Guest Lecture by Mr. R M Pattanaik, Ex-GM, Indian Overseas Bank, Aug. 12, 2015 for the Course "Commercial Bank Management" taught by Prof. D N Panigrahi

Mr. R M Pattanaik, Ex-GM, Indian Overseas Bank, CO, Chennai was invited to IMT Nagpur on August 12, 2015 to address the second year students of "Commercial Bank Management (CBM)" subject taught by Prof. D.N Panigrahi.

Mr. Pattanaik delivered a lecture on "**CAPITAL ADEQUACY FRAMEWORK & RISK MANAGEMENT IN BANKS**". He started his address by stressing on the importance of ' Risk Management' in any business. Risk is a fact of life and Risk Management is more important in bank management because banks earn their revenues in two ways , by extending customer service and by managing risks. Risk Management is the name of the game for all bank managers. So all bank managers should have "Risk Orientation' in all of their activities. Risk is unavoidable in banking business and bank managers at all level have to manage the risk prudently. Bank faces a host of risks in all their activities covering Credit Risk, Market Risk, Operational Risk, Liquidity Risk, Reputation Risk, Legal Risk, Settlement Risk, Business and Strategic Risk etc. Risk management involves identification of the risks, quantification or measurement of the risks, mitigation or management of the risks. There are two types of losses: expected losses and unexpected losses. To take care of expected losses, banks make provisions like provisions for non performing loans or loan loss provisions and provisions for other contingencies. To take care of unexpected losses banks are required to maintain adequate capital.

He then elaborated that banks are important economic institutions and are catalyst for economic development. Banks are also highly leveraged entities as bulk of their funding (sources of funds) consists of deposits from the public which are unsecured borrowings. Failure of a bank is not limited to a single bank, rather it leads to a cascading effect on many banks due to their inter-connected borrowings and lendings. And with globalisation, the contagion of a bank failure may have international ramifications. So to ensure that the banks and financial institutions world over remain fundamentally strong, sound and resilient, Bank for International Settlements (BIS) – a bank of central banks of many countries, located in Basel (aka Basle) in Switzerland has been framing guidelines since 1988 in respect of bank capital as well as risk management for compliance by banks of the member countries. These guidelines are known as "Capital Adequacy Framework" or "Basel Capital Accord". The 1st

Capital Accord was prescribed in 1988 (known as Basel I Capital Accord) which covered Credit risk and Market risk. The 2nd Capital Accord was formulated in 2004 which covered additionally Operational risk (known as Basel II Capital Accord). The objective of these capital accord is to ensure that banks are adequately capitalised and capital of each bank should be commensurate with its risk exposure. In the aftermath of global financial crisis, a new capital accord was framed in 2013 known as Basel III Capital Accord where emphasis is on quality of capital of banks, rather than quantity and liquidity coverage. In a nutshell, capital adequacy requirement puts a constraint on the bank's capacity on risky asset expansion, ie, a bank has to first ensure availability of adequate free capital on its balance sheet before making any loan. RBI has been prescribing a set of capital adequacy and risk management guidelines for Banks in India since 1992 which is a little more stringent than the BIS guidelines applicable internationally. Mr. Pattanaik also explained that with Basel III Capital Accord coming into force in India from March 2019, the capital requirement of all the banks in India will be very huge considering more restrictions on capital quality and balance sheet leverage ratio.