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Research Article

A Study On Impact Of Near Miss On Operational Risk Of Hdfc Bank Ltd

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ABSTRACT

In this paper have discuss the operational risk management of HDFC Bank Ltd with the brief introduction to the concept of near miss and its impact on operational risk. The research helps in avoiding revenue leakage from the public bank accounts and the importance of customer profiling to avoid unnecessary charges to customer and the processing cost to the bank .We discussed fundamental operational practices, risk identification process and controls against the risk with the near miss banking transactions i'e cash and non- cash along with service request for the updating and modification of bank details which is the routine practice of branch banking. Compliance to control all such practices which leads to unfair financial loss of lay man. Testing the impact of near miss on the operational risk is our research result

1.1 Introduction

Operational Risk Management practices in banks involves all such processes which are implemented in a bank branch where the customer walks in to the primary contact solution of his requirements. Banking itself is a business of risk as it deals with the economic instruments which are considered as the high risk products including cash. Branch banking is designed in a certain structure where the job role changes with every change in desk .All banking areas are risk oriented whereas cash is known as the high risk area across the spectrum. Other areas are also risk based including Clearing cheques, Demand drafts, Pay orders/Manager cheques, RTGS/NEFT, Inward/Outward Remittance, Forex cash and non-cash transactions. Moreover there are many other practices followed to facilitate the customer with third party product services like Insurance, Mutual Funds, Trading accounts etc along with asset products like loans and credit cards in HDFC Bank

1.2 Operational Risk Management Practices in HDFC Bank Ltd

"Branch of a bank being a small representative of the entire bank practices the entire functions and works as a one stop solution for customer not in banking products but also provides all financial services under one roof. The concept of cross selling is back bone of all private banks and is also a greater revenue generator for HDFC Bank Ltd as they earn the profitability out of cross selling with an added advantage of customer retention and the deep relation with the customer by offering multiple products and to make customer dependent on that bank services to convert his direct income into a recurring income for the bank.

The more products used by the customer the more he becomes profitable to the bank. The relationship involves the risk which leads to the financial loss either to the bank or to the customer and needs best practices to be followed to mitigate the risk .This not only involves financial loss it also involves reputational loss and sometimes by negligence termination of an employee which effect his professional career.

2. Objectives of the study

The objectives of the study are as follows:

- Identifying the risk associated with the near miss
- Test the controls practiced by HDFC Bank Ltd

Review of Literature

1. Operational Risk

This is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Given below is a detailed explanation under four different heads: Framework and Process, Internal Control, Information Technology and Security Practices and Fraud Monitoring and Control.

A. Framework and Process

To manage operational risks, the Bank has in place a comprehensive and operational risk management framework, whose implementation is supervised by the Operational Risk Management Committee (ORMC) and reviewed by the RPMC of the Board. An independent Operational Risk Management Department (ORMD) implements the framework. Under the framework, the Bank has three lines of defence. The first layer of protection is provided by the Business line (including support and operations) management. These managers are primarily responsible for not only managing operational risk on a daily basis, but also for maintaining strict internal controls, designing and implementing internal control-related policies and procedures. The second line of defence is the ORMD, which develops and implements policies, procedures, tools and techniques to assess and monitor the adequacy and effectiveness of the Bank's internal controls. Internal Audit is the last line of defence. The team reviews the effectiveness of governance, risk management, and internal controls within the Bank.

B. Internal Control

HDFC Bank Ltd has implemented sound internal control practices across all processes, units and functions. The Bank has well laid down policies and processes for management of its day-to-day activities. The Bank follows established, well-designed controls, which include traditional four eye principles, effective separation of functions, and segregation of duties, call back processes, reconciliation, exception reporting and periodic MIS. Specialised risk control units function in risk prone products / functions to minimise operational risk. Controls are tested as part of the SOX control testing framework.

C. Information Technology and Security Practices

The Bank operates in a highly automated environment and makes use of the latest technologies to support various operations. This throws up operational risks such as business disruption, risks related to information assets, data security, integrity, reliability and availability amongst others. The Bank has put in place a governance framework, information security practices and business continuity plan to mitigate information technology related risks. An independent assurance team within Internal Audit provides assurance on the management of information technology related risks. The Bank has a robust Business Continuity and Disaster Recovery plan that is periodically tested to ensure that it can meet any operational contingencies. There is an independent HDFC Bank Limited Annual Report Directors Report Information Security Group that addresses information security related risks. A well-documented Board approved information security policy is put in place. In addition, employees mandatorily, and periodically undergo information security training and sensitisation exercises.

D. Fraud Monitoring and Control

The Bank has put in place a whistle blower policy, and a central vigilance team oversees implementation of fraud prevention measures. Frauds are investigated to identify the root cause and relevant corrective steps are taken to prevent recurrence. Fraud prevention committees at the senior management and Board level also deliberate on material fraud events and initiate preventive action. Periodic reports are submitted to the Board and senior management committees.

2. Compliance Risk

Compliance Risk is defined as the risk of impairment of HDFC Bank Ltd.'s integrity, leading to damage to its reputation, legal or regulatory sanctions, or financial loss, as a result of a failure (or perceived failure) to comply with applicable laws, regulations and standards. The Bank has a Compliance Policy to ensure highest standards of compliance. A dedicated team of subject matter experts in the Compliance Department works with business and operations teams to ensure active compliance risk management and monitoring. The team also provides advisory services on regulatory matters. The focus is on identifying and reducing risk by rigorously testing products and also putting in place robust internal policies. Products that adhere to regulatory norms are tested after rollout, and shortcomings, if any, are fully addressed till the product stabilises on its own. Internal policies are reviewed and updated periodically as per agreed frequency or based on market action or regulatory guidelines / action. The compliance team also seeks regular feedback on regulatory compliance from product, business and operation teams through self-certifications and monitoring.

3. ICAAP

The Bank has a structured management framework in the Internal Capital Adequacy Assessment Process (ICAAP) to identify, assess and manage all risks that may have a material adverse impact on its business / financial position / capital adequacy. The ICAAP framework is guided by the Bank's Board approved ICAAP Policy. Additionally, the Board approved Stress Testing Policy and Framework entails the use of various techniques to assess potential vulnerability to extreme but plausible stressed business conditions. Changes in the Bank's risk levels and in the on / off balance sheet positions are assessed under such assumed scenarios using sensitivity factors that generally relate to their impact on profitability and capital adequacy.

4. Group Risk

HDFC Bank Ltd has two subsidiaries, HDB Financial Services Limited and HDFC Securities Limited. The Board of each subsidiary is responsible for managing their respective risks (Credit Risk, Market Risk, Operational Risk, Liquidity Risk, and Reputation Risk). The ICAAP at the subsidiaries is overseen within the Bank's ICAAP framework. Stress testing for the group as a whole is carried out by integrating the stress tests of the subsidiaries. Similarly, capital adequacy projections are formulated for the group after incorporating the business / capital plans of the subsidiaries

5 Research Methodology:

5.1 Methodology

The model adopted for this study "the impact of Near Miss on Operational risk of HDFC Bank Ltd" The basis and justification of the model and method is distilled from the literatures. Researchers such as Ali (2015), Ernest and Fredrick (2017), Syed (2017) and Naceur and Kandil (2006) used a regression model. On the basis of this literature the model was formulated thus:

In order to see the impact of Near miss on operational risk, we fitted a linear regression model considering operational risk as dependent variable and near miss as an explanatory variable (Predictor/covariate/independent variable). On carrying out the regression analysis, we got the following model:

$$Operational\ Risk = 2.566 \times 10^{-3} + (1.942 \times 10^{-6})\ Near\ Miss$$

Thus from the derived model we concluded that there is positive impact of Near miss on the operational risk and the per unit impact of near miss on operational is 1.942×10^{-6}.

The six number summary of the two variables is given in the following table where in Q1 and Q3 represents the first and third quartile respectively.

Near Miss

Minimum	Q1	Median	Q3	Mean	Maximum
5029	8404	11612	13100	13777	118000

Operational Risk

Minimum	Q1	Median	Q3	Mean	Maximum
0.01333	0.02000	0.02667	0.02800	0.03333	0.23333

Findings

- The main purpose of this research is to investigate the impact of near miss on the operational risk, it has been found that there is the positive impact of near miss on the operational risk with per unit impact of 1.942×10^{-6}
- This has been proven that if the instances of near miss increases in the bank operational risk also increases with the same proportion which can lead to the financial, credit, reputational loss to the bank and the monetary loss to the customer.
- Internal Control testing has been found as the major contributor to verify the risk control matrix

Conclusion

- Risk management underlines the fact that an organization's survival is heavily dependent on its ab ility to anticipate and prepare for the change, rather than just waiting for and responding to the ch ange.
- Risk management is not aimed at prohibiting or preventing activity taking risks, but at ensuring th at the risks are consciously taken with full knowledge, clear purpose and understanding so that th ey can be measured and mitigated.
- Risk management functions should be specific to the bank dictated by the size and quality of the balance sheet, the complexity of the functions, the technical / professional manpower and the stat us of the MIS in that bank.
- The effectiveness of risk measurement in banks depends on efficient information management sys tem, computerization, and branch activity networking.

Limitations:

- The Data was only getting possible for 5 Years
- Research was carried out on only on One bank and have large scope to study the position of other banks as well
- Due to lockdown and Covid 19 Pandemic. Interview was conducted on phone to the bank officials.

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