Risk Awareness and Role of the Central bank

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ABSTRACT

The Indian financial sector has made significant advancements pertaining to technology, quality and stability. The Banking sector of India has also expanded and diversified at a rapid rate. But at the same time, such advancements attract number of risks. Thus 'Risk' plays an important role in the earnings and survival the financial institutions, especially banks. Therefore, it becomes imperative to incorporate a set of systematic and professional approach for the management of risk. Basel has devised a set of banking regulations for risk management, thereby strengthening the banking system.

Realizing the importance of Risk Management in financial sector, RBI also issued guidelines to Indian banks in 1999 aiming at making banks aware of the risks and to institute proper Risk Management Practices. The study aims to gauge the awareness on theRisk Management Practices among the employees in Indian Public sector and Private sector banks, status of the training of employees and daily practices used by the banks to avert risks. It also attempts to emphasize the role of RBI in proliferating awareness about banking risks and thus in imbibing risk management behavioramong the bank employees.

Key Words: Risk Awareness, Risk Management, Central Bank, Indian Banking Sector

1. Introduction

Financial system is the most important tool for the growth and development of any economy, and Banking sector, undoubtedly is the backbone of the financial system.

Globalization, privatization and liberalization has made the present day environment extremely capricious for the survival and success of the banking Institutions as banks are exposed to large number of risks, such as, credit risk, market risk, operational risk, foreign exchange risk, liquidity risk, sovereign risk, etc.

The Indian banking sector, which is recognized as the pillar of the Indian economy, is thriving, and keeping pace with the technological advancements, stability and force of the financial system. The expansion, advancement and diversification of the Indian banking sector accentuate the very special need of an efficient and well-built risk management framework stressing on all forms of risks involved in the banks. All the banks and other financial institutions are exposed to various types of risks, which is considered to be the most important factor in their earnings. Therefore, balancing the relationship between risk and return becomes extremely important for the survival and growth of the financial sector.

The State Bank of Pakistan, in 2003 defined Risk as "the possibility that the outcome of an action or event could result in an adverse impact on a bank's earnings or capital, or it could affect the bank's ability to meet its current or future objectives.".

In financial institutions risk results from variations and fluctuations in assets or liabilities or both, in incomes from assets and payments on liabilities or in outflows and inflows of cash. In the current economic scenario, all the banks and other financial institutions have brought 'Risk management' into main spotlight. Banks by their very nature of their business attracts several types of risks: Credit Risk, Market risk, Operational risk, Interest Rate risk, Foreign exchange risk, liquidity Risk, money laundering Risk, Equity risk, IT risk, Reputational risk, Counterparty Risk, Marketing risk and Human Resource risk etc.

The Basel Committee on Banking Supervision (BCBS) in the year 1988 stepped in to manage banking risks by introducing Basel 1 norms which were established as the first International Standards. The task of tackling the widespread problem of banking risks were addressed with the help of standardized CRAR which stands for Capital to Risk weighted Assets Ratio or commonly called as CAR (Capital Adequacy Ratio). It aimed at protecting depositor's money from risky assets by ensuring minimum capital, and thus promoting the stability and efficiency of financial institutions around the globe. Thus, Basel 1 focused primarily on the credit risk.

However, soon after frauds and system failures in the financial sector reported around the world, Basel

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Committee on Banking Supervision issued their second of the 'Basel Accord' in the year 2004. It realized the importance of Market risk and Operational risk and the need of flexibility in the whole financial system. Therefore, Basel 2 works on a three pillar approach, where:

1stPillar: stands for the Minimum Capital Requirements

2ndPillar: stands for the Supervisory review; and

3rdPillar: stands for the Market Discipline (Disclosure requirements).

To match the risk management level of banks, BCBS has included a range of approaches; from basic standardized approaches to advanced approaches in Basel 2 accord.

But, internationally, failures like The collapse of Lehman brothers in the year 2008, the Subprime Mortgage crisis which occurred between 2007-2010 and the Financial crisis of 2007-2008 revealed that there were some major deficiencies in the financial regulation and thus, in response, the third installment of Basel Norms were issued in the year 2010, scheduled to be introduced from 2013 until 2015, however, the deadlines were kept extending further, until 2023.

The Basel 3 norms addressed some key issues by introducing the terms like LCR (Liquidity Coverage Ratio), Capital Conservation Buffer, Counter Cycle Buffer, and Leverage Ratio.

The Reserve Bank of India (RBI) adopted Basel norms in a stringent manner for the Indian Banks. It maintained tougher standards than the Basel norms and the various approaches were introduced gradually in phases, to adapt to the changes in the Indian Banking Industry.

It is being said that 'The success of any organization depends on its employees' and thus, it also applies to the banking Industry. The bank employees should continuously work for the success and stability of the banks and thus, it becomes very important for the bank employees to keep them well aware and updated with the latest regulations and norms in the banking Industry.

Thus, the study has tried to scrutinize the awareness about the risk management practices and Basel framework among the bank employees within the different categories of banks, i.e. Public sector, Private Sector (New) and Private Sector (Old). This paper also emphasizes the role of RBI in raising the awareness level in the bank employees through training workshops etc.

2. Literature Review

In the year 2007, Al-Tamimi and Al-Mazrooei inspected the Risk Management Practices imbibed by the UAE banks, wherein they tried to analyze the techniques used by UAE banks to deal with the various types of risks in the banking industry. They further drew the comparison between the two sets of banks and concluded that among all the risks, the three most important risks faced by the commercial banks are: Credit risk, Operating risk and Foreign exchange risk.

The results also indicated that the UAE national banks and foreign banks differ significantly in terms of the risk management practices and that the UAE banks are somewhat efficient in managing the risks.

The Governor of Board of Governors of the United States Federal Reserve System, Laurence H. Meyer (2000), highlighted the importance of Risk Management for Global Financial Institutions. He also stressed that "Risk Matters" as if it is temporarily ignored, it will eventually come out. It is important that the lending institutions and the economies in which they operate must recognize this fact and thus deal with it for their own benefit. He believed that in the present scenario of globalization, all the economies around the globe must adopt sophisticated Risk Management Practices in the years ahead.

Hassan (2009) in his study tried to assess the degree to which the Risk Management Practices are implemented by the Islamic banks existing in Brunei Darussalam and the techniques used by them to counter different types of banking risks. The findings of the study further exhibited that Risk Identification and Risk Assessment and Analysis are the most persuading variables in the Risk Management practices.

Shafiq and Nasr, in the year 2009 explored the Risk Management Practices followed by the banks, specifically, the commercial banks in Pakistan. The results of the study revealed that Credit risk, Liquidity risk, Interest rate risk, Foreign exchange risk and operating risks are the most important risk exposures faced by the banks. It further stresses that there are significant differences in the application of risk management practices among the public sector banks and local private commercial banks. It was also observed that although there is a general awareness and understanding about risk management among the bank employees, but still there is a need of additional training courses to enhance their expertise in this area.

In the year 2011, Wood and Kellmanper formed a study on the Risk Management of Banks operating in Barbados wherein they observed the key aspects affecting the efficiency of Banking Industry in their country to manage the Banking risks. One of the finding of the paper was that credit risk, market risk, operational risk, interest rate risk and country/sovereign risk are the major types of risks that the banks are mainly exposed to. Also, the study revealed that the banks operating in Barbados are "Risk Intelligent" or are indeed "Risk Focused".

Ghosh, Kohli and Khatkale in the year 2013 studied the risk journey of Indian banking Industry through BASEL 1 to BASEL 3 in their research. The study highlighted the important features of Basel Accord explaining the intricacies of Basel 1, 2 and 3 while analyzing their advantages and shortcomings.

The research executed by Arunkumar in 2006, "Risk Management in Commercial Banks (A case study of Public and Private Sector banks)" analyses the trends in the NPA levels of the banks, the CRM practices of the banks and the response to reforms under Basel Accord. The study made various comparisons between private sector and public sector banks based on Risk Supervision.

3. Methodology

The research tool used in the study is a structured questionnaire aimed to gather response from

from 500 banking executives from three categories of banks, i.e. Public Sector banks, Private sector (New) and Private Sector (Old) banks. The employees (respondents) for the survey belong to both Retail & Regional/Head Office and different branches of banks spread over different cities representing major proportion of business of these banks. The questionnaire seeks to explore the awareness of employees regarding various aspects of Basel Accord which would assist us in bringing out the role of RBI in the whole scenario.

Objective

The key objective of the study is to gauge the present level of awareness in three categories of banks [Public Sector banks, Private sector (New) and Private Sector (Old)]. The secondary objective of the study is to also underline the role of the Central bank in increasing the awareness about the banking risks and Risk management culture in banking industry.

4. Data Analysis & Interpretation

The primary data needed for the study has been gathered with the help of a questionnaire, containing closed end options, attempted to gauge the awareness of the bank employees about risk management and the Basel accord. A total number of 500 employees were surveyed for the research.

For the cross comparison of the responses between categories of banks, cross tabulation was performed on different factors related to risk management.

1. Respondent Profile

Of all the 500 respondents who participated in the survey, 222 (44.4%) are employed in the Public Sector, 278 (55.8%) employees belongs to Private Sector from which 142 belongs to New Private Sector (28.4%), and 136 (27.2%) are employed with the Private Sector (Old) Bank.

Exhibit 1: Pie Chart of Respondent Profile

2. Awareness about Baselnorms across Bank Categories

Of all the respondents, 62.8 percent i.e. 314 employees are aware about the Basel Accord. A cross comparison of awareness across different categories of Banks shows maximum awareness among the employees of the Private sector (New) banks at 81.7 percent. Only 53.7 percent of the employees at the Private sector (Old) banks are aware about the Basel Accord whereas the percentage of awareness is 56.3 percent among the Public Sector bank employees. This implies that RBI should make efforts to improve the awareness about Basel Accord in Indian banks especially in the Public sector banks and Private sector (Old) banks.

Chi square test reveals a significant relationship between bank categories and awareness Basel Accord at the Public Sector bank (p value 0.004) and Private sector (Old) banks (p value .046). However, the relationship is not significant at the Private sector (New) banks (p value .129).

3. Awareness of Basel Norms related to banking

Though respondents are aware of the Basel accord per se, however it is also significant to gauge the awareness about implementation of Basel norms for the banks. When in the previous question, the respondents are asked about the Basel accord, they are unable to link it to banking sector reforms or risk management. Thus, they have showed less awareness. But when another question is put before them asking about the Basel norms more specifically in the context of banking sector reforms the employees have showed a better understanding resulting in the increase in their awareness level as compared to the previous question. The total percentage of the employees who are aware of the implementation of the Basel norms in banking is 68.4 percent. Cross-tabulation is performed to assess significant differences in awareness acrossthe three categories of bank, the respondent was working for.

Table 1: Category and Norm Aware Cross tabulation

			Norm_Aware			Total
			Yes	No	Cannot say	
Category	Public	Count	146	6	70	222
		% within Category	65.8%	2.7%	31.5%	100.0%
	Private (Old)	Count	90	7	39	136
		% within Category	66.2%	5.1%	28.7%	100.0%
	Private (New)	Count	106	3	33	142
		% within Category	74.6%	2.1%	23.2%	100.0%
Total		Count	342	16	142	500
		% within Category	68.4%	3.2%	28.4%	100.0%

It is also observed that New Private sector bank employees are the most aware lot with 74.6 percent of the employees aware about the Basel norm implementation. However, 65.8 percent Public sector employees and only 66.2 percent Old Private sector employees are aware about the Basel norm implementation.

4. Awareness about different risks

This section investigates the awareness among the employees about the different types of risks faced by the Indian Banking sector within the different sets of banks.

Table 2: Awareness about different types of risks

Types of Risks	Frequency	Percentage
Credit Risk	365	73.0
Market Risk	99	19.8
Liquidity Risk	68	13.6
Reputational Risk	70	14.0
Legal Risk	21	14.2
Operational Risk	125	25.0

It is observed that the bank employees are more aware of the Credit Risk than any other type of risks. 73 percent of the respondents are aware of the Credit risk and only 14.2 percent are aware about the Legal risk. Only 13.6 percent of the bank employees are aware about Liquidity and 14.0 percent are aware about Reputational risk. Therefore, it must be underlined that efforts must be made by the Central bank to increase the awareness among the bank employees about all the types of risks to develop a holistic risk management culture.

5. Awareness about Basel II

The second of the Basel Accord, Basel II emphasizes on Operational Risk. However, awareness of this fact is a meager 17.6 percent among the bank employees. Respondents misconceive that Basel II lays more emphasis on credit risk (72.2%) and market risk (13%).

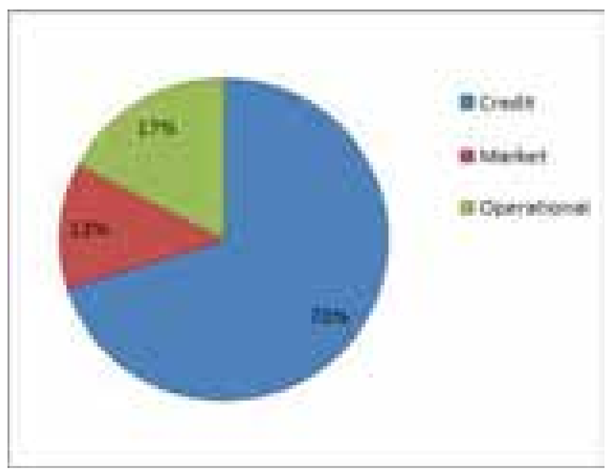

Exhibit 2: Pie Chart of Respondent's awareness about Basel II

6. Basel III's awareness

Indian Banks were supposed to implement the Basel III recommendations from 2013 and had to be completed by 2019, which was extended to January 2022. It is also to be noted here that due to the outbreak of the pandemic (COVID-19), the implementation of Basel III norms has been deferred until January 2023. When the bank employees were questioned on the awareness about the Basel III norms, it was observed that lone 26.9 percent of the respondents are aware.

Cross tabulation has been performed to assess significant association in awareness across the various categories of bank among different level of employees. It is again evident from the analysis that the awareness percentage varied across different categories of bank. The awareness about implementation of Basel III is maximum at Public sector employees at 30.2 percent. Only 19.1 percent respondents at New Private sector bank are aware about the Basel III implementation and only 28.67 percent employees at the Old Private sector banks are aware about the year of Basel III implementation in Indian banks.

Chi square test reveals a significant relationship between bank categories and awareness about implementation of Basel III (p value .001).

7. Workshops organized to increase the awareness about Basel norms

It is where the role of Central bank comes directly into picture. RBI instructs banks to organize various workshops for the bank employees for promoting the awareness about Risk Management and Basel norms. However, it was observed that there are differences amongst different categories of banks with regard to awareness about the workshops and attendance requirement at such workshops.

Table 3: Awareness about the workshops and attendance requirement at workshops(Figure in percentage)

	Holding Basel II workshop	Attendance Mandatory
Public Sector	58.6	73.6
Private (New)	70.4	45.4
Private (Old)	63.2	60.2

Overall across all categories of banks, 63.2 percent respondents have reported that their banks hold a Basel awareness workshop. The awareness about these workshops at the Public Sector Banks is 58.6 percent and with private (Old) sector banks is 63.2 percent. New private sector banks have reported maximum awareness at 70.4 percent.

This stark difference in awareness about workshops is authenticated by the Chi Square test which shows significance of 0.000 implying there is significant association between categories of banks and awareness about Basel workshops at 0.01 significance level.

The respondents who are aware about Basel workshops being held at their banks are further inquired about attendance requirement at such workshops; this has reduced the sample size to 364. Similar association is observed in this analysis too.

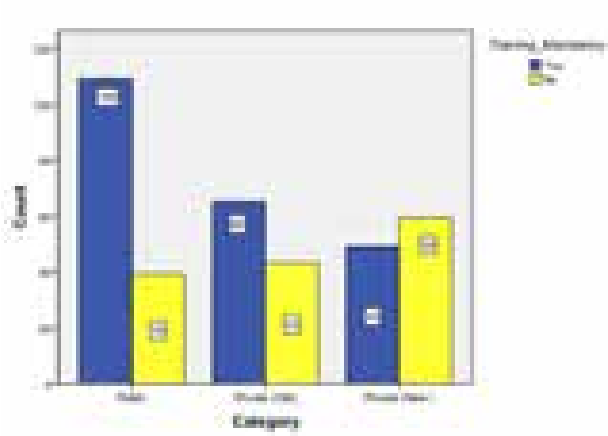

Exhibit 3: Bar chart of the Attendance required at the Workshops organized

At the Public Sector banks, 73.6 percent respondents have reported attendance to be mandatory whereas 60.2 percent respondents at Private Sector (old) Banks reported mandatory attendance. Only 45.4 percent respondents at Private Sector (new) banks report mandatory attendance.

8. Frequency of workshops

There are wide variations about the frequency of such workshops with 70.1 percent i.e. 253 respondents out of 361 reporting that the workshop frequency is not fixed across all categories of banks.

Table 4: Category and Training Frequency Cross tabulation

			Training_Freq				Total
			Every Quarter	Every 6 months	Annually	Not fixed	
Category	Public	Count	15	24	7	99	145
		% within Category	10.3%	16.6%	4.8%	68.3%	100.0%
	Private (Old)	Count	11	16	2	79	108
		% within Category	10.2%	14.8%	1.9%	73.1%	100.0%
	Private (New)	Count	14	11	8	75	108
		% within Category	13.0%	10.2%	7.4%	69.4%	100.0%
Total		Count	40	51	17	253	361
		% within Category	11.1%	14.1%	4.7%	70.1%	100.0%

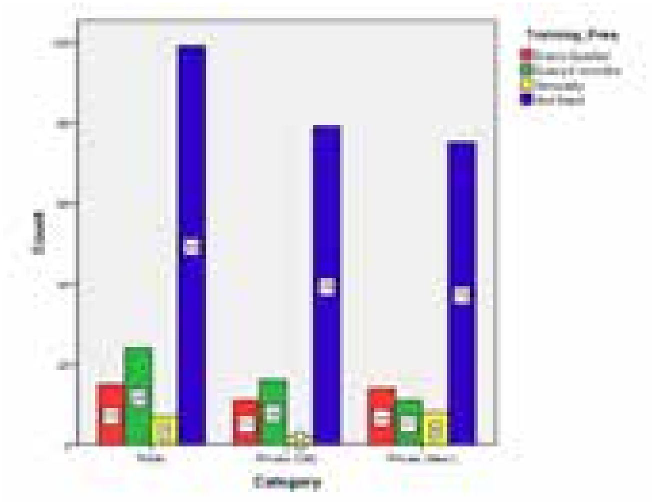

Exhibit 4: Bar chart showing Training Frequencies in Different categories of banks

It is clear thatthe Indian banks organize training workshops for the bank employees on the instructions from RBI. The aim of such workshops is to make the bank employees aware about the Basel norms and other policy regulations. Nonetheless, it is observed that the awareness about such workshops among the employees is not encouraging. Additionally, the attendance requirements are not so strict and there is no clear schedule about the frequency of these workshops.

5. Conclusion

Through this study, it has been concluded that there is an evident mark of low level of awareness about the Risk management and Basel norms among the bank employees. The difference in the awareness level of employees of different categories of banks has also significantly varied. This implies that RBI should make efforts to improve the awareness about Basel Accord in Indian banks especially in the Public sector banks and Private sector (Old) banks.

Regarding the workshops organized by the banks, it is concluded that the Awareness level of the training workshops is low and also the bank employees are either reluctant to attend the workshops or there is no strict regulation to make them attend the workshops. So, here the role of RBI could be underlined in a way that the Central bank of India along with the management of different category of banks can post an annual schedule of workshops on the website and make it mandatory for all employees to attend one workshop as a prerequisite to their career growth path.

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