

***Governance Risk and Compliance
&
Risk Management***



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Course Outline

Future of Banking

Digital Transformation in Banking Sector

Governance Risk and Compliance

Reg Tech

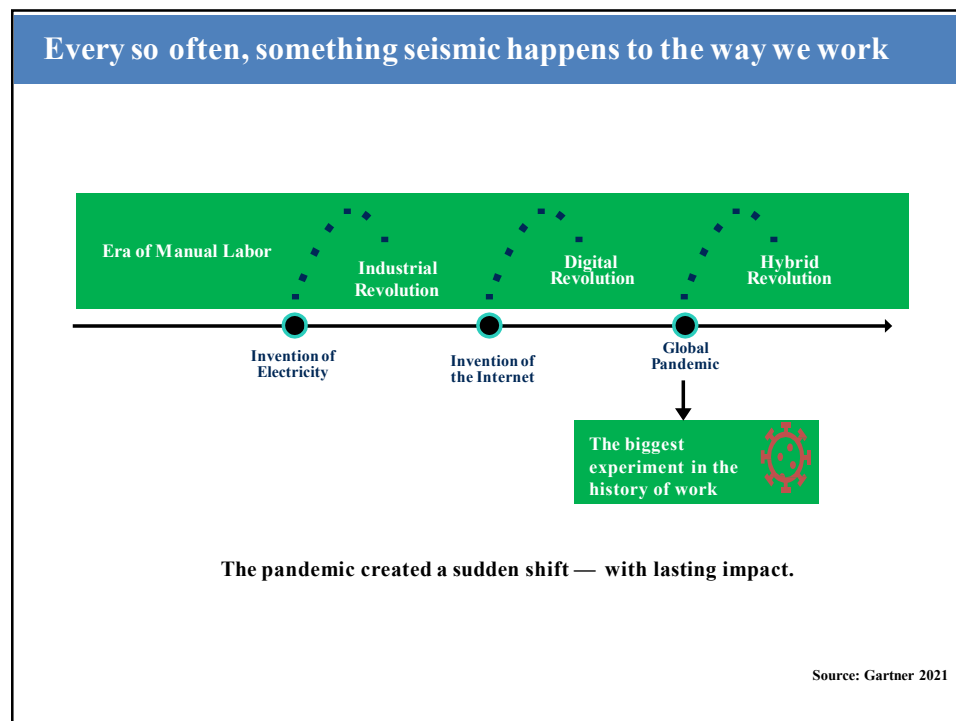
Digital Trust/ Information/ Cyber Security

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“The greatest danger in times of turbulence is not the turbulence itself, but to act with yesterday’s logic.”

– Peter Drucker

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Megatrends in the Workplace

- Accelerated Digital transformation
- Data Driven decision making
- Collaboration
- Demographic Shifts - Multigenerational Work force
- The Gig Economy
- New Skills for the workforce
- Business Continuity
- Hybrid Work Environments
- Climate Change
- Sustainability

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What is Future of Work?

The future of work describes changes in how work will get done over the next decade....

....influenced by technological, generational and social shifts.

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Future of Banking

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BFSIUncertain Times

- In today's BANI world - characterized by ***Brittle, Anxious, Non-linear, and Incomprehensible*** conditions - *adaptability is imperative for thriving amidst uncertainty.*
- Navigating the complexities of a BANI world necessitates *flexible strategies, resilient business models, and proactive risk management.*
- Today, BFSI sector grapples with a gamut of uncertainties and risks, including regulatory flux, economic volatility, and disruptive technological innovations.
- Failure to effectively mitigate these risks can spell disaster, particularly for Regulated entities in the BFSI sector, necessitating the critical importance of robust risk management practices.
- BFSI sector has taken major hits in the recent years, *from the 2008 financial crisis to the pandemic, hacking of numerous banks, and customer data leakages and Ransomware attacks over the last few years.*

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BFSIUncertain Times

- Rapid advancements in digital technologies present unprecedented challenges for banks globally, reshaping the banking landscape, impacting their competitiveness and driving the need for significant digital advancements, posing both challenges and opportunities for financial institutions globally.
- In the BANI world, banks must prioritize digital transformation to remain agile and responsive to changing customer demands and market dynamics.
- ***Today, Banking customers expect a fully personalized digital experience***
- Disparities in digital readiness among banks exacerbate the divide in the BANI world, with digitally adept institutions gaining a competitive edge over their counterparts.

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Emerging Risks in BFSI sector

- In addition to conventional risks, such as market fluctuations, cybersecurity vulnerabilities, privacy concerns, and sophisticated fraud tactics are on the rise.
- Proactive measures and investments in cybersecurity infrastructure are essential to safeguarding sensitive assets and financial data.
- Banks need to regain customer trust to remain relevant in the digital era.

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Banking..... going Digital

Now more than ever, Digital technologies are reshaping the financial ecosystem and the future of banks

- Startups, Technology companies are providing banking services, traditionally provided by Banks
- Millennials demanding more convenience and better customer services through digital channels mobile or tablet platforms.
- The pandemic has resulted in an acceleration of the adoption of digital technologies in Banking and financial services.
- The gap between customer expectations and services that banks could offer was quickly picked up by new entrants: fintech's and bigtech's
- To stay competitive vis-à-vis new players, attract customers and reduce costs, banks have set digital transformation as a business priority.

According to Beaumont and others (2019), mobile based payment innovations tend to be diffused at a much faster speed than that of many past payment's innovations.

According to Temenos (2019), the biggest organization challenge for banks was “tighter regulations”, while this challenge together with “profitability” and “satisfying customers” remained the top three challenges.

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Emerging Trends in India's Banking Sector

- Core banking serves as a cornerstone for modern banking technology, enabling customers to conduct basic transactions without visiting their home branches.
- Technological advancements have shifted banking services online, allowing customers to access banks 24/7 from nearly anywhere.
- Digital and mobile banking extend this accessibility by providing customers with convenient access to various banking products and services via their mobile devices.
- Reduced human intervention in banking operations benefits both banks and customers, offering greater efficiency and convenience.
- The ongoing evolution of the Indian banking sector has significantly enhanced the customer experience, from account opening to accessing a wide array of services.
- As the world embraces advanced technology and recovers from the COVID-19 pandemic, further developments in banking are anticipated, promising even more convenient and innovative solutions for customers.

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What 'Digital'
really means

Is it Technology?
New ways of doing Business?

Digital should be seen as a thing or way of *doing things*

Three Attributes :

1. **Creating Value at the New frontiers**
2. **Creating Value in Core Businesses**
(Rethinking how to use new capabilities to improve how customers are served)
3. **Building foundational capabilities**
 - a) **Mindsets** : Use data to make better and faster decisions
 - b) **Systems and Architecture** : Commitment to building networks that connect devices, objects and people

Source : Mc Kinsey & Company (Karel Dorner and David Edelman)

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Definitions

Digitization refers to *“the action or process of digitizing; the conversion of analog data (esp. images, video, and text) into digital form.”*

Digitalization is also known as the *“ability to turn existing products or services into digital variants, and thus offer advantages over tangible product”* .

Digitalization, or Digital Transformation, refers to “the changes associated with the application of digital technologies in all aspects of Business.”

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Digital Technologies

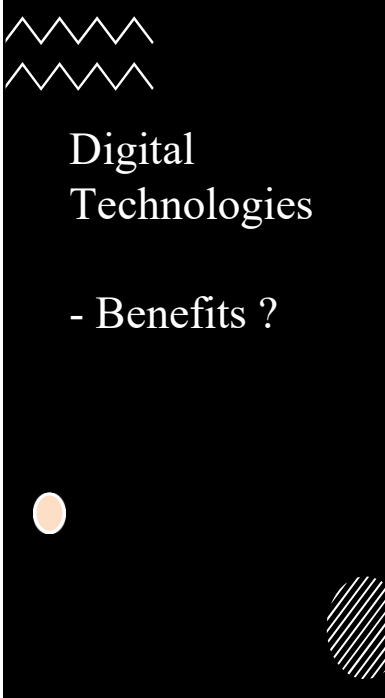
Technology is necessary for digital transformation - it is the engine and enabler for the business revolution.

Snapshot of some key digital technologies and their roles:

- **Cloud computing** gives quicker anytime, anywhere access to software, new functions and updates along with data storage and scalability.
- **Mobile platforms** enable anytime, anywhere access for employees and customers.
- **Machine learning and AI** provide faster data-driven decisions and continuous improvement to automated systems.
- **Robotic process Automation (RPA)** uses bots to perform routine repetitive tasks faster and with less error than humans.
- **Emerging Technologies** such as blockchain, augmented reality and virtual reality, IoT and edge computing offer new ways of taking advantage of the explosion of digital data generated by enterprises and customers.

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Digital Technologies

- Benefits ?

Digital Technologies are a major force shaping strategy in organizations

Going digital has tangible benefits: profit/ productivity/performance/ experience


Organizations are struggling and succeeding in their challenge of becoming 'Digital'

Organizations succeeding in using digital are called "**Digital Masters**"

Digital Masters use Digital technologies to transform the way they do Business

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Digital Strategy

A Digital strategy is the strategic form of digitization intentions of organizations.

- 1. The short and mid-term objectives are to create new or to maintain competitive advantages.*
- 2. Within the digital strategy, digital technologies and methods are applied to products, services, processes and business models.*
- 3. The digital strategy consists of a vision, mission, strategic objectives, strategic success factors, values and measures.*

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Digital Transformation

Digital transformation is defined as changes in ways of working, roles, and business offering caused by adoption of digital technologies in an organization, or in the operational environment of the organization.

This refers to changes at several levels, including the following:

1. **Process level:** adopting new digital tools and streamlining processes by reducing manual steps;
2. **Organization level:** offering new services and discarding obsolete practices and offering existing services in new ways;
3. **Business level:** changing roles and value chains in ecosystems;
4. **Society level:** changing society structures (e.g., type of work, means of influencing decision making).

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Dimensions of Digitalization

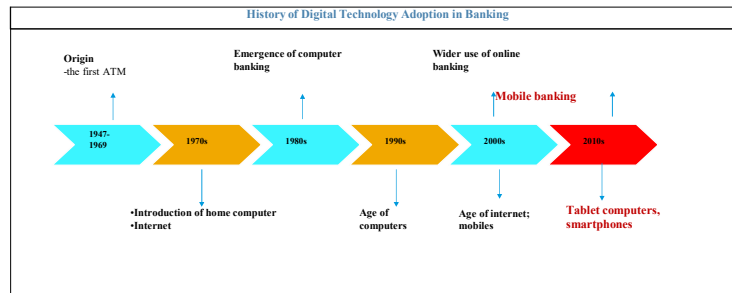
Banking/ Financial Services	Technology
✓ Payments, clearing, settlement	✓ Cloud
✓ Credit, deposits, and capital-raising	✓ AI/machine learning/advanced data analytics
✓ Wealth Management	✓ Big data
✓ Investment banking	✓ Distributed ledger (DLT)
✓ Communication	✓ Application programming interfaces (APIs)
	✓ Robot advisor
	✓ Mobile technology

- *The highest application of digital technologies in financial services is in the category of payments, clearing and settlement (BIS, 2017).*
- *Within this category, many fintech firms are also active, with the majority represented by the retail payment services firms, as compared with wholesale payment service providers*

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Adoption of digital technologies in Banking

As digital technology has advanced, banks have often been leaders in adopting these new technologies



Source : IMF Working Paper WP/21/46 : Stay Competitive in the Digital Age: The Future of Banks, by Estelle Xue Liu

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Changing Paradigms in BFSI Sector

Five elements a robust and resilient financial system are:

1. Strong governance and management,
2. Sound regulatory principles,
3. Adequate capital and liquidity,
4. Strong supervisory and risk management practices, and,
5. Effective crisis management and resolution frameworks.

The importance of these measures have been reinforced repeatedly through the frequent international episodes of financial crises

A resilient financial system is one that can withstand and quickly recover from the episodes of financial shocks and crises.

Such a financial system also requires early identification of vulnerabilities and risk build-up within each entity as well as at the system level, and initiation of appropriate corrective actions.

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Corporate Governance is “the conduct of business in accordance with shareholders’ desires, which generally is to make as much money as possible, while conforming to the basic rules of the society embodied in law and local customs.”

*~ Milton Friedman
Noble Laureate*

“Global market forces will sort out those companies that do not have sound corporate governance.”

~ Mervyn King S.C.

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Governance

- Governance is “the set of responsibilities and practices exercised by the board and executive management with the goal of providing strategic direction, ensuring that objectives are achieved, ascertaining that risks are managed appropriately, and verifying that the enterprise’s resources are used responsibly.”
- ***Strategic planning and corporate responsibility are best accomplished using an approach industry refers to as governance, risk management, and compliance (GRC)***

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Governance

- Governance means administering the processes and systems placed for satisfying stakeholder expectations.
- Corporate Governance means *a set of systems, procedures, policies, practices, standards put in place by a corporate to ensure that relationship with various stakeholders is maintained in transparent and honest manner.*
- The phrase “corporate governance” describes *“the framework of rules, relationships, systems and processes within and by which authority is exercised and controlled within corporations. It encompasses the mechanisms by which companies, and those in control, are held to account.”*
- “Corporate Governance is the application of best management practices, compliance of law in true letter and spirit and adherence to ethical standards for effective management and distribution of wealth and discharge of social responsibility for sustainable development of all stakeholders.” (ICSI)

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Governance

- Corporate governance addresses the processes, systems, and controls by which organizations, both public and private, operate.
- The Latin origin of the word *governance* denotes steering, and governance typically includes the exercise of legal and regulatory authority and the use of institutional resources to manage organizations
- ***Governance relationships include those between board directors, owners, managers, employees, suppliers, customers, regulators, and communities***
- Corporate governance is the process by which an organization defends the interests of the stakeholders, which can include board members, company executives, employees, stockholders, suppliers, customers, and the community in which the organization operates.

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Principles of Governance systems

-  **Provide Stakeholder value**
-  **Holistic approach**
-  **Dynamic process**
-  **Governance distinct from Management**
-  **Customised to enterprise needs**
-  **End to End coverage**

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Governance

Today, there is a need to upgrade the quality of board deliberation in banks to provide greater strategic focus.

There are seven themes which appear critical to their medium-term strengths comprising:

- 1. Business Strategy,*
- 2. Financial Reports and their Integrity,*
- 3. Risk,*
- 4. Compliance,*
- 5. Customer Protection,*
- 6. Financial Inclusion and*
- 7. Human Resources.”*

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Accepted Principles of Governance

COMMONLY ACCEPTED PRINCIPLES OF CORPORATE GOVERNANCE.

Regardless of the national jurisdiction and local conditions, there are some principles and issues of corporate governance that have been widely embraced over the years.

- **Rights and Fair Treatment of Shareholders**
- **Roles and Responsibilities of the Board of Directors**
- **Ethical and Professional Behaviour**
- **Financial Transparency and Disclosure** : Transparency is seen as exposing core business financials and strategies, which would benefit competitors and regulators, with few tangible benefits to the organization.
- **Internal Controls (COSO framework)**

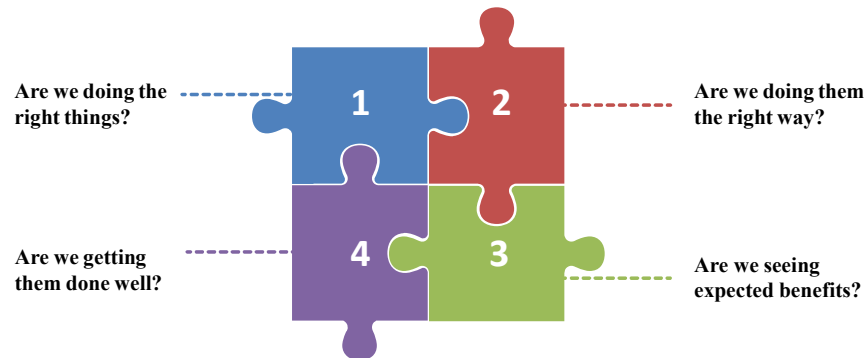
“Many large corporations have dominant control over business affairs without sufficient accountability or monitoring by their board of directors.” (Lorsch and MacIver, HBS).

History has demonstrated that improvements in governance and compliance typically come as a result of scandals.

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Governance Answers Four Questions



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Corporate Scandals

U.S. Savings and Loan Crisis of 1986 to 1995. Over 1,000 savings and loan institutions were closed, holding over \$500 billion in assets and representing about half of the total number of savings and loans. Deregulation, changing market conditions, volatile interest rates, tax changes, and reduced regulatory capital have all been cited as causes of the crisis.

U.S. Corporate Crises of 2001–2002. The collapse of Enron and World-Com, and the ensuing scandals and collapses of other corporations such as Arthur Andersen, Global Crossing, Adelphia, HealthSouth, and Tyco, demonstrated the weakness of corporate oversight, rating agencies, audit firms, and business press. The resulting losses impacted millions of investors and several thousand employees.

Financial Services Scandals of 2003–2006. The past few years have seen a wide variety of scandals:

- *Securities and Exchange Commission/National Association of Securities Dealers (SEC/NASD) and New York Stock Exchange (NYSE).* Fines of \$8.5 million were levied against five brokerage firms for failure to preserve e-mail communications.
- *Credit Suisse First Boston.* Criminal charges were brought against CSFB investment banker Frank Quattrone for allegedly telling people to “clean up” files after learning about an investigation.
- *BCCI.* The Bank of Credit and Commerce International (BCCI) scandal resulted in the Bank of England being sued by creditors for £1 billion (\$1.8 billion).

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Governance

Institutional investors are prepared to pay a premium of up to 40 percent for shares in companies with superior corporate governance practices (Mc Kinsey)

Good governance is integral to the very existence of a company. It inspires and strengthens the investor's confidence by ensuring company's commitment to the higher level of growth and profits.

It seeks to achieve following objectives:

- *A properly structured Board capable of taking independent and objective decisions is in place at the helm of affairs;*
- *The Board adopts transparent procedures and practices and arrives at decisions on the strength of adequate information;*
- *The Board effectively and regularly monitors the functioning of the management team; and*
- *The Board has an effective mechanism to serve the concerns of stakeholders;*
- *The Board is balanced as regards the representation of adequate number of non-executive and independent directors who will take care of the interests and well-being of all the stakeholders;*
- *The Board keeps the shareholders informed of relevant developments impacting the company;*
- *The Board remains in effective control of the affairs of the company at all times.*

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Board

A Board should have a mix of the following skills, knowledge and experience: – ***Operational or technical expertise, commitment to establish leadership; – Financial skills; – Legal skills; and – Knowledge of Government and regulatory requirement.***

The role of the board of directors was summarized by the King Report (a South African report on corporate governance) as:

- ***to define the purpose of the company***
- ***to define the values by which the company will perform its daily duties***
- ***to identify the stakeholders relevant to the company***
- ***to develop a strategy combining these factors***
- ***to ensure implementation of this strategy.***

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Advantages of Corporate Governance

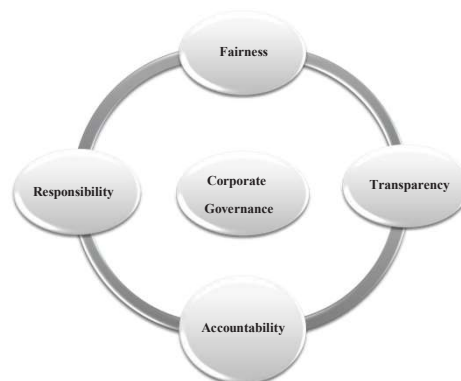
Some of the advantages of Corporate Governance are stated hereunder:

- 1. Good corporate governance ensures corporate success and economic growth.*
- 2. Strong corporate governance maintains investors' confidence, as a result of which, company can raise capital efficiently and effectively.*
- 3. There is a positive impact on the share price.*
- 4. It provides proper inducement to the owners as well as managers to achieve objectives that are in interests of the shareholders and the organization.*
- 5. Good corporate governance also minimizes wastages, corruption, risks and mismanagement.*
- 6. It helps in brand formation and development.*
- 7. It ensures organization in managed in a manner that fits the best interests of all.*

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Corporate Governance in India

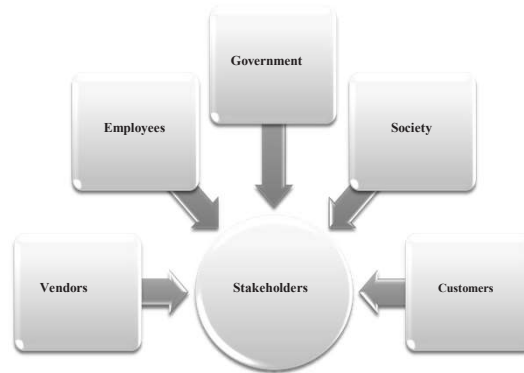
- Corporate Governance is managing, monitoring and overseeing various corporate systems in such a manner that corporate reliability, reputation are not put at stake.
- Corporate Governance pillars on transparency and fairness in action satisfying accountability and responsibility towards the stakeholders



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Governance

- *Various stakeholders affected by the governance practices of the company :*



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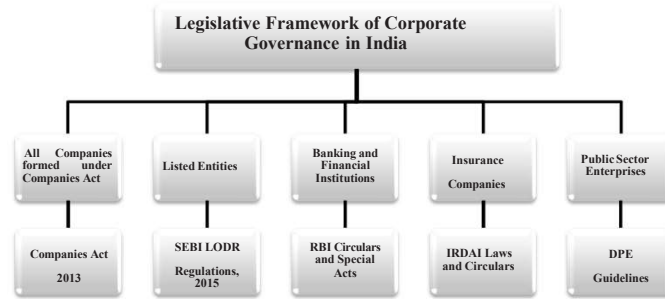
Contemporary Developments in India

- *The initiatives taken by Government of India in 1991, aimed at economic liberalization, privatization and globalisation of the domestic economy, led India to initiate reform process in order to suitably respond to the developments taking place world over.*
- *On account of the interest generated by Cadbury Committee Report (UK), the Confederation of Indian Industry (CII), the Associated Chambers of Commerce and Industry (ASSOCHAM) and, the Securities and Exchange Board of India (SEBI) constituted Committees to recommend initiatives in Corporate Governance.*

Kumar Mangalam Birla Committee (1999), Task Force on Corporate Excellence through Governance (2000), Naresh Chandra Committee (2002), N. R. Narayana Murthy Committee (2003), Dr. J. J. Irani Committee on Company Law (2004), CII's Task Force on Corporate Governance (2009), Corporate Governance Voluntary Guidelines (2009), NASSCOM Recommendations (2010), Policy Document on Corporate Governance (2012), Companies Act (2013), SEBI (Listing Obligations and Disclosure Requirements) Regulations (2015), Uday Kotak Committee (2017).

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Legislative framework for Corporate Governance



The Companies Act, 2013 clearly indicates focus of regulators toward enhancing the responsibility and accountability of boards. The Act outlines various requirements for Governance, disclosures and enhanced roles, responsibilities and liabilities of the board, its committees and independent directors.

Enhanced disclosures and assertions in Board Report, Annual Return and Directors' Report with regard to Managerial Remuneration, risk management, internal control for financial reporting, legal compliance, Related Party Transactions, Corporate Social Responsibility, shareholding pattern, public money lying unutilised, etc.

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Principles of Corporate Governance



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Corporate Governance of BFSI

The Reserve Bank of India (RBI) and the Securities and Exchange Board of India (SEBI) established in 1992 are two important statutory bodies empowered to regulate and maintain the standard required for the effective corporate governance.

Additionally,

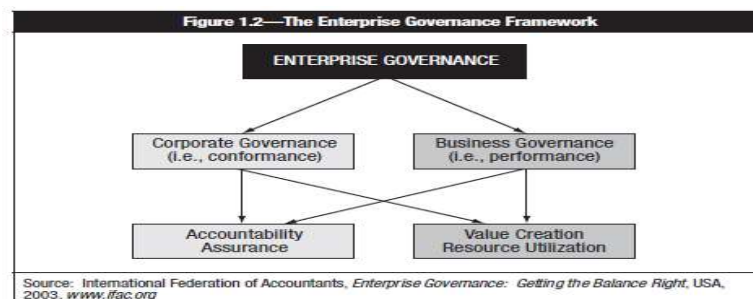
- Banking Regulation Act, 1949,
- The State Bank of India is governed by the State Bank of India Act, 1955.
- Nationalized banks are governed by the Banking Companies Act, 1970 and 1980
- The private sector banks came into being as company registered under the Companies Act 2013/1956 or under the Indian Companies Act, 1913 or prior to that).
- Foreign Exchange Management Act (FEMA), 1999,
- Payment and Settlement Systems Act, 2007,
- New Companies Act, 2013 and other directives/ regulations/ guidelines/ instructions issued by RBI and SEBI from time to time have created a positive environment and future scope for enhancing corporate governance.

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Conformance and Performance

International Federation of Accountants (IFAC) states that **“enterprise/ corporate governance constitutes the accountability framework of the organization”** and identifies two dimensions namely :

1. Conformance and
 2. Performance
- They must be balanced



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Conformance vs Compliance

- Conformance is voluntary adherence to a standard, rule, specification, requirement, design, process or practice.
- Compliance is forced adherence to a law, regulation, rule, process or practice.
- Conformance applies to strategies and plans that are adopted to be more productive or to improve quality.
- Compliance applies to laws and regulations that one has no option but to follow or face penalties. Such regulations may potentially be productive for society but don't necessarily contribute to an organization's goals.

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Governance and Management Compared

<u>Governance</u>	<u>Management</u>
<p style="text-align: center;">Evaluate, Direct, Monitor and Control an enterprise</p> <p>Enable enterprises to create value for their stakeholders or promote the creation of value</p> <p>Includes:</p> <ul style="list-style-type: none"> • Financial accountability and oversight • Operational effectiveness • Legal and regulatory compliance • Adoption of fair labor practices • Social responsibility • Governance of IT investment, operations and control 	<p style="text-align: center;">Focus on Planning, Building, Running and Monitoring</p> <p>Ensure alignment with defined goals and objectives established by the governing body</p> <p>Ensure enterprise strategic vision achievement as directed by governing body</p> <p>Create value for enterprise</p>

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Governance

- *The Caux Round Table (CRT) is an international network of business leaders working to promote a morally and sustainable way of doing business.*
- *The CRT believes that its Principles for Responsible Business provide necessary foundations for a fair, free and transparent global society.*
- The principles also have a risk management foundation - because good ethics is good risk management.

Principles:

1. Respect stakeholders beyond shareholders
2. Contribute to economic, social and environmental development
3. Build trust by going beyond the letter of the law
4. Respect rules and conventions
5. Support responsible globalisation
6. Respect the environment
7. Avoid illicit activities

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Compliance Risk

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Compliance Risks

- *Compliance with law and regulation need to be managed as an integral part of corporate strategy.*
- *The board of directors and management must recognize the scope and implications of laws and regulations that apply to the company.*
- ***Regulatory enforcement risks are increasingly crossing jurisdictional boundaries, leading to fines imposed by regulators from multiple jurisdictions.***
- *Compliance risks have evolved beyond mere regulatory concerns; they now encompass reputational, strategic, and financial risks.*
- *Understanding these interconnections is vital for enhancing risk maturity and effectively managing compliance challenges.*
- *Organizations need to establish a compliance management system as a supporting system of risk management system as it reduces compliance risk to a great extent.*

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Governance

- *Corporations and government agencies face increasing regulatory obligations and penalties.*
- *The financial services sector, for instance, must adhere to numerous regulations such as prudential regulations, RBI laws, AML compliances, and consumer credit and protection laws.*
- *Integrating governance, compliance, and risk elements is essential for advancing risk maturity.*
- *Compliance with laws and regulations should be integral to corporate strategy.*
- *Establishing a compliance management system reduces compliance risk significantly.*
- *Senior management involvement is crucial in developing and maintaining an effective compliance program, which should be regularly reviewed to remain updated with regulatory changes and business environment.*

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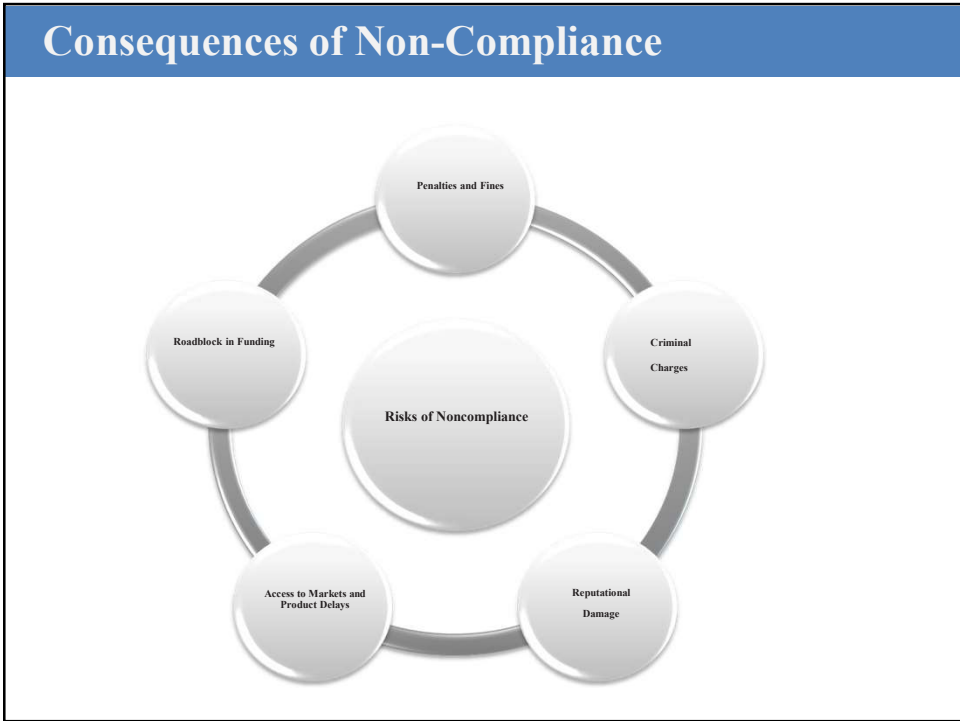
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Challenges to Compliance

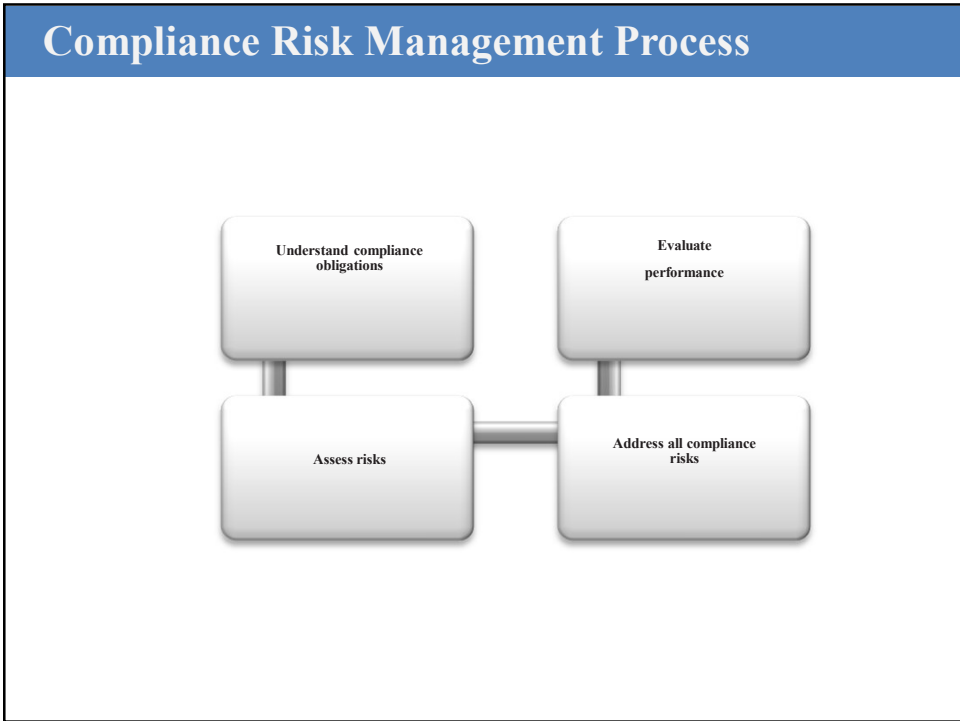
1. Large number of legislations and multiple regulators
2. Multiple business locations attracting state legislations
3. lack of ownership /awareness of functional staff about compliance requirements
4. Segmented compliance initiatives
5. Time-consuming and unreliable manual reporting
6. Dynamic legal environment, lack of a robust updation process, frequent changes in process owners and internal processes.

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Consequences of Non-Compliance

Compliance area (illustrative)	Possible risk of Non-compliance
Direct tax compliance	<ul style="list-style-type: none"> Imposition of penalty Prosecution of directors Loss of reputation
Indirect tax compliance	<ul style="list-style-type: none"> Cancellation of licences Withdrawal of tax benefits Stoppage of operations Loss of reputation
Labour law compliance	<ul style="list-style-type: none"> Imposition of penalty Prosecution of directors / occupier Loss of reputation Employee dissatisfaction
Environment, health & safety laws	<ul style="list-style-type: none"> Stoppage of operations Loss of reputation Imposition of penalty
Corporate law compliance	<ul style="list-style-type: none"> Imposition of penalty Vacation / prosecution of directors or management Loss of reputation
IT Act ad Data Protection Acts	<ul style="list-style-type: none"> Imposition of penalty Civil and Criminal liability

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Compliance Risk Mitigation

Management Assurance	<ul style="list-style-type: none"> Assists in setting and executing strategies. Provides direction, guidance and oversight Promotes a strong risk culture & sustainable risk return thinking Promotes a strong compliance culture and management of risk exposure. Ongoing monitoring and management of risks.
Risk Management, Legal & Compliance	<ul style="list-style-type: none"> Formal, robust and effective risk management within which the organisation's policies and minimum standards are set. Objective oversight and the ongoing challenge of risk mitigation, management and performance while reporting is achieved across the business units. Overarching risk oversight across all risk types. Compile and maintain a legislative universe for the organization. Facilitate the risk prioritization of all pieces of legislation in the regulatory universe. Initiate new legislative requirements within the organization Analyze and send out alerts on the new law to inform the organization of the new requirements. Facilitate an executive review of the legislation by Legal analysts. Facilitate the completion of the Compliance Risk Management Plan ("CRMP") Update compliance monitoring plans on the CRMP. Escalate compliance matters to management. Undertake quarterly compliance reporting.
Internal Audit & other Independent Assurance Providers	<ul style="list-style-type: none"> Independent and objective assurance of overall adequacy and effectiveness of governance, risk management and internal controls within the organization Ability to link business risks with established processes and provide assurance on the effectiveness of mitigation plans to effectively manage organizational risks.

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Essentials of Compliance Risk Management Program

Active board and senior management oversight	<ul style="list-style-type: none"> An effective board and senior management oversight is the cornerstone of an effective compliance risk management process.
Effective policies and procedures	<ul style="list-style-type: none"> Compliance risk management policies and procedures should be clearly defined and consistent with the nature and complexity of an institution's activities.
Compliance risk analysis and comprehensive controls	<ul style="list-style-type: none"> Organizations should use appropriate tools in compliance risk analysis like self-assessment, risk maps, process flows, key indicators and audit reports; which enables establishing an effective system of internal controls.
Effective compliance monitoring and reporting	<ul style="list-style-type: none"> Organizations should ensure that they have adequate management information systems that provide management with timely reports on compliance like training, effective complaint system and certifications.
Testing	<ul style="list-style-type: none"> Independent testing should be conducted to verify that compliance-risk mitigation activities are in place and functioning as intended throughout the organization.

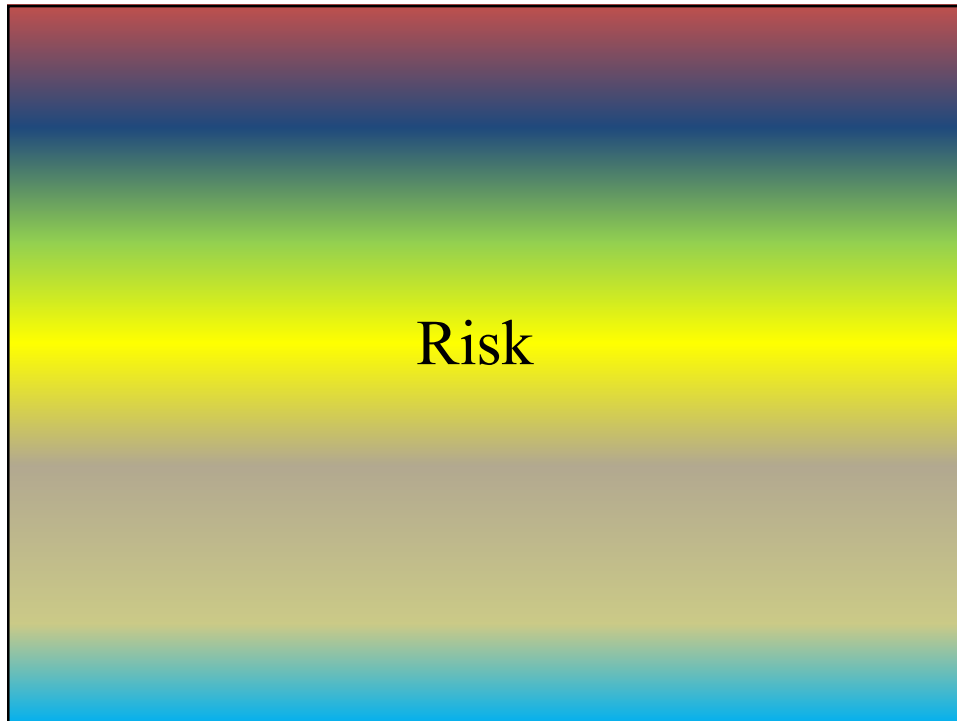
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Developments in GRC

- Governance, risk management, and compliance (GRC) have evolved to overlap significantly, integrating activities like internal audits, incident management, regulatory compliance, and vendor compliance.*
- Many companies now adopt an integrated GRC approach to achieve objectives reliably, manage uncertainty, uphold integrity, and ensure compliance with regulatory and vendor requirements.*
- GRC encompasses governance, enterprise risk management, regulatory compliance, vendor compliance, assurance, performance management, information security, quality management, ethics, values, and business continuity.*
- Effective GRC implementation enhances risk reduction, control effectiveness, security, and compliance by integrating processes and eliminating organizational silos.*
- GRC professionals play a strategic role, providing insights on risk profiles, data interpretation, revenue generation, and sales strategies.*
- The future focus will be on aligning GRC initiatives with business performance objectives to drive organizational success and resilience while fostering collaboration within a comprehensive GRC community.*

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Risk Management in Banking

- Risk Management in Banking (60 minutes)
- Provide an overview of risk management frameworks and methodologies relevant to banking, such as Basel III and the COSO Enterprise Risk Management framework.
- Discuss different types of risks faced by banks, including credit risk, market risk, operational risk, and compliance risk.
- Explain risk assessment techniques, risk appetite, and risk tolerance levels in the context of banking.

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Risk Management

- Risk typically refer to the possibility of a loss or an injury created by an activity or by a person.
- Risk management seeks to *identify, assess, and measure risk and then develop countermeasures to handle it*. This typically does not mean eliminating risk but rather seeking to mitigate and minimize its impact.
- Risk should not be viewed as inherently bad. All opportunities come with some degree of risk.
- An organization that is totally risk averse is not likely to be very attractive to investors and may be doomed ultimately to fail

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Risk Management

The types of risks that impact companies vary depending on the home country location, industry, level of globalization, and many other factors.

Banks worry about credit and market risks.

Many firms worry about reputation and legal risks.

Risks can be internally or externally based, but one area of risk impacts all companies: operational risk.

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Risk Management

Risk may be classified according to controllability, i.e Controllable risk and Uncontrollable risk.

- Controllable risk is categorized as Unsystemic Risk and
 - Uncontrollable risk is categorized as Systemic Risk.
- but one area of risk impacts all companies: operational risk.

<u>Systemic Risk</u>	<u>Unsystemic Risk</u>
<ul style="list-style-type: none"> • It is not fully uncontrollable by an organisation. • It is not entirely predictable. • It is usually of a macro nature. • It usually affects a large number of organisations operating under a similar stream. • It cannot be fully assessed and anticipated in advance in terms of timing and gravity. • The example of such type of risks is Interest Rate Risk, Market Risk, Purchasing Power Risk. 	<ul style="list-style-type: none"> • It is usually controllable by an organization. • It is reasonably predictable. • It is normally micro in nature. • If not managed it directly affects the individual organisation first. • It can be usually assessed well in advance with reasonable efforts and risk mitigation can be planned with proper understanding and risk assessment techniques. • The examples of such risk are Compliance risk, Credit Risk, Operational Risk.

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Types of Risks on the basis of impact on finance

<u>Financial Risk</u>	<u>Non-Financial Risk</u>
<p>The risk which has some direct financial impact on the entity is treated as financial risk.</p> <p><i>This risk may be Market risk, Credit risk, Liquidity risk, Operational Risk, Legal Risk and Country Risk.</i></p>	<p>This type of risks do not usually have direct and immediate financial impact on the business, but the consequences are very serious and later do have significant financial impact if these risks are not controlled at the initial stage.</p> <p><i>This type of risk may include, Business/Industry & Service Risk, Strategic Risk, Compliance Risk, Industry, Fraud Risk, Reputation Risk, Transaction risk, Disaster Risk.</i></p>

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Types of Risks

Financial Risks

1. Market Risk (interest risk, currency risk, equity risk etc)
2. Credit Risks
3. Liquidity risk
4. Operations/ system/ management risk
5. Obsolescence risk
6. Geopolitical risk
7. Legal risk

Non financial Risks

1. Business/ Industry & Services Risk
2. Strategic Risk
3. Compliance Risk
4. Fraud Risk
5. Reputation Risk
6. Transaction Risk
7. Disaster Risk
8. Regulatory Risk
9. Technology Risk

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Risk Management process



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Risk Analysis

Identify Threats: The first step in Risk Analysis is to identify the existing and possible threats that one might face. These can come from many different sources. For instance, they could be:

- Human – Illness, death, injury, or other loss of a key individual.
- Operational – Disruption to supplies and operations, loss of access to essential assets, or failures in distribution.
- Reputational – Loss of customer or employee confidence, or damage to market reputation.
- Procedural – Failures of accountability, internal systems, or controls, or from fraud. Project – Going over budget, taking too long on key tasks, or experiencing issues with product or service quality.
- Financial – Business failure, stock market fluctuations, interest rate changes, or non-availability of funding.
- Technical – Advances in technology, or from technical failure.
- Natural – Weather, natural disasters, or disease.
- Political – Changes in tax, public opinion, government policy, or foreign influence.
- Structural – Dangerous chemicals, poor lighting, falling boxes, or any situation where staff, products, or technology can be harmed.

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Other Factors to Consider

Dependency of the enterprise on third parties (supply chain)

Influence of financing, debt and partners or substantial stakeholders

Vulnerability to changes in economic or political conditions

Changes to market trends and patterns

Emergence of new competition or new and disruptive technologies

Impact of new legislation

Existence of potential natural disaster

Constraints caused by legacy systems and antiquated technology

Strained labor relations and inflexible management

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Risk Analysis - Tools

Tools such as SWOT Analysis and Failure Mode and Effects Analysis can also help to uncover threats, while Scenario Analysis helps to explore possible future threats.

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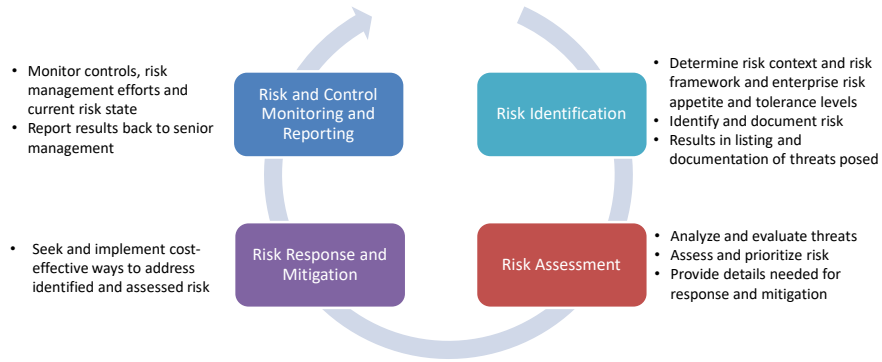
Risk Relative to other Major Categories of Risk



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Risk Management Life Cycle



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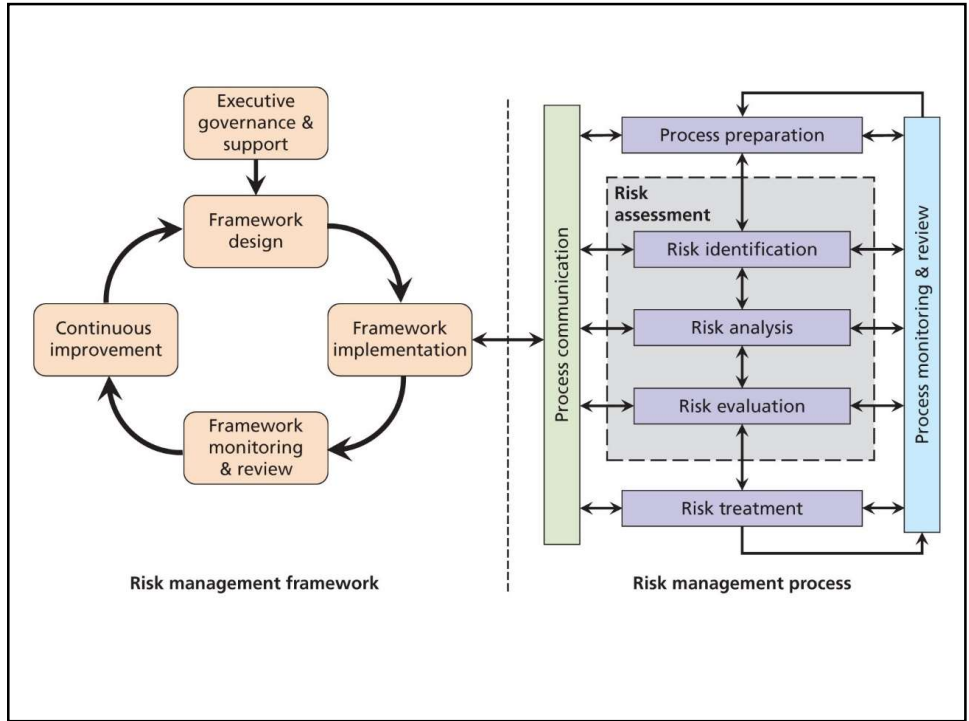
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Alignment With Business Goals and Objectives



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Organizational Culture Relating to Risk

Vulnerable (Don't Care Culture)	Reactive (Blame Culture)	Compliant (Compliance Culture)	Proactive (Ownership Culture)	Resilient (Way of Life)
Apathy	Resistance to caring	Responsibilities assigned	Clear lines of accountability and responsibility defined	Lines of accountability and responsibility communicated and understood
Near misses not considered	Some near-miss reporting	Reporting limited to compliance areas	Processes defined to enhance long-term sustainability and operationalization	Active monitoring and reporting
Negligence	Some window dressing	As-required process definition	Appropriate instrumentation and investments are made	Advanced instrumentation and investments made
Hiding of incidents	Ad hoc/inconsistent training	Limited instrumentation and investments	Training defined and required	Training is encouraged
No or little training	Communication on a need-to-know basis	Minimal required training	Open communication	Active communication
Poor or no communication		Compartmentalized communications		

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Applying Organizational Culture

Determine the risk appetite of senior management

Culture and ethics help determine risk-appetite variances

Risk appetite can change or vary based on risk type and should be reviewed periodically

Extent of risk-appetite change depends on market conditions, confidence, past successes or failures, global economics, reports in the media, availability of resources, new regulations or long-term strategy

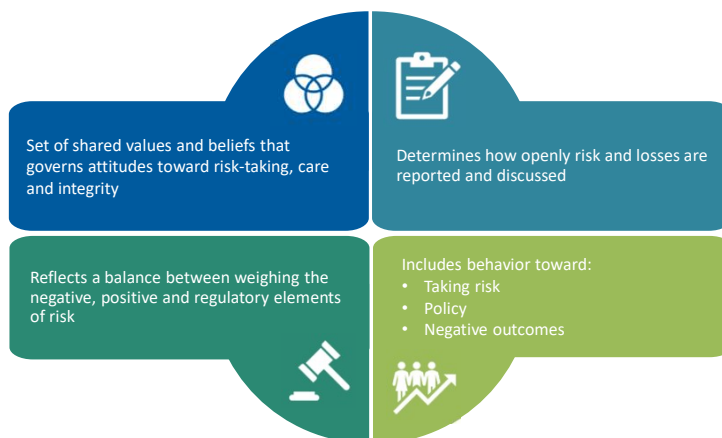
Enterprise decisions:

- Invest
- Take on a new line of business
- Develop a new product
- Open a new office
- Hire a new employee
- Invest in new hardware or software
- Upgrade existing applications
- Implement new controls

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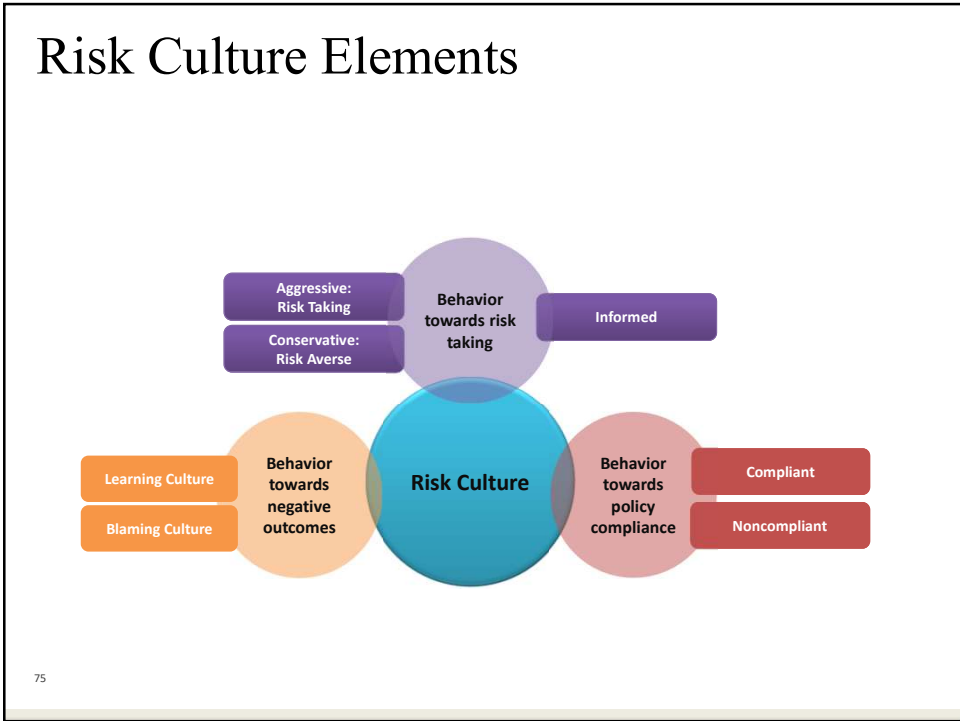
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Risk Culture



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Determining the Risk Profile

Assets

- New assets
- Total cost of ownership (TCO) of assets
- People and the morale of the organization
- Regulations and legal changes
- Availability of staff/resources

Business

- Changes to the scope of risk assessment
- Changes in business priorities, assets, services, products and operations
- Risk acceptance levels
- Actions of competitors
- Changes in the supply chain
- Changes in financial markets

Events

- New threats (internal and external)
- Newly discovered vulnerabilities
- Possibility of increased risk due to aggregation of threats and vulnerabilities
- Incidents
- Logs and other data sources
- Impact from external events

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Defining the Organization's Risk Tolerance and Risk Appetite

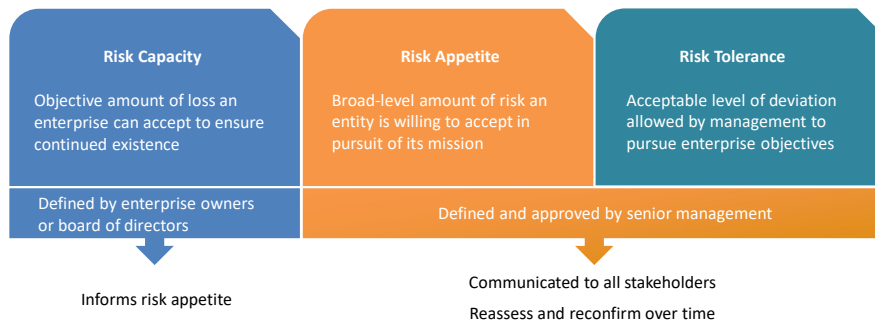
As the governance group communicates its intent to the RM framework development team, it also needs to communicate its general perspective on *what level of risk is acceptable and what risk must be reduced or resolved* in some fashion

The *amount of risk that remains after all current controls are implemented is residual risk*

The difficulty lies in the *process of formalizing exactly what the organization "can live with," which is its risk appetite*

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Risk Capacity, Appetite and Tolerance

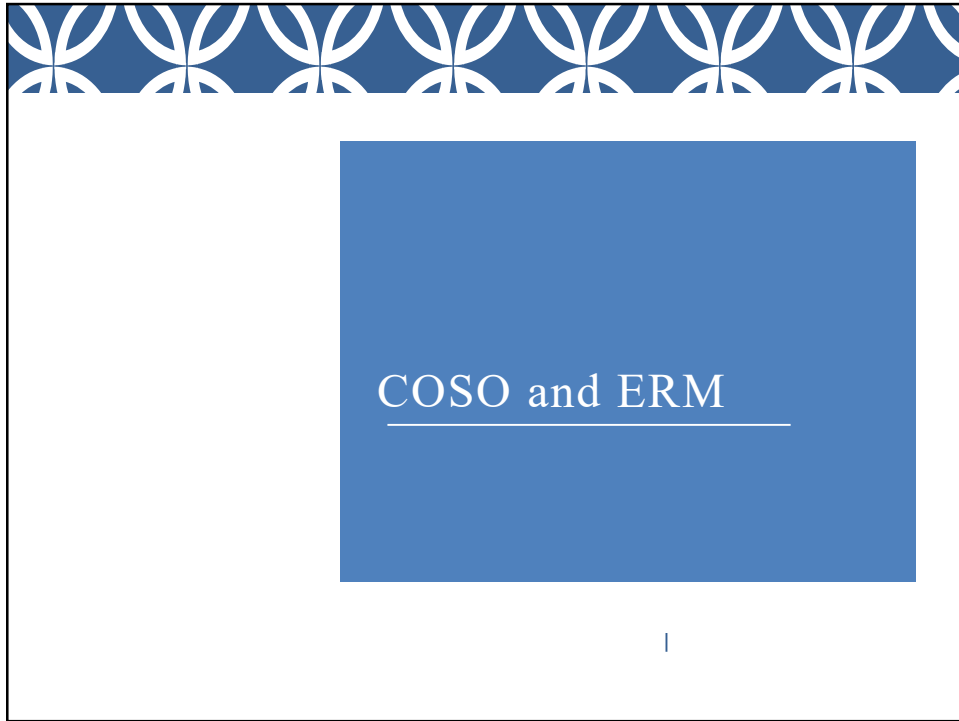


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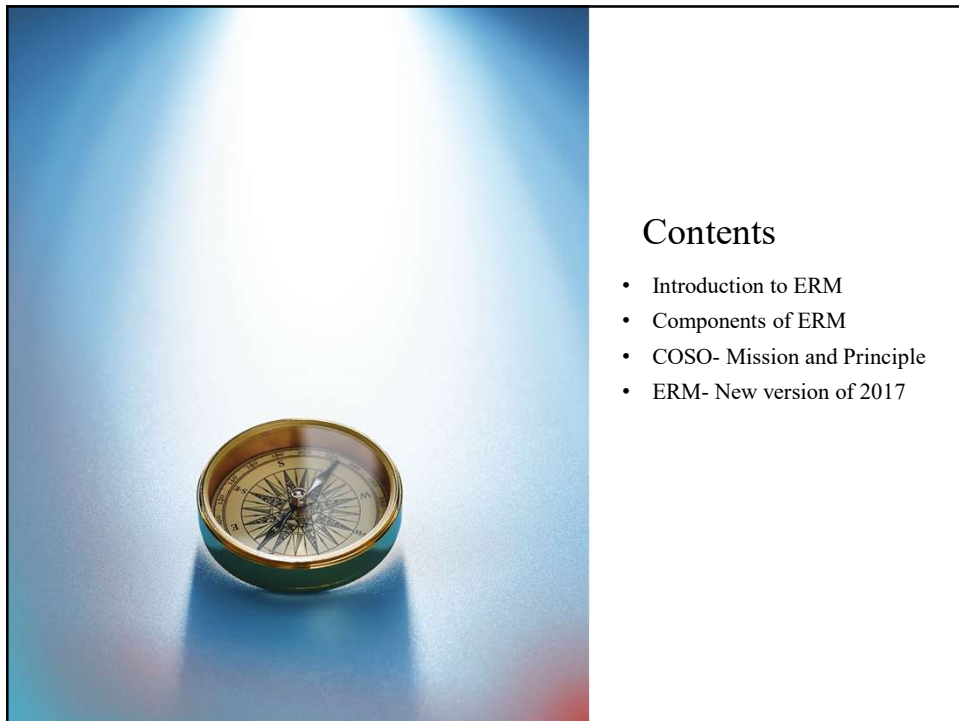
- Section 134(3) (n) of the Companies Act, 2013 provides that a statement indicating development and implementation of a risk management policy for the company including identification therein of elements of risk, if any, which in the opinion of the Board may threaten the existence of the company.
- SEBI (LODR) Regulations, 2015 also provides that company shall lay down procedures to inform Board members about the risk assessment and minimization procedures. The Board shall be responsible for framing, implementing and monitoring the risk management plan for the company.
- Regulation 21 of SEBI (LODR) Regulations, 2015, requires that every listed company should have a Risk Management Committee

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Enterprise Risk Management

Enterprise risk management is a process, effected by an entity's board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives




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ERM ENCOMPASSES



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graph TD
    A[Aligning risk appetite and strategy] --> B[Enhancing risk response decisions]
    C[Reducing operational surprises and losses] --> D[Identifying and managing multiple and cross-enterprise risks]
    E[Seizing opportunities] --> F[Improving deployment of capital]
    A --> C
    B --> D
    D --> F
    
```



STRATEGIC	OPERATIONS	REPORTING	COMPLIANCE
Internal Environment	Objective Setting	Event Identification	Risk Assessment
Risk Response	Control Activities	Information & Communication	Monitoring
FINANCIAL	OPERATIONAL	LEGAL	REPUTATIONAL
BUSINESS UNIT	SUBSIDIARIES	PARTNERS	SUPPLIERS

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NOTE



Enterprise risk management is not strictly a serial process, where one component affects only the next.




It is a multidirectional, iterative process in which almost any component can and does influence another

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COSO's FUNDAMENTAL PRINCIPLE


Good risk management and internal control are necessary for long term success of all organizations

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- The COSO Board released in September 2017 an update to the 2004 Enterprise Risk Management-Integrated Framework

COSO PROJECT TO UPDATE THE ERM FRAMEWORK



- That framework is widely used by management to enhance an organization's ability to manage uncertainty and to consider how much risk to accept as it strives to increase value



- This initiative enhanced the framework's content and relevance in an increasingly complex business environment so that organizations can attain better value from enterprise risk management

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COSO framework's 17 principles of effective internal control

Internal Control Component	Principles
Control environment	1. Demonstrates commitment to integrity and ethical values
	2. Exercises oversight responsibility
	3. Establishes structure, authority, and responsibility
	4. Demonstrates commitment to competence
	5. Enforces accountability. Risk assessment
Risk assessment	6. Specifies suitable objectives
	7. Identifies and analyzes risk
	8. Assesses fraud risk
Control activities	9. Identifies and analyzes significant change Control activities
	10. Selects and develops control activities
	11. Selects and develops general controls over technology
	12. Deploys control activities through policies and procedures Information and communication
Information and communication	13. Uses relevant information
	14. Communicates internally
	15. Communicates externally Monitoring activities
Monitoring	16. Conducts ongoing and/or separate evaluations
	17. Evaluates and communicates deficiencies

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ISO 31000

ISO 31000:2009 gives a list on how to deal with risk:

1. Avoiding the risk by deciding not to start or continue with the activity that gives rise to the risk
2. Accepting or increasing the risk in order to pursue an opportunity
3. Removing the risk source
4. Changing the likelihood
5. Changing the consequences
6. Sharing the risk with another party or parties (including contracts and risk financing)
7. Retaining the risk by informed decisionrisk.

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Compliance

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“ Compliance is the act of adhering to, and the ability to demonstrate adherence to, mandated requirements defined by laws and regulations, as well as voluntary requirements resulting from contractual obligations and internal policies”.

~ OECG

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Thank You

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