

Analysing the Operational Risk Management of China's Commercial Banks

—The Case of Bohai Bank's \$2.8 Billion Deposit Disappearance as an Example

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Abstract

The continuous expansion and extension of the business of commercial banks have exacerbated the occurrence of operational risk events, which has caused huge losses and at the same time caused a bad impact on the image and reputation of the bank. This paper takes the example of the disappearance of 2.8 billion deposits of Bohai Bank Nanjing Branch in October 2021, analyses the operational risk management problems exposed by the case of the disappearance of 2.8 billion deposits of Bohai Bank from the definition, classification and risk of operational risk, and puts forward proposals to make the operational risk management of commercial banks more and more sound in view of the relevant problems.

Keywords

Operational Risk, Commercial Banks, Risk Management, China

1. Introduction

When China's economy embarked on the fast track of development, commercial banks, as major players in China's financial market, continued to widen their banking business to cater for people's ever-expanding financial needs. When the level of financial services and services of commercial banks is rapidly increasing, the financial business is also becoming more difficult to operate and more difficult to manage the operational risks of banks, giving people who like to exploit the legal loopholes the opportunity to take advantage of the system deficiencies in order to carry out some unlawful acts (Wen, Wu, & Sun, 2024). In recent years, cases of operational risk in commercial banks have occurred frequently

and caused huge losses, which has had a bad impact on the image and reputation of banks and also brought negative impact on the social economy. Therefore, the operational risk management of commercial banks is particularly important. Through the introduction and analysis of the case of Bohai Bank Nanjing Branch exposed to the disappearance of 2.8 billion deposits in October 2021, this paper discusses the strategy of operational risk management of commercial banks in China.

2. Definition, Classification and Key Features of Operational Risk

2.1. Definition of Operational Risk

Prior to Basel II, commercial banks focused on market and credit risks. When the bank business process is more and more standardised, the bank operation risk will bring more harm, even higher than other risks. At present, there are different definitions of operational risk in the international arena, and the author believes that operational risk can be understood as the loss suffered by commercial banks in the course of operation due to irregular operation (Qu & Zhang, 2011).

2.2. Classification of Operational Risk

Operational risk is often difficult to measure, so commercial banks usually classify it in terms of the type of event or what causes it, with specific categorisations varying in ideas between organisations. Basel II considers seven types of operational risk that banks and financial institutions should be concerned about: firstly, internal fraud, which refers to the perpetration of fraudulent acts within an organisation that are against its interests. Intentional fraud, tax non-compliance, misappropriation of assets, counterfeiting, bribery, intentional misplacement and theft can all cause losses. Secondly, external frauds are activities committed by third parties. Theft, cheque fraud and breaches of system security, such as hacking or access to unauthorised information, are commonly encountered practices under external fraud. Thirdly, Employment Practices and Workplace Safety is where non-compliance with employment or health and safety laws and regulations is a serious operational hazard in any organisation. Incompetent maintenance of employee relations can harm employees by depriving them of the compensation and benefits they deserve. Unethical dismissal standards and discrimination are other operational risks that expose organisations to serious financial and reputational losses. Fourthly, customer, product and business practices are unforeseen circumstances caused by negligence where the institution fails to honour its commitments to customers. Privacy and fiduciary breaches, misuse of confidential information, suitability issues, market manipulation, money laundering, unlicensed activities and product defects are very common practices that lead to firms facing litigation. Fifth is damage to tangible assets, these are losses incurred as a result of damage to tangible assets caused by natural disasters or oth-

er events such as terrorism and vandalism. Sixthly, business interruption and system failure, supply chain disruption and business continuity have always been a major challenge for banks. System failures (hardware or software), telecommunication disruptions and power outages can lead to business interruption and financial losses. Seventh is execution, transaction and process management, which refers to the fact that unfavourable transaction or process management is a risk that exists in the course of production and operation, perhaps costing the business. Data entry errors, miscommunication, missed deadlines, accounting errors, inaccurate reporting, incorrect customer records, negligent loss of customer assets and supplier disputes are all operational risk events that may pose a legal threat to the organisation.

2.3. Key Features of Operational Risk

Commercial bank operational risk arises for a variety of reasons, characterised as follows:

Firstly, operational risk is intricate and has different points. Operational risk emerges much later than credit and market risk, and it covers a wide range of areas, like personnel, external environment, etc. are included. Different banks and their related departments, different time and space, will present different operational risk, even the same business, there will be different operational risk, because of different operational risk, its own will become complex.

Secondly, the coverage of operational risk is wider. From the concept of operational risk, we can find that it comes from people, systems and internal processes, which indicate that operational risk originates from internal, and at the same time, operational risk can also occur because of external events. In addition, since banks are different, banking sectors are different, banks are located in different spaces, their characteristics are also different, the reason why operational risk occurs, the diffusion of a large surface is a very important aspect, so operational risk is also characterised by the existence of a wide range of this point.

Thirdly, operational risk is difficult to predict in advance and is highly variable. Operational risk can be found in all departments of the bank, man-made colour, and related to the management, business personnel's work experience, professionalism, psychological changes, so it is difficult to be found, when the banking industry continues to develop, there will continue to emerge new types of business, equipment and institutions, of course, the new operational risk also came into being, operational risk is always present in the unpredictable and changeable.

Fourthly, operational risk can be controlled by human beings. For operational risk to emerge, there are two prerequisites, one is human and the other is systematic. And most of the operational risks are caused by human reasons. Since the reasons are found, either human or systematic, the operational risks can be avoided and minimised by organising more trainings and lectures to substantially improve the quality of the operational staff, or by reforming the system or facilities.

Fifthly, it is difficult to match operational risks with expected returns. Among financial risks, credit and market risks are often related to returns, and the magnitude of risk is directly proportional to the magnitude of return, and losses from operational risks are not about returns (Xu, 2017).

3. Introduction to the Case of Bohai Bank's \$2.8 Bn Deposit Disappearance and the Operational Risk Management Issues Reflected Therein

3.1. Introduction to the Case of the Disappearance of \$2.8 Billion Deposits of Bohai Bank Nanjing Branch

In October 2021 Bohai Bank Nanjing Branch was exposed to 2.8 billion yuan of deposits were pledged as security without the knowledge of corporate depositors (Zang, 2021). Now the official information shows that the Mountain Harvest Pharmaceuticals in November 2020 deposited into the Bohai Bank Nanjing branch of the money, into the Huaye petrochemical note financing, the nature of the change, the bank opened the term of half a year's promissory note to Huaye petrochemicals, the first promissory 300 million yuan. Time came to 9 August 2021, Shanhe received a notice from the bank, the other party claimed that its real shareholders' information did not match with the officially announced information, and asked it to send a copy of the articles of association stamped with the company's official seal to the other party. 10 days later, Chairman of Shanhe, Mr. Yu Jianghua, heard a bad information, saying that some people were pretending to be the Company's personnel to handle the deposit pledging procedures at the bank, and asked the bank to report to the police quickly. The next day, Jimin Trusted found originally existed in the bank 2.8 billion yuan was pledged. 21 August, Jimin Trusted submitted relevant evidence, the bank assistant general manager pipe Pengcheng, in the measures provided to the Jimin Trusted, expressed the hope that the Jimin Trusted promise Bohai Bank Nanjing Branch will Mountain Harvest pharmaceutical 500 million yuan deposits pledged down to guarantee the Huaye Petrochemicals in the Bohai Bank Nanjing Branch of the loan obtained. 25 August. Because Huaye Petrochemical did not pay off the loan within the stipulated time, the bank put 450 million yuan into its own account, which was originally the guarantee deposit of Hang Seng Pharmaceuticals. On 3 September, Jimin Trust called the Wuxi police.

3.2. Operational Risk Management of Banks Reflected in the Case of the Disappearance of \$2.8 Billion of Deposits in Bohai Bank's Nanjing Branch

3.2.1. Incomplete Personnel Management Mechanism

Commercial bank operation risk is mainly due to the operator, for the risk of loan pledge, the relevant personnel within the bank should take the first step to make an assessment, and report the details to the loan pledge depositors, for the compliance of the pledge procedure should be strictly controlled throughout. The approval procedures for deposit pledges are very cumbersome and de-

manding, involving a wide variety of contracts, face-to-face signatures, levy authorisations, receipt of certificates of deposit, resolutions of shareholders' meetings and so on. The fact that Bohai Bank Nanjing Branch still pledged the 2.8 billion deposits of Shanhe Pharmaceuticals despite the strict and complicated deposit pledging procedures reflects the lack of professionalism and prudence on the part of the relevant operators, as well as the lack of risk awareness and awareness of procedural compliance (Wang, 2020).

3.2.2. Inadequate Internal Control Mechanism

The concept of business operation risk suggests “unsound or yet to be perfected internal procedures”, and the internal control mechanism will not only affect the standardised implementation of the bank's internal processes, but also monitor the timeliness and usefulness of the internal procedures (Guo, 2022). Paper deposit slips are indispensable when dealing with pledges, which are evidence at a later date. When converting an electronic deposit into a paper deposit slip at the counter, the required documents are the company seal and the legal person's seal. If it is entrusted to another person, there should also be the signature of the entrusted person, etc. Jeemin Credible claimed that the company has done a good job of internal correction, and there is no internal problem of violation of the use of the seal. The bank must have included many forged official seals when handling the pledge guarantee. After Mountain Harvest Pharmaceuticals' deposits were set up as a loan pledge in March 2021, it was still possible to read in the bank's solicitation letter that “Mountain Harvest Pharmaceuticals' 7 sums of money, totaling 1.01 billion yuan, which existed in the bank, were not subject to any restriction on use.” The above reflects that Bohai Bank has imperfect internal control mechanism in account supervision and official seal management.

3.2.3. Backward Operational Risk Management Culture

Risk management culture and risk management system are interdependent, with culture building guiding the risk management system from the ideological level and the risk management system providing institutional guarantee for culture building. In terms of operational risk, although Bohai Bank has formulated many relevant policies to improve the operational risk reporting standards, and will also give the staff publicity in the appropriate time, but it has not yet elevated the height of operational risk management, so that it is in line with the bank's overall cultural construction. Only when operational risk management becomes part of the bank's own culture and is integrated with the thinking of its employees, can it be coordinated when risk arises and operational risk can be restrained from the root cause (Zhou, 2023).

4. Suggestions for Improving Operational Risk Management in Commercial Banks

4.1. Strengthening People Management

One of the key factors in the occurrence of operational risks is the issue of per-

sonnel, so in preventing operational risks, an extremely crucial way is personnel management. It mainly includes the following initiatives: First, scientific planning of personnel, reasonable distribution of personnel work, to ensure that the labour intensity of grass-roots employees is comparable, so as to avoid the occurrence of operational risks due to excessive labour. The second is to increase the training of staff thinking and risk awareness, like learning risk prevention knowledge, risk warning of the business process, risk prevention and control awareness throughout all business processes, so that employees have a better concept of prevention, more capable of setting up a safety barrier for themselves, with a stronger sense of responsibility, and better able to discipline themselves with morality. Thirdly, we endeavour to enhance employees' competence in business, and make them more professionally competent by means of training and lectures, so as to reduce the risk of improper operation at the source. Fourthly, we should increase our efforts to supervise our employees, monitor their behaviour in their normal work, and if we find that some of them are behaving abnormally, we can talk to them privately or take other measures to prevent the risks. Fifth, the operational risk management culture is integrated into the staff, in order to influence the staff in an ideological way, so that the staff can better understand the operational risks that will arise when handling the business, react in time, have a sharper observation, better combine with the internal rules and regulations, and standardise the operation of the business. Sixthly, improve the employee performance appraisal mechanism, and take the risk prevention ability of employees as one of the criteria when appraising their performance, so that their behaviour will be more in line with the norms (Liu, 2021).

4.2. Improvement of Internal Control System Construction

In order to better improve the internal holding system, commercial banks can take the following initiatives: Firstly, according to the developmental aspects that banks must go through, they should promptly amend the rules and regulations and operational processes that are in place today, and improve the relevant systems. Operate different businesses in a more standardised manner and specifically analyse the risk areas that exist and prepare contingency plans in advance by studying the risk areas. For the repeated occurrence of operational risks should be promptly eliminated, give appropriate measures to warn employees in advance of the operation. Moreover, the redundant process of auditing business should be avoided, and the process should be simplified as much as possible, so that the possibility of risk is greatly reduced. Third, increase the ability to implement rules and regulations, so that employees pay more attention to the rules and regulations. Through the supervision of each functional department and each employee, we can better fulfill the relevant systems and prevent operators from ignoring the rules and regulations, which may lead to operational risks. When implementing the system, we should always make sure that the process is strict, and if there is any non-compliance with the rules and regulations, corre-

sponding penalties should be imposed. Fourthly, the internal authorisation system of banks should be improved, loopholes in it should be identified, and what kind of authority within banks at all levels and their own positions should be stipulated, so as to prevent the phenomenon of overstepping authority from occurring. Fifthly, through on-site inspections, remote monitoring and other means, hidden operational risks can be seen in the first instance and measures can be taken to address them, thus preventing the emergence of risks (Cao, 2020).

4.3. Promoting Information Systems Development and Management

By analysing the operational risk management information system, the operational risk is strongly supervised by means of equipment control, and the data on how much loss is caused by the operational risk are obtained, and the relevant data are studied so that the operational risk can be effectively controlled and the risk due to some human factors can be substantially reduced. In the construction and management system, the following points must be observed: First, the purpose of the R&D system is to raise the level of risk management, to study and predict the entire business process, so that the control means can be better put into practice, and should pay attention to the assessment and supervision of internal control mechanisms. The second is to make the real-time system management mode realised, with a variety of R&D methods, so that it is more capable of collecting data and studying it. Thirdly, in the process of bank operation, the information and data backup work are really put into practice, so as to avoid the risk due to accidents in the system, and it is necessary to make a good contingency plan, and to take positive initiatives to deal with the unforeseen circumstances. Fourthly, testing should be done well in advance before the information system is put into full use, so as to avoid risks arising from major errors during the launching of the system, and timely supervision should be carried out during the use of the system, so that shortcomings can be improved and remedied in the first instance (Li, Ge, & Liu, 2020).

5. Conclusion

The rapid expansion of China's commercial banking sector has brought about significant challenges in operational risk management. The analysis of the Bohai Bank Nanjing Branch case, where 2.8 billion deposits disappeared, highlights critical issues in personnel management, internal control mechanisms, and risk management culture. Operational risks, unlike credit and market risks, are often unpredictable and originate from both internal and external sources. They encompass a wide range of events from internal and external fraud, employment practices, customer and business practices, to system failures and process management.

The Bohai Bank case demonstrates the consequences of incomplete personnel management mechanisms, inadequate internal control systems, and a backward

risk management culture. It underscores the need for comprehensive and stringent measures to mitigate such risks. The paper suggests several strategies for improving operational risk management in commercial banks. These include strengthening personnel management through training and supervision, improving internal control systems by updating and enforcing rules and regulations, and promoting the development and management of information systems to better supervise and control operational risks.

By implementing these recommendations, commercial banks in China can better manage operational risks, safeguard their financial stability, and maintain their reputation. The findings of this paper emphasize the importance of a proactive and holistic approach to operational risk management, integrating it into the overall culture and operations of the bank to prevent future incidents and ensure sustainable growth in the banking sector.

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Conflicts of Interest

The author declares no conflicts of interest regarding the publication of this paper.

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