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PwC India’s FS Risk Symposium

Key takeaways from the Reserve Bank of India’s (RBI) keynote session

July 2023

PwC India conducted the inaugural event of its flagship **Financial Services Risk Symposium** on 19 June 2023 at Trident, BKC Mumbai.

The symposium brought together experts from the BFSI and regulatory sector to share their knowledge, experiences, insights, and strategies to navigate the uncertain and unprecedented risk landscape.

Mr Bhargeshwar Banerji, Chief General Manager, RBI, commenced the discussions by sharing his experience and insights on risk governance from a regulatory perspective.

He initiated the session by posing a thought-provoking inquiry on why Nifty and BSE are on an upward trend, and the source of the confidence in trading which stems from it.

Despite the decrease in the share of public sector banks (PSBs) from 2020 till March 2023, credit expansion in the retail, agriculture, and micro, small and medium enterprises (MSME) (RAM) sectors of PSBs have overtaken corporate portfolios, rising from 0.22% in 2021 to 16.58% as of March 2023. Granular credit growth of MSMEs and retail loan portfolios has played a crucial role in fostering trust and assurance in trading markets.[1]

He also credited the recent upswing in Nifty/BSE’s confidence to the consistent reduction of the nonperforming assets (NPA) ratio in private sector banks, PSBs and scheduled commercial banks (SCBs) in the last three years. Private sector banks experienced a decline in their NPA ratio, dropping from 1.53% in 2020 to 0.55% in 2023. On the other hand, PSBs witnessed a more significant and robust decrease with their NPA ratio falling from 3.76% to 1.2% in the same time period. This indicates that Indian banks are well-capitalised and that cleaner balance sheets lead to enhanced lending by financial institutions.[2]

Mr Banerji also discussed some of the credit risks which stem from various divisions of the Indian banks:

01

Retail segment PvtSBs: Due to the growth of unsecured retail, the share of retail credit has increased along with a rise in delinquencies in credit cards and personal loans. There is also a shift in the lenders’ focus in assessing borrowers based on their consumption patterns and alternate sources of income, accompanied by onboarding lower credit-rated individuals and longer EMI tenures.

Mr Banerji recommends prioritising the implementation of the loan management cycle and enhancing the credit monitoring framework as a means to mitigate risk consequences.

02

Corporate and MSME advances: The exposure to top and vulnerable borrowers has caused a strain on corporate loans, particularly within stressed sectors and highly leveraged borrowers. Banks should adopt RBI's vulnerability assessment guidelines, implement risk-based pricing, risk-adjusted return on capital (RAROC), establish effective collateral management systems, and address risks associated with non-fund-based facilities like bank guarantees, letters of credit and other derivatives.

MSMEs face higher vulnerability to event risks and unfavourable economic circumstances; therefore, developing customised rating models for MSME borrowers can help address these challenges.

03

Governance and internal controls: Mr Banerji advised the participants to automate the NPA identification system while simultaneously developing robust frameworks for early warning systems which can strengthen the role of risk functions and enhance the effectiveness of the risk management committee. The accuracy, completeness, and reliability of management information systems (MIS), especially Central Repository of Information on Large Credits (CRILC) reporting, are deemed crucial.

1. Mr Bhargeshwar Banerji, Chief General Manager, RBI – Symposium Sessions Deck
2. Mr Bhargeshwar Banerji, Chief General Manager, RBI – Symposium Sessions Deck

Business strategies

Mr Banerji highlighted the importance of balancing credit growth strategies by focusing on both aggressive and conservative approaches, with a specific emphasis on retail and MSME sectors. He emphasised the need for a cautious approach towards high-growth and high-return strategies in the long run, considering concentration risks and aligning business strategies with risk appetite and limits.

Future expectations

Banks must understand the importance of transitioning to Indian Accounting Standards (IndAS)- expected credit loss (ECL) based loan loss provisioning, increase the use of credit risk models, and conduct enhanced due diligence for emerging segments and new products while also underlining the significance of stress testing credit portfolios for informed business strategy.

Gaps within different functions of a bank

During his keynote, Mr Banerji highlighted the gaps in the **compliance function** focusing on leaving compliance risk root causes unaddressed, lack of experience, incomplete compliance integration with other functions, inadequate independent compliance testing, and the challenges of sustaining compliance.

The **risk management** system gaps are prominent if there is a misalignment of risk appetite with strategic plans, ineffective risk identification, weak authority and independence, and concerns regarding conflicts of interest.

Internal audit gaps occur due to ineffective policies, lack of independence, inadequate reporting and coverage, design gaps in risk identification processes, low priority given to compliance management processes, persistent irregularities, and the need for validating the internal audit rating model with actual risk status.

Risk focus

Financial institutions must recognise the importance of addressing **IT risks** that can be mitigated with robust capacity management/monitoring process across technology stack coupled with prioritising operational resilience and a thorough understanding of obsolescence in technology components to minimise risk exposures.

The significance of **cyber security risks** lies in effective governance and continuous board/IT strategy committee oversight, urging organisations to prioritise management of IT assets, applications change details, logs for forensic readiness and risk vulnerability measures to safeguard against evolving threats. Additionally, there is a need for thorough evaluation and **risk management in IT outsourcing**, emphasising the importance of selecting reliable vendors and establishing strong contractual agreements to mitigate potential risks associated with outsourcing IT services.

Conclusion

Mr Banerji concluded his session with reminding the audience about the crucial role the board and senior management in assessing and addressing risks. There is an expectation from the board to ask the right questions, prioritise developing a healthy corporate culture with an acute focus on business models and strategies. He advised the audience to always have one eye on the rear view for assessing preventive compliance and the other looking ahead to gauge the emerging risks.

His key message was, 'Risk strategies should always align with a firm's risk appetite and capital plans.'[3]

3. Mr Bhargeshwar Banerji, Chief General Manager, RBI – address at PwC India's FS Risk Symposium

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