Investigating the Risk Management Systems in the South African Banking Industry

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Abstract

Over the last decade, there has been a huge debate that has risen around the issue surrounding risk management within banking sector mostly due to current monetary crisis. Numerous attempts were put in place with the objective of improving the risk management and performance in banking industry comprising the introduction of the Basel Accords and also risk management strategies by central banks. As a result, the South African state-owned Banks have allotted risk management policies to reinforce the risk management system and to enhance the functioning of the banking sector. But, the existing literature within South African perspective do not elucidate the influence of these attempts on the functioning of banks. Lin light of this, the present research paper aimed at examining the efficiency of risk management systems in the South African local banks. This paper appraises the related literatures on banking risk management as of various methodological aspects and develops a conclusion to contribute to the existing literature; mainly in addressing some flaws concerning risk management system in the South African baking sector.

Keywords: Risk Management, baking sector, South Africa

1. Introduction

The Business environment that organisations find themselves operating in today, is a completely different one to a few years ago, as it is constantly changing at a rapid pace and new risks are emerging not only internally but externally. "Risk exposure has become greater, more complex, diverse and dynamic, due to rapid changes in technology, speed of communication, globalisation and changes in the market" Chapman (2006:3) Therefore, the need for Risk management in an organisation is vital if an organisation wants to prosper and succeed in today's turbulent environment. Risk can be described as an undesired and unexpected outcome of an event, risk usually emerges due to a degree of uncertainty and the lack of knowledge about the future, so understanding and treating risk must be the primary responsibility of any organisation Cooper et al, (2014:4) According to Dludhlu (2016:1) "risk can be identified as a loss due to an occurrence of an incident, the probability of the incident reoccurring and then determining to what extent the consequences may be changed". Risk management can be described as a process for managing risk, the main objective of risk management is to prevent losses from occurring or to minimise the extent of the risk impact on an organisation. According to Young (2014:3) to manage risk effectively risk must be measured, the basis of this assignment is to investigate the risk management systems of the Banking industry in order to monitor and measure risk. Bank X utilises a system called Open pages which is used throughout the organisation by every business segment, it is a data base for managing, controlling and monitoring risk. According to Young (2014:55) "the primary responsibility of risk management function is to coordinate all risk management information on a centralised system".

The purpose of this assignment is twofold, firstly we need to understand what "Risk Management" is and secondly to investigate the risk management systems within the banking industry. Risk management is vital to ensure the survival and success of an enterprise and can assist in providing a competitive edge to be more successful in the current economic environment (Dos Santos, 2014: 1-1). Banks are constantly exposed to risks weather its internal and external, internal risks comprise of financial, technological and operational risks which can be controlled by an organisation depending on how stringent their controls and frameworks are.

Unfortunately, the same cannot be said for external risks, these are risks that cannot be controlled by an organisation as they are uncertain and unpredictable, they consist of political, economic, social, technological, legal and environment (PESTLE), (Cooper et al, 2014: 52). The following frameworks and policies are built into risk management to safe guard organisations in South Africa the Basel committee plays a huge role in the Banking industries and is one of the frameworks that the bank adheres too (Young 2014:29).

The Banks framework and policies are the responsibility of Enterprise Risk Management (ERM) and they would be responsible to reference certain standards e.g. King III Report, Basel II ensuring that those standards comply with the banks framework. The banks framework and policies would reference the King III report in one way or another and Basel II aligns to the banks systems. It's important that the bank documents its theory but it's important that the system enables the theory. Below is an explanation of what ERM, Basel committee and King committee are in order to understand why they are incorporated into the banking industries framework.

2. Basel Committee on banking supervision

According to Young (2014:29) in the 1970's the issue regarding regulatory supervision of international active banks became an issue which in the end lead to the 1988 Basel Capital Accord being initiated by the Basel Committee on Banking Supervision. According to Young (2014:29) the Basel Committee supports broad supervisory standards and guidelines in the banking industries. According to Young (2014:30) the Basel committee stated that the vital objectives was to "develop a framework that would further strengthen the soundness and stability of the international banking systems, all the while maintaining sufficient consistency that capital adequacy regulation will not be a significant source of competitive inequality among internationally active banks".

According to Young (2014:30) the Basel committee has three pillars of operational risk and Corporate Governance:

1. Regulatory capital requirements

This first pillar refers to the treatment of operational risk that results in a measurement of operational risk being included in the bank's capital ratio.

2. Supervisory oversight

This second pillar is based on principles regarding the need for the banks to assess their capital adequacy positions in relation to their actual risks

3. Market discipline

The third pillar compliments the first and second pillar, this pillar contains a set of disclosure requirements regarding marketing participants access to key information regarding the banks risk profile and level of capitalisation. According to Young (2014:30) "market discipline can produce significant benefits by assisting banks in the management of risk and improvement of stability". According to Young (2014:31) the Basel III framework is intended to strengthen the standards of regulation, supervision and risk management within the banking sector.

3.King Committee

The King Committee on Corporate Governance was founded in 1992 to take into consideration corporate governance in South Africa. In 2002 the King reports aim was to "promote the highest standards of corporate governance in South Africa" (Young 2014:31). In the King Report, there is a section on risk management and it is advised that it should be considered and applied when developing a risk management framework. According to Young (2014:32) it is the responsibility of the Board to decide on the organisations appetite for risk, and to implement effective processes to identify and manage those risks accordingly. The following models and frameworks must provide assurance with regards to the following:

- Effectiveness and efficiency
- Compliance and applicable laws
- Business sustainability
- Responsible behaviour towards stakeholders
- Safeguarding of assets

According to the King committee the responsibility for risk management is the ultimately the responsibility of the board, when it comes to the process of risk management and the risk strategy policies. According to Young (2014:33) King III states that the board of directors should ensure that the following principles are adhered to:

- Responsible for the governance of risk and the tolerance of risk within the organisation
- Audit and risk committee must assist in carrying out their duties
- Delegate responsibility to management regarding the monitoring, implementation and design of the risk management plan (RMP)
- Risk assessments must be continuously performed in the organisation
- Ensure that the frameworks are implemented in order to detect if there is an increase in unpredicted risks
- The risk management process must be effective from an internal and external audit perspective
- There must be transparency and risk disclosure to the stakeholders.

4. Risk Management Process

4.1 Business Analysis

The first process involves the analysis of the business in order to understand the business as a whole, as well as the specific activity, process or project forming the subject of the risk management plan.

4.2 Risk Identification

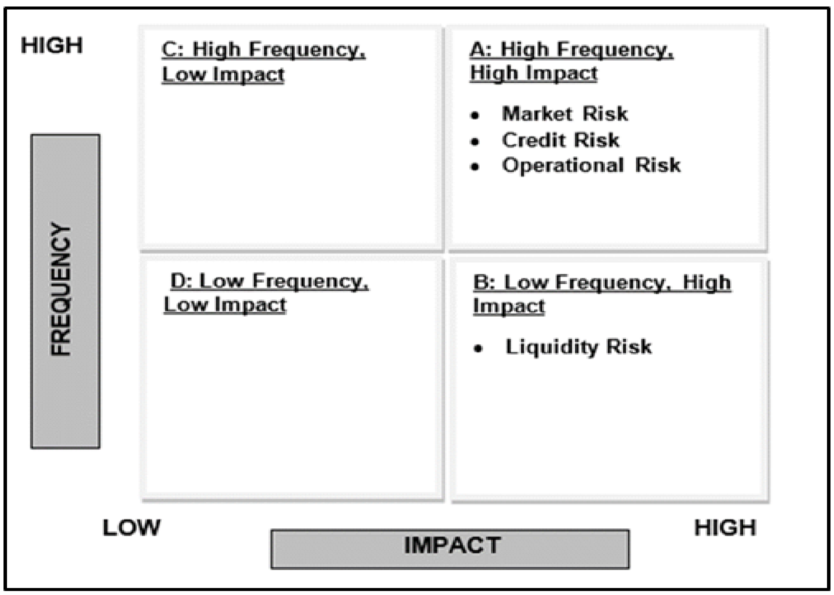
In order for an organisation to effectively manage risk, risk identification will assist as it consists of determining and identifying the potential risks which may arise, and which are likely to affect a particular activity, process or project (Merna et al. 2005: 38). In this regard, it is important to keep in mind that risks may not only flow from the actual activity, process or project (i.e. internal risk, external risk) and therefore the macro (economy) and market environments should also be considered as these may also pose potential risks. According to Renault et al. (2016:127) Risk identification is an important step in the risk management process reason being is that if a risk is not identified it would be impossible to respond to that risk in time. According to Renault and Agumba, (2016:3) "risk identification facilitates the activities where organisational resources are at risk, affecting their ability to achieve their business goals". For the purpose of this assignment we will be looking at the Banking Industries major risk types as an example to demonstrate how the various tools are used, these risks will be set out in a table format which can be used as an easy reference point when continually evaluating and monitoring the risks.

The major types of risks the banking industry faces are listed and demonstrated below (Quantzig, c2007-2018), Currently within Bank X they utilise a system called Nimbus, which assist in identifying risks from a process view. Nimbus can be classified as a process mapping tool and is a complimentary system to Open Pages. All bank processes are documented. Nimbus can provide the bank with a platform whereby they can look at a process end to end and identify risks from a broad spectrum and minimise the chances of missing key risk and controls. Within Nimbus you can relate the risks back to the processes. Nimbus allows the bank to look at a specific department within a team, they can view a departments sub processes and can see a detailed flow of a departments processes, this view provides the platform to identify risks and identify the controls within that process.

Risk management will then attach the key risk and controls to the process on Nimbus. Process classification, Risks description, Inherent risk, control categorisation, control category, characteristics of the control, and how the control is rated and what is the control based on. Processes are documented on Nimbus but not feed into Open Pages, only the information on the risks and the controls is feed into the Open Pages System. Nimbus facilitates risk and control identification which is the main purpose of Nimbus. The information that has been documented on Nimbus then gets uploaded on to Open Pages, Nimbus facilitates the identification process and completes the assessment of controls on Open pages. This is how the information is aggregated to group level, who then submit the information to SARB. Open Pages and Nimbus are officially the only two systems that Bank X uses, everything goes back to Open Pages. That's why Bank X states that the main Risk Management system is called Open Pages.

4.3 Risk Evaluation

The purpose of risk evaluation or risk is to make decisions about which risks are acceptable to the organisation and which are not. Those risks which are not acceptable to the organisation need to be addressed by implementing certain controls in order to manage them, until they get to a point that they are acceptable to the organisation. According to Young (2014: 79) if a risk can be measured it can be managed. Risk evaluation also assists the organisation to prioritise the various risks so that decisions can be made as to which risks need to be addressed first. By utilising the risk matrix below an organisation will be able to identify where the risks lie and put in place control measures. Block "A" is the most crucial section as it has high frequencies and high impacts followed by block "B" if you are aware of your risks you can plan ahead and can reduce the impact to the business. According to Maier (2013:19) risk evaluation determines if the risk or extent of the risk is worth accepting. With regards to the banking risks identified above they can be measured and prioritized by inserting them into the following quadrants of a risk matrix:



Bank X evaluates risk by using the process, risk, control, identification, and assessment policy (PRCIA). Individual business entities and combined insurance identify and assess risk within key business processes. Those processes are then assessed to ensure adequacy and effectiveness and that controls are in place to mitigate the risks and to assess the effectiveness and appropriateness of the key processes from a risk management perspective by considering the risk and control assessments. PRCIA is a core component of the Operational Risk Management framework (ORMF). PRCIA together with internal loss data and key risk indicators (KRIs) provides information with respect to the extent to which risks are mitigated and the robustness of the overall internal control environment. The bank captures these risks and controls by using a PRCIA taxonomy where the Bank categorise the risks and controls accordingly to the taxonomy from an aggregation perspective, the open page's system allows the bank to drill down information per category, per process category, per risk category and per control category.

The banks system has 10 high level process categories:

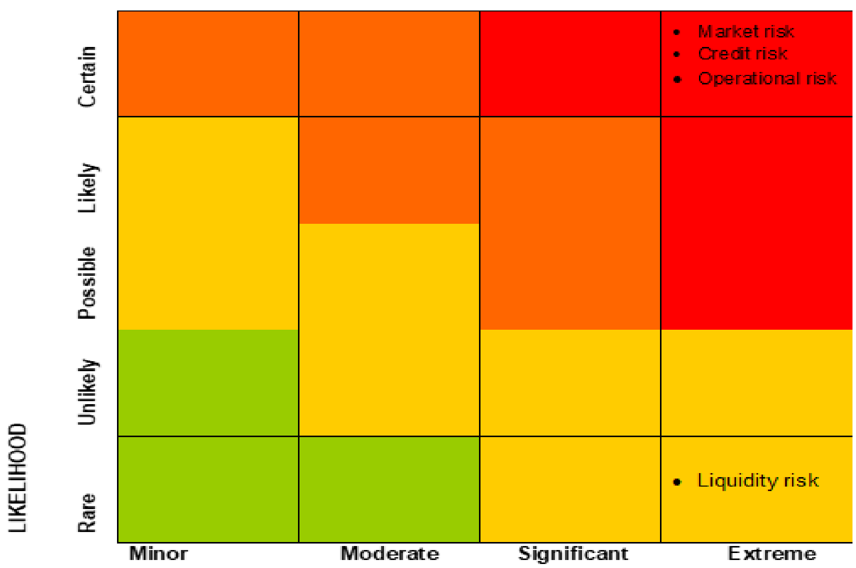
- strategic and business planning
- governance risk and reporting
- business product and service development
- infrastructure design and capacity to termination

- resource management
- process relevant to on boarding of new clients
- deal execution, settlements and payments
- finance accounting
- evaluation and integrated performance
- risk analytics

Risk categorisation is categorised at level 3 with a high level of operational risk e.g. internal and external fraud, theft accessing system with no valid reason. The reason the bank has categories is to aggregate the reporting and provide an aggregated view to SARB. If the bank is asked to provide a risk profile of the e.g. management of third parties, the Bank can provide the information by going to the process, then to the relevant sub category, the system allows you to see how many risks are linked to that specific process, how many controls are in place, what are the ratings per control and if issues where created, what is the remediation plan again all of this is facilitated on Open Pages. Categorisation is key and is facilitated on Open pages, everything is captured on open pages and categorised accordingly, should SARB want a report on internal theft, because the bank has categorised the risk all the bank needs to do is drill down and extract all losses pertaining to that risk category, hence the importance of categorisation.

4.4 Risk Analysis

The process of risk analysis involves doing a risk assessment on the specific activity, process or project undertaken by the organisation. The risk assessment is done by evaluating the likelihood of the risk occurring and the impact which such risk will have on the activity, process or project should it occur. Once the risk assessment has been completed, the organisation will then be able to identify which risks need to be mitigated and which risks are acceptable and fall within the organisations risk appetite. After risks, have been evaluated and identified in the risk matrix, those risks are then analysed with the use of a risk assessment. (demonstrated below)



In the current situation at Bank X, the Risk managers make use of a Risk assessment when doing a walk through or review of a process. On completion of the walk through or review, the high risks are then identified as KRI's (Key Risk Indicators) and then uploaded on Open pages for further monitoring and tracking. The KRI's are then updated on a Risk register and aligned to one of the Banks important policies PRCIA, it stands for process, risk, control, identification, and assessment policy which is a central tool to risk management.

4.5 Risk Planning

When an organisation has identified, evaluated and analysed the potential risks posed to an activity, process or project, the organisation needs to consider what controls, can be put in place in order to minimise the effects of such risks. In this regard, it may happen that the organisation will accept the risk and therefore put no controls in place whilst on the other hand; the organisation may consider a specific risk as detrimental and therefore invest a lot of time and effort in putting sufficient controls in place to mitigate the risk. The organisation may decide that a risk should be avoided at all costs and therefore restructure the activity, process or project so that the risk is no longer applicable. According to Mhlanga (2012:6) "risk management is how organisations select the type of risk that they want to mitigate and what risks they are not prepared to take".

4.6 Risk Management

An interview was conducted with the Head of Risk Management for Branch Banking at Bank X, the question raised was what risk management system does Bank X use when reporting on their risks? The system that Bank X use is called "Open Pages", and it is the only official risk management system within the group and only tool that the South African Reserve Bank (hereafter after referred to as SARB) recognises. Bank X is a business segment within a large organisation and having a uniform system in place for the entire group is important, because ultimately what Bank X reports on as well as the other segments needs to be accumulated and provide to the various stakeholders. The reason for this is that Bank X reports to SARB at a group level and therefore it's imperative that there is one system that is used between the various business units for the collection and reporting of risks. Open pages is a uniform system where every business unit in the group will log the risk management requirements as dictated by policy and framework, defined by group level and that then gets aggregated to Bank level and then to a Group level. What follows hereunder is a discussion regarding how Bank X monitors risks using Open pages. Open pages are the Operational Risk Management system which contains the Process Based Risk and Control Identification and Assessment (PRCIA) framework and is used to:

- Capture risks
- Assess risks
- Monitor and report on processes
- Risks and controls
- Internal losses and external losses
- KRIs
- Risk Scenarios

Open Pages is the data base where all risks are captured by all business units within the organisation.

5. Conclusion

Risk is everywhere whether it be internal or external, what is significant is how an organisation prepares for it, as risk is unpredictable and uncertain and can occur at any given time. Organisations prepare for risks even if they do not transpire, they do this by implementing certain controls and processes involving continuously monitoring and reporting. If an organisation implements the six steps in the risk management process, and everyone within the organisation from top to bottom understands the purpose and importance of risk management the entire organisation will benefit. There are many frameworks and models an organisation can implement, however at the end of the day what matters is what the organisation does with the information that they collect, how do they utilise it and implement it to better the current risk controls of the organisation. Enterprise risk management is entrenched in most organisations, for an organisation to thrive and remain competitive they need to ensure that all risks affecting an organisation have been predicted and treated. The main objective of this assignment was to provide an understanding of what risks management is and how Bank X incorporates the theory into their risk management system called Open Pages. It is vital to have a system that speaks theory and is a centralised point for the collection of data it allows for accurate reporting when there is one centralised system for capturing of risks. Risks usually emanates from external and internal factors both locally and internationally and therefore it's important that organisations constantly monitor new risk that emerge. ERM should ensure that policies and regulations are constantly updated and incorporated within the Banks ERM framework. Risk is an ongoing threat and if an organisation implements the systems and processes discussed throughout this assignment, the organisation should be resilient enough to survive unscathed.

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Biography

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