

## ELECTIVE PAPER 6A – RISK MANAGEMENT

### SUGGESTED SOLUTION – CASE STUDY 1

1.

#### Source- Exhibit 1

Risk Scenario Title	Fraud Risk
Scenario description	The system of the Bank can be hacked to create may face a claim for money when a foreign bank tries to recover its money released against an LC.
Impact of scenario	Huge loss to bank if the number of LC transactions is large.
Current measures to manage risks	<p>Bank should have in place a system of detecting any unusual activity and how the staff shall respond when such an untoward event happens.</p> <p>Some measures must be taken to prevent such reoccurrences in future. Firstly, physical access to the system must be controlled. Secondly, strong password and multi-layer authentication policy should be there. And, lastly, identity and token management policies are needed to control who has access to data.</p>

#### Source- Exhibit 2

Risk Scenario Title	Governance or Reputation Risk
Scenario description	Using name of bank to customers for higher returns and opening fictitious accounts.
Impact of scenario	Bank may lose its reputation and may face unwarranted litigations.

Current measures to manage risks	Proper internal control system should be set up to combat frauds and to take pro-active fraud control and enforcement measures.
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**Source- Exhibit 3**

Risk Scenario Title	Reputation Risk
Scenario description	Bank account can be used for illegal transfer of funds and money laundering activities.
Impact of scenario	Bank may face paucity of funds and its reputation may also take a beating. It will be also being answerable to various stakeholders.
Current measures to manage risks	The bank should check the original identification documents of individuals dealing in cash above the prescribed threshold, to weed out the use of forged or fake copies.

**Source- Exhibit 4**

Risk Scenario Title	Natural Hazardous Risk
Scenario description	Small businesses are generally affected by a storm, earthquake or extreme weather.
Impact of scenario	The business of a bank may also be impacted by the natural disaster by which the physical office from which it conducts its business is also being affected by the calamity.
Current measures to manage risks	It can insure itself from any natural calamity.

**Source- Exhibit 5**

Risk Scenario Title	Regulatory or Compliance Risk
Scenario description	<p>In case payment bank is engaged in the business of P 2 P and their receipt and payment of money from India to any foreign country and vice-versa takes place. However, the platform matches and netted the transaction and the money never actually leaves the jurisdiction of a country.</p> <p>Since, Indian rupee is not freely convertible and Foreign Exchange Management Act, 1999 i.e. FEMA has provided certain regulations which curbs the free flow of money.</p>
Impact of scenario	Non-compliance of FEMA provisions will attract penalty.
Current measures to manage risks	The risk can be managed to a large extent with the compliance of RBI notifications.

**Source- Exhibit 6**

Risk Scenario Title	Regulatory or Governance Risk
Scenario description	The company is yet to draft a suitable policy for training and performance evaluation of directors and it has not appointed any committees.
Impact of scenario	This may invite penalties from the court and wrath of the investors.
Current measures to manage risks	Constitute an audit committee and shall have atleast two independent directors. Further, it is required to appoint a Nomination and Remuneration Committee and draft a suitable policy for training and performance evaluation of directors.

	Even though, the Companies Act, 2013 do not contain any compulsory provision for constitution of a Risk Management Committee, but it is in the interest of bank to constitute a Risk Management Committee.
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**Source- Exhibit 7**

Risk Scenario Title	Cyber or Technology Risk
Scenario description	Breaches of financial data and security of debit cards were compromised. The malware introduced in systems enabling the fraudsters to steal information and allow them to steal funds.
Impact of scenario	Penalties and litigations to be faced by bank.
Current measures to manage risks	Banks may either replace or ask users to change the security codes.  Reissue of debit cards and asking customers to change their PIN numbers as well.

**Source- Exhibit 8**

Risk Scenario Title	Fraud or Data Security Risk
Scenario description	Non-banks are getting access to the bank's customer information through third party applications developed for the Unified Payment Interface (UPI).
Impact of scenario	Privacy is the issue here. Customers' details are getting compromised.

Current measures to manage risks	Bank should be very careful while entering into any agreement with a third party app like PhoneSe. Agreement shall be entered into only after proper verification and knowledge about their business.
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**Source- Exhibit 9**

Risk Scenario Title	Reputation or Business Continuity Risk
Scenario description	The rumour that bank is the only bank which has been hit directly by the recent disasters and it could fail.
Impact of scenario	This may leads to people flocking to ATMs and bank branches to withdraw cash. Also, bank's stock price hammered.
Current measures to manage risks	Such rumour should be taken care of by proper media and people management. There should be a prompt response on the part of the Bank to ward off such rumour with the help of media. Proper people management requires action on the part of banks to pacify and inform customers so that future reoccurrences of such panic situations can be avoided.

**Source- Exhibit 10**

Risk Scenario Title	Finance or Forex and Interest Rate Risk
Scenario description	As banks can issue the Forex Card there may be some variation in the rates at which same has been acquired and disposed of.

	Since the rate of interest offered by the bank on its deposit is higher in comparison to the traditional banking and the fund shall be deposited in Govt. Securities instead of Commercial lending, the spread between receipt and payment of interest will be marginalized. Hence any change in the market interest rate shall lead to erosion in the spread.
Impact of scenario	Loss on account of Forex exchange rate volatility and squeezing of Interest Spread Gains.
Current measures to manage risks	Hedging the forex and interest rate using various techniques such as Forward, Futures and Option contracts.

**Note:** Students are expected to design any 5 risk scenarios in the prescribed format out of the above-mentioned 10 scenarios.

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To: The Board

From: ABC, Risk Consultant

Date: 29 December 2017

Subject: Risk Management

### **Introduction**

This report covers

- (i) Bucketing of above identified risks
- (ii) Likelihood Scale

(i) **Bucketing of above identified risks**

<b>Risk No.</b>	<b>Risk Scenario Title</b>	<b>Bucketing of identified risks</b>
1	Fraud Risk	Severe
2	Governance or Reputation Risk	Major
3	Reputation Risk	Major
4	Natural Hazardous Risk	Severe
5	Regulatory or Compliance Risk	Major
6	Regulatory or Governance Risk	Major
7	Cyber or Technology Risk	Major
8	Fraud or Data Security Risk	Major
9	Reputation or Business Continuity Risk	Moderate
10	Finance or Forex and Interest Rate Risk	Moderate

(ii) **Likelihood Scale**

<b>Exhibit</b>	<b>Risk Scenario Title</b>	<b>Likelihood Scale</b>
1	Fraud Risk	Unlikely
2	Governance or Reputation Risk	Likely
3	Reputation Risk	Likely
4	Natural Hazardous Risk	Unlikely
5	Regulatory or Compliance Risk	Likely
6	Regulatory or Governance Risk	Likely

7	Cyber or Technology Risk	Very unlikely
8	Fraud or Data Security Risk	Likely
9	Reputation or Business Continuity Risk	Very unlikely
10	Finance or Forex and Interest Rate Risk	Very likely

### Conclusion

As a small bank, some of the risk which especially Risk Nos. 5,6 and 8 needs special attention.

3. (i) (d)  
(ii) (c)  
(iii) (a)  
(iv) (c)  
(v) (b)  
(vi) (c)  
(vii) (b)  
(viii) (b)  
(ix) (a)  
(x) (c)