



Operational Risk Assessment for Bank Branches

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ABSTRACT

Risk management has become all pervasive and is the concern of all banks. In the emerging scenario with a large number of branches as sales outlets, management of operational risks at branch level has become important to banks. This paper postulates an operational risk assessment template for bank branches to identify and aggregate the operational risk elements thereat using simple empirical model. The model can be used to study operational risk profile of branches for initiating corrective actions.

Keywords : Operational Risk Management, Risk Architecture, Technology, Basel II

1. Introduction

Bank Branch scenario has changed enormously in the last two decades due to rapid changes taking place in the banking sector. While the trigger is the reform process, it is accelerated by the shifting customer preferences and their life styles. Branch contours however have undergone remarkable changes in recent times with massive induction of technology and alternate delivery channels being made available to customers in the form of ATMs, Net Banking, Mobile Banking, etc. The central focus continues to be the customer but with new ways of communication and interfaces. Branch head today has to dynamically manager people, processes, systems, etc. at the branch level than hitherto before. The concomitant risks have therefore shot up.

Since the reform process started in the 1990s, banks in India have initiated several changes and have emerged stronger. The Reserve Bank of India has introduced risk based supervision of banks in India and advised banks to progressively adopt risk management framework. Banks have to, therefore, fully prepare themselves to meet these requirements and strengthen their MIS for the purpose.

Capital requirement, the foundation of the regulatory framework, is the key indicator of the health of the banking sector. Capital Adequacy Ratios are intended to ensure that banks maintain a minimum amount of own funds in relation to the risks they face, to absorb unexpected losses, and run the bank on safe lines. Advances in technology and communications, innovation in banking products and services and the increasing globalization of financial markets have changed the way the banks measure and manage risk. Risk management has become all pervasive from the apex level to Branches. In the emerging scenario, the management of operational risks at the bank branches have become critical for banks. However, it is still to percolate down to the operating level. Advanced statistical models may be developed at bank level but at the operating level it has to be simple.

2. Rationale of the Study

With a view to sensitizing branch level functionaries to risk management, this paper postulates a simple risk assessment method for the branches using simple empirical model. The model will help in determining how efficiently the branch is functioning with reference to operational risk management.

3. Objectives

The objective of the study is to formulate a simple operational

risk assessment template at branch level, as a self assessment tool for the Branch Head, to identify and aggregate the risk elements at the branch. By aggregating the branch-level data, bank can measure operational risks at different bank levels.

4. Research Methodology

Research methodology used is exploratory in nature based on published literature. Data and information for the research study were gathered and analyzed from secondary published sources viz., books, newspapers, periodicals, journals, web sites, research studies, etc.

5. Limitation of the Study and Scope for Further Study

This study is confined to operational risk elements at Branch level. This does not cover other risk categories. This model can be amplified for further research for putting in place robust risk management systems encompassing people, processes and systems.

6. Findings of the Study

6.1 Formulation of a Template for Bank Branch Operational Risk Assessment

A template listing the Operational risk elements as shown in Exhibit 1 is prepared. Sample testing / verification of each risk element is carried out. The extant of deviations of each parameter from the laid down systems and procedures, rules and regulations are weighted against the degree of risk involved and the Branch exposure for heat mapping. The movement of risk (increasing, steady or decreasing) is assessed and causes identified.

The technique is described below step by step.

- i. List the risk parameters under operational risk.
- ii. On the basis of verification of branch books, records, documents and analysis / scrutiny of accounts, for each risk parameter, assess / quantify the deviations in percentage terms and indicate the same in the appropriate column under the head "Deviation". The following table gives a suggested degree of deviation on the basis of the percentage of accounts with deviations in the risk parameter to the total accounts:

Percentage of Deviations		Description
From	To	
0%	5%	VERY FEW

Above 5%	10%	FEW
Above 10%	20%	SOME
Above 20%		MANY

iii. The above deviations have to be then related to the degree of risk involved and indicated in the appropriate column under "Risk".

Degree of Risk involved	
VERY LOW RISK	Above 90%
LOW RISK	Above 70% to 90%
MEDIUM RISK	Above 60% to 70%
HIGH RISK	50% or below

iv. There after the heat mapping is done based on the emerging risk sensitivity of the extant of deviations and degree of risk involved.

Heatmap Indicator -----	 Very Low Risk	 Low Risk	 Medium Risk	 High Risk
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v. The next step is to identify the trend of risk as follows.

Movement of Risk -----	↑	Increasing	↔	Steady	↓	Decreasing
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vi. Lastly, the heat map should be evaluated in conjunction with the movement of risk to identify the critical areas of concern at the branch for taking corrective actions.

The above model can be used to study the risk profile of the branch for initiating suitable corrective actions at the operating level. The beauty of the model lies in its simplicity. The model can be used by branches themselves from time to time to make self assessment and corrections to minimize risk.

A typical model of the templates for operational risks is given in the exhibit in the annexure. One can suitably add elements, sub-elements under each risk parameter for a more detailed analysis.

6.2 Advantages of the Model

The method helps in

- anticipating areas of potential risk
- determining level of risk (high, medium, low) and
- trend of risk (increasing, stable, decreasing)
- identifying causative factors
- continually evaluate and thereby minimize risk

The model is risk focused. The format helps assessment of operational risk of each activity / process and trend of the risk. It enables to clearly identify and quantify high risk areas at branch. It can help in risk alleviation to reduce / eliminate risks. The results of the assessment can be used to discuss and sensitize staff at branch. This will not only strengthen the risk architecture but also help in improving customer service.

The model also facilitates aggregation of the branch-wise data to measure risk at different bank levels for each process / sub-process / product / service level. This can help in initiating enterprise-wide actions to contain risks.

7. Conclusion

Risk management should not be understood as zero risk approach but as containment of risk by adopting proper systems and procedures. By instituting a robust risk management across the bank, the customer service can be enhanced. Training and sensitizing the work force is essential. Staff should be familiar with proper use of ICT to exploit them to enhance their productivity.

With Basel II implementation, the need for improved risk management in banks has become increasingly clear. There is a felt need to develop a framework that introduces greater transparency around the bank's risk profile through consistent and comprehensive risk measurement, aggregation and management.

Knowledgeable work force is essential for effective risk management. Therefore, re-skilling of staff with proper training inputs at all levels is required. The suggested simple model can sensitize the work force at branches to risk management.

Reputation of a Bank is the sum total of its various service outlets. Banks have to ensure that proper laid down systems and procedures are followed at the operating level. Continuous monitoring and analysis of the branch functioning would help identify weak links. While branch head would ensure the micro management by periodically making self-risk assessment on the lines of the suggested model, apex level offices should extend necessary support functions. This will supplement periodic internal audits for effectively measuring, managing and mitigating risks at the delivery points.

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