

# **OPERATIONS RISKS**

**Back-office sub committee**

# WHAT IS RISK THE BANKS ARE FACING?

 **Barings Bank**

 1995 – Nick Leeson  
Concealing of loss position  
Euro 953mn

Internal fraud cases caused bank to collapse and represent some of the largest operational risk losses of recent past.

Fraudulent financial reporting, such as concealing of large losses in trading positions, the misappropriations of funds and embezzlement are the key causes for large events

 **Sumitomo Corp**

1999 – Yasuo Hamanaka  
'Mr 5%' - Concealing of loss position. \$2.6bn



 **Societe Generale**

 2008 – Jerome Kerviel  
Concealing of loss position  
US\$7.1bn

Underlying factor allowing these cases to happen is the multiple failure of key controls.



# OPERATIONAL RISK

Operational risk is of loss resulting from inadequate or failed internal processes, people, system, or from external event.

Operational risk is:

- One of the biggest risks that banks face
- A risk that can be managed and controlled (but, generally, not eliminated)



# OPERATIONAL RISKS, WHAT DOES IT COVER

<b>People</b>	Includes: fraud; breaches of employment law,; unauthorised activity; loss or lack of key personnel; inadequate training; inadequate supervision
<b>Processes</b>	Includes: payment or settlement failures; documentation which is not fit for purpose; errors in valuation/pricing models & processes; project management failures; internal/external reporting; (mis) selling
<b>Systems</b>	Includes: failures during the development and systems implementation process, as well as failures of the system itself; inadequate resources
<b>External Events</b>	Includes: external crime, outsourcing risk; natural and other disasters; regulator risk; political risk; utilities failures; competition



# RESULTS OF OPERATIONAL RISKS

- Legal cases
- Financial losses
- Damage payments
- Penalty payments decided by regulatory authorities
- Reputation damage
- Interruption of business activities



# THE RELATIONSHIP BETWEEN OPERATIONAL RISK MANAGEMENT AND OTHER RISK TYPES



## WHY OPERATIONAL RISK MANAGEMENT IS IMPORTANT?

- The increasing complexity and sophistication of operations & products
- Risk management help reduce operational losses by defining effective control and monitor the implementation.
- Risk management help improve production conditions: streamlining of processes which results in increased productivity, improved quality.



## HOW RISK IS ASSESSED

- Probability of occurrence
- Resulting losses, adverse reputation and franchise impact.
- The analysis of business processes and of incurred risks must be entrusted to relevant operational staff.

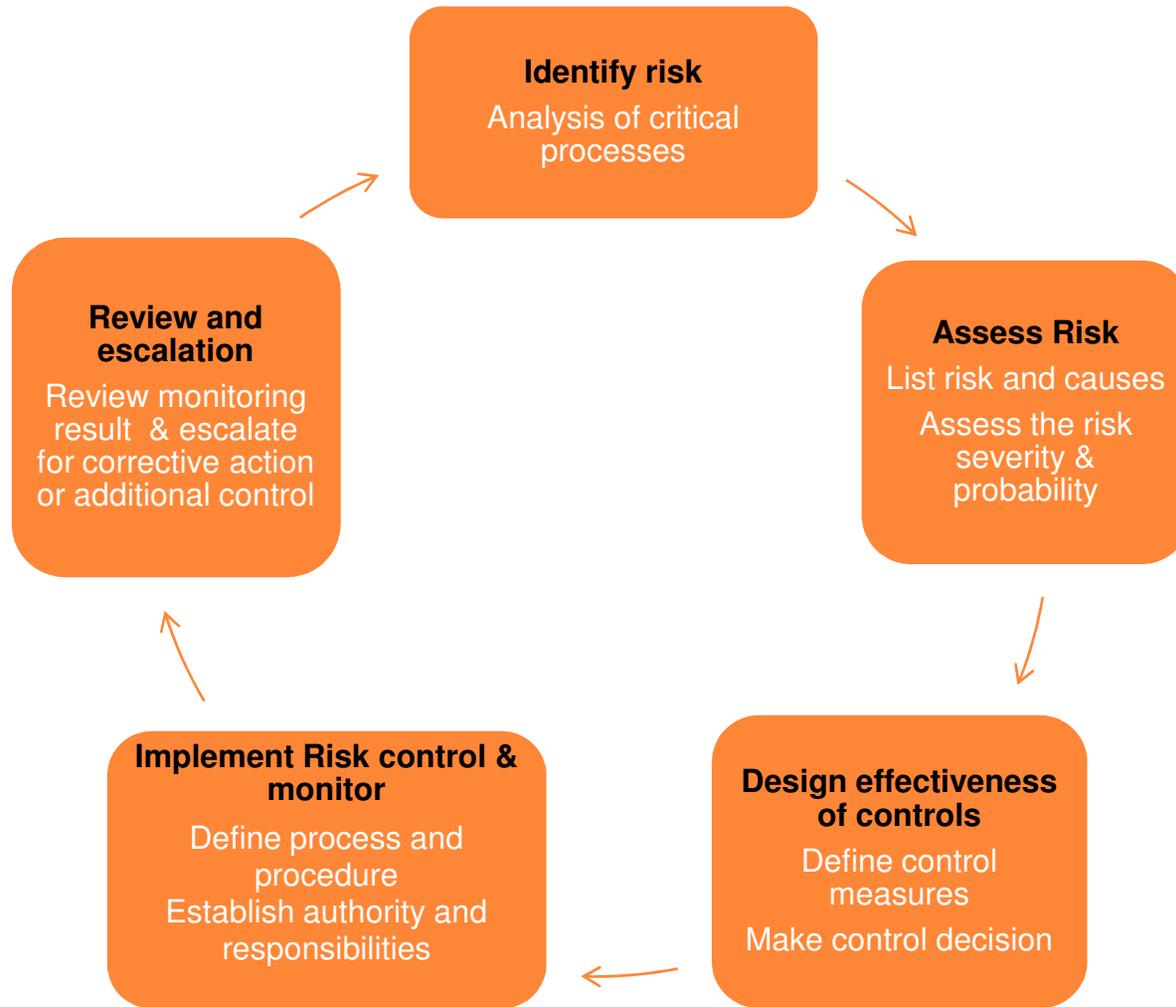


# OPERATIONAL RISK CONTROL

- Mitigate of operational risk.
- Identify the required actions to bring the "inherent" risk (existing risk before the application of preventive measures) to an acceptable level of risk.
- The implementation of control measures and action plans results from a compromise between enforcement cost and obtained risk level.
- The framework of risk management should include a risk aspect in order to:
  - Revise business processes : creation of new processes, removal or adaptation of existing processes,
  - Identify incurred risks,
  - Define mitigation measures to be taken in order to reduce risks.
- True operational risk management should be iterative process.



# RISK MANAGEMENT IS A CONTINUING PROCESS



# OPERATIONS FUNCTION IN RISK MANAGEMENT

- Increasing regulation, compliance requirements and lesson learned from the past mistakes, risk management has jointed forces in the trading operations and able to make 'back-office' efficiency.
  - Verify deal booked by FO
  - Confirmation with counterparty
  - Generate payment
  - Accounting
  - Reconciliation
  - Collect documentation as regulatory requirement and record transaction



# RISKS MANAGEMENT SUGGESTION FOR OPERATIONS

Jobs	Risk	Control	Monitoring
<p>Verify the deal booked in system against term sheet/email/Reuters In case there is no STP software system</p> <ul style="list-style-type: none"> <li>- Deal Makers/Entry</li> <li>- Validate deal with traders (deal checker)</li> <li>- Limit checking</li> </ul>	<ol style="list-style-type: none"> <li>1. Inaccurate trade capture</li> <li>2. Unbooked trades</li> <li>3. Unauthorised trade booking</li> </ol>	<ol style="list-style-type: none"> <li>1. Segregation of duties: Verification process is independently performed by Ops</li> <li>2. Dual controls on deal verification.</li> <li>3. EOD reconciliation to ensure all deals are captured.</li> </ol>	<ol style="list-style-type: none"> <li>1. # of unreconciled positions noted.</li> <li>2. # of wrong booking which is undetected by Operations</li> </ol>
<p>Confirm deal with counterparty</p>	<ol style="list-style-type: none"> <li>1. Internal and external fraud.</li> <li>2. Wrong details in paper confirmation and /or miss sending confirmation and/or Unclear/disagreement on terms &amp; conditions -&gt; settlement impact, financial losses</li> <li>3. Non compliance with regulatory -&gt; litigation, regulatory sanction.</li> </ol>	<ol style="list-style-type: none"> <li>1. Signatures verification</li> <li>2. Dual controls on confirmation generation.</li> <li>3. Confirmation formats of both parties are approved by Legal and reviewed periodically.</li> <li>4. Day-end reconciliation to ensure confirmation is sent/received .</li> <li>5. Escalation of pending unconfirmed deals after required date.</li> </ol>	<ol style="list-style-type: none"> <li>1. Randomly pick up ...samples to check if confirmation are signature verified .</li> <li>2. Randomly pick up EOD report to verify if EOD reconcile is performed with dual control evidenced .</li> <li>3. Check ...unconfirmed report to see if it is properly escalated</li> </ol>

# RISKS MANAGEMENT SUGGESTION FOR OPERATIONS

Jobs	Risk	Control	Monitoring
Settlement	Inaccurate or untimely processing of transactions (including processing of sending buy/sell orders to HNX and funds arrangement at clearing bank - BIDV) -> operational losses or regulatory fines	<ol style="list-style-type: none"> <li>1. Tracking and monitoring of upcoming settlements/ coupon payments through system reports/manual inventory with dual-control</li> <li>2. Dual controls on sending buy/sell orders to HNX/broker and settlement release</li> </ol>	<ol style="list-style-type: none"> <li>1. # of failed trade items over a period.</li> <li>2. # of 'due to due from' items greater than ... biz days at period end.</li> </ol>
Accounting	Failure of the timely record transactions in financial book or wrong accounting entries -> Incorrect reporting and incorrect business planning / decision making	<ol style="list-style-type: none"> <li>1. Standard accounting entries are defined and approved by Finance Department</li> <li>2. Dual control on booking manual entries</li> </ol>	<ol style="list-style-type: none"> <li>1. # of adjustment for correction made by Operations .</li> </ol>

# RISKS MANAGEMENT SUGGESTION FOR OPERATIONS

Jobs	Risk	Control	Monitoring
Reconciliation	Failure of the timely reconciliation and monitoring of settlement accounts & bond holding -> the risk of fraudulent / inappropriate Accounting Entries posted and financial loss to the bank.	<ol style="list-style-type: none"> <li>1. Closely reconcile Cash /Bond settlement &amp; monitor the pending item, reason for pending must be obtained and escalate immediately</li> <li>2. Monthly reconcile the Bond holding with statement from SBV &amp; VSD.</li> </ol>	<ol style="list-style-type: none"> <li>1. Randomly check pending items to see if the reason has been obtained and escalation process is done properly.</li> </ol>
Documentation	Failure to store and maintain records in accordance with legal and/or regulatory requirements for retention, disposition and handling -> hamper the ability to retrieve bank records in response to legal / regulatory requests.	<ol style="list-style-type: none"> <li>1. Refer to the Circular 43/2011/TT-NHNN, record retention is 10 years</li> <li>2. Monthly/ Quarterly independent check to ensure confirmations are properly stored.</li> </ol>	<ol style="list-style-type: none"> <li>1. Randomly pick up ...boxes to verify if there is any missing transactions.</li> </ol>

# FACTS for SHARING & DISCUSSION



# CASE 1

- Facts:

Broker requires Bidding Client to transfer fund for Bond settlement to Broker's account (instead of settlement directly with the ISSUER)

- Risks:

- Broker Default risk
- Late settlement to ISSUER -> late receipt of bonds



## CASE 2

- Facts:

In case of Issuance Guarantee Combination with Broker is not Principal Guarantee Organization.

Broker requests client to deposit 15% of registered value before bidding date.

- Risks:

- Default Risk of Principal Guarantee Organization and/or of the Broker.
- Liquidity Risk when returning deposit late in case of unsuccessful bidding.



## CASE 3

- Facts:

Related to insurance companies who have more than one funds for Bond investment while only 1 bidding account at HNX.

- Risk:

Costly when placing sell and buy orders to reallocate the Bonds to different funds after bidding.



## CASE 4

### ○ Facts:

- Pursuance to Appendix 04 of Circular 224/2012/TT-BTC, Article 3.A.4: Bonds with tenor to maturity of less than 3 months will be valued at purchasing price. However, in fact, Bonds with TTM < 3months can be traded at HNX.
- Pursuance to Appendix 04 of Circular 224/2012/TT-BTC and Appendix 13 of Circular 183/2011/TT-BTC, Bonds will be valued:
  - Circular 224: Clean Price
  - Circular 183: Average listed price on date having latest transactions prior to valuation date plus accumulated interestHowever, currently, HNX hasn't provided these two prices.

### ○ Risk:

- Accuracy of the NAV calculation is not high and therefore affects the reporting on Performance of Funds

