or company policy, excluding diversity/discrimination events, which involves at least one internal party.
External Fraud	Losses due to acts of a type intended to defraud, misappropriate property or circumvent the law, by a third party.
Employment Practices and Workplace Safety	Losses arising from acts inconsistent with employment, health or safety laws or agreements, from payment of personal injury claims, or from diversity /discrimination events.
Clients, Products & Business Practices	Losses arising from an unintentional or negligent failure to meet a professional obligation to specific clients (including fiduciary and suitability requirements), or from the nature or design of a product.
Damage to Physical Assets	Losses arising from loss or damage to physical assets from natural disaster or other events.
Business Disruption and systems failures	Losses arising from disruption of business or system failures.
Execution, Delivery & Process Management	Losses from failed transactions processing or process management, from relations with trade counterparties and vendors.

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Classification / Categorization of Risk

The table below enables the participants to classify the risk

Impact	Frequency
Very High (Devastating/Catastrophic)	Very High (Almost Certain)
High (Substantial/ Major)	High (Likely)
Medium (Tolerable/ Moderate)	Medium (Moderate)
Low (Negligible/ Minor)	Low (Unlikely)
Very Low (No Impact/ Insignificant)	Very Low (Rare)

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Risk Matrix

Categories:

A - Acceptable;
M - Manageable;
U - Unmanageable

Catastrophic	U	U	U	U	U
Substantial	M	M	M	U	U
Moderate	A	M	M	M	U
Negligible	A	A	M	M	M
No Impact	A	A	A	A	A
Severity Frequency	Rare (Very Low)	Unlikely (Low)	Moderate (Medium)	Likely (High)	Almost Certain (Very high)

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Coverage of Operational Risk Policy

Nature of Events –

- Single event and non repetitive
- Multiple events and repetitive
- Multiple event types affected
- Multiple refunds to clients(known failure points)
- Multiple Business Lines

Exclusions –

- Opportunity costs
- Lost future business
- Events involving reputational damage
- Events causing gains

Effect Types –

- Legal Liability
- Regulatory action
- Loss or damage to assets
- Restitution
- Loss of recourse
- Write Down

Contd ..

Coverage of Operational Risk Policy

 .Contd

Business Lines –

- More than 1 Business Line impacted
- Buying a new Business Line(s)
- Merger / Demerger of Business Line(s)

Overlaps –

- Credit
- Market
- Strategic

Ops Risk Boundaries

- Fixed Assets
  - Replacement Cost
  - Market Value
  - Book Value
- Pending Losses
  - Legal Cases
  - Damage to Physical Assets

Contd .

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Coverage of Operational Risk Policy

….Cont

- Timing Losses
- Date
  - Occurrence
  - Accounting
  - Detection
- Recoveries
  - Direct
  - Insurance (Indirect)

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Some major losses being witnessed by the Bank Industry

- Unauthorised debits to customer accounts
- Unauthorised debits to transit/ office accounts
- Misappropriation of collections- asset accounts; unauthorised collections by agents/ staff
- Fake cheques/ forged cheques- collection/ payment
- Mortgage frauds- various types- fictitious docs, fabricated financials, valuation frauds, forged/ fake sale deeds, release of mortgage security (intentionally), multiple sale deeds, fraudulent sale of mortgaged property
- Chargeback losses
- Cross sales of third party products- mis-selling
- Phising/ skimming attacks
- Data entry errors
- Cash/ cheques lost in transit or stolen
- IPO- recon/ delay/ errors
- Purchase/ sale of stocks
- Limit breaches,
- Fake LCs
- Fake guarantees
- Double/ error in remittances
- ATM frauds- atm carried away, drilled open, reconciliation issues (switch, GL and physical cash), cash stolen by employees of service providers, cash un-reconciled in vault of service providers, cash limit breaches in atm cassetes, stolen
- POS/ Internet frauds- fraud merchants/ usage of counterfeit cards (data security)- collusion between staff and merchant,

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General Causal Examples

- Misuse of system inadequacies includes absence of validation checks, gaps in system interface, mis-operation by systems.
- Lack of due diligence.
- Eagerness to achieve the tight targets
- Heavy attrition- sales staff
- Lack of domain knowledge
- Rapid changes in the existing products/ roll out of new products without the necessary system enablements/ lack of product knowledge
- Misuse of powers by superiors to coerce juniors to execute unauthorised txns
- Process inadequacies
- Inadequacies in segregation of duties- operations, collections, sales and credit reporting to same head.
- Lack of due diligence in asset/ individual / property verification
- Facilitating business by diluting controls due to business complexity.
- Rapid change in usage of technology/ channels.
- Business disruption
- Data leakage
- Gaps in recon
- Absence of real time limit monitoring tool.
- Gaps in account sourcing
- Gaps in data quality/ de duping process.
- Monitoring of chargebacks, merchant blacklisting/ delisting, payment gateway security in terms of data security
- Information flow and security

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Thank You

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