Chapter-5

Inferences & Conclusions
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INFERENCES AND CONCLUSIONS

The research was conducted with the problem statement of “A Comparative Study of Implementation of Basel II Accord and its implication in Indian and U.A.E. Banking Sector”.

Basel II is a response to the need for reform of the regulatory system governing the global banking industry.

The purpose to conduct a study on the implementation and the impact of Basel II in two different countries was to understand whether environmental differences have an implication on various related issues.

For this purpose a study with exploratory design was conducted which covered secondary as well as primary data. On the basis of observations made the following inferences could be drawn:

5.1 Inferences

1. Banks are still living in a protective shell: While collecting the primary data for the study, the banks were reluctant to opine, share views, give information about their preparedness for Basel II and the current status in that context. At the one hand, the back office operations are being outsourced, the banks are keeping curtains on the less sensitive information despite being assured of confidentiality. As a matter of fact, the study was planned to be a conducted as a survey covering the entire study universe in both the countries, however, owing to reluctance of banks to participate, finally the study was finally conducted using convenience sampling technique only. Among those who responded, the aspect of Basel-II posing greatest concern for industry was found to be Pillar III (83.3%) which is concerned with sharing of information implying that it's not going to be easy to change
the tradition conservative approach of bankers to conceal more and reveal less. There are still apprehensions amongst bankers that disclosure of information may affect their competence (mean score 2.333±0.922).

2. **Banking universe is open for all players:** Today, ownership restrictions on banking operations are no more existing, both in UAE and India, the ownership of banks is diversified, there are private banks, public sector/government banks, cooperative banks while leaving room for the foreign banks too. The era of nationalisation of banks seems to be a forgotten story, now the rule is for efficiency and performance.

3. **Much demand for Improved Risk Management:** Today, market forces govern the business – there is a solution for each demand. As regards the risks in the financial world, everybody wants a cover against it. It was observed during the course of study that even making the preparation for Basel II improved the risk management as it helped people to think about the potential areas of risk.

4. **Operational Risks: Cause of much worry:** As far as the level of concern of the banks was concerned operational risks under Basel-II attracted greatest concern. This implies that the banks who participated in the study are still not clear about the various safeguards provided by the Basel II on the issues of operational risks. Being relatively a recently covered area under Basel II, its efficacy is not fully understood by the respondents.

5. **Banking is going to be more competitive:** Majority of respondents feel that banking is going to be more competitive in future as the main impact of Basel-II. Given the huge costs that one has to bear for implementation and adaptation to Basel-II, the smaller banks are
apprehensive of being affected and are trying to make themselves competent in the changed environment.

6. **Much more to do to understand the concepts:** Very low scores for the items related to complexity (2.33±1.18) indicate that the very basic concepts of Basel II are not well understood by the banks. Structuring of almost all the processes and business operations by banks, which usually were subject to discretion earlier, apprehends the banks about its complexity, though with the use of modern information technology tools, it's going to be too easy, rather than being complex.

7. **Lack of right people for the right job:** Basel II seems to be a complex riddle for the banks which though they are determined to solve, however as yet they have not even identified the problem (as depicted by low scores for identification of processes), leave apart the task of finding the right person for the right job. Use of third party/specialized personnel to analyze the market risks is below the desired levels.

8. **Credit Adjudication – A Paradox:** With the confusing risk weight calculations (for *e.g.* for a corporate house rated Below BB- the calculated risk weight is 150% while for an unrated corporate house the same is 100% which is equivalent to those rated as BB+ to BB-, then why will one go for ratings at the first hand?), that's why there are too low scores regarding the relevance of credit adjudication processes (2.500±1.167). Assigning objectivity to each credit seems to be distant dream in an economy like India – is it going to be more discretion (mean score 2.233±0.922) rather than objectivity that is going to rule the roost.

9. **From where the money will come?** One of the key areas of concern emerging in the study was adequacy of financial resources (1.83±1.29), with the global recession on, there is concern regarding the stressed resources.
10. **Risk Management Processes still far from desired**: Very poor scores (1.433±1.104) were obtained for the item adequacy of risk management processes implying that despite much brouhaha about Basel II being an effective tool to manage the risks, the risk management processes as embodied in Basel II accord are being felt to be inadequate by the banks in India and UAE. This may be due to environmental differences between the Asian and Global banking.

11. **Financial Crises – No one can predict**: Asian tigers were humbled within a day, mighty Americans within a span of three weeks, with that kind of history, the burgeoning economies touching the nadir in a short span of time, no-one thinks that Basel II, in any case, is going to be a safe bet against a financial crisis.

12. **Credit Derivatives – Still a distant dream**: Dealing in credit derivatives helps in utilization of resources as well as mobilization of resources, but the complexities, associated risks, restrictions by regulatory authorities and lack of knowledge about its practical implications make credit derivatives still a distant dream.

13. **Trident of Statistics, Data sufficiency and Modeling**: Very low scores for statistical modeling for implementation (1.833±1.206), inadequacy of availability of data these are the main blockers in the path of achieving the goals of Basel II. In statistical tools, the forecasting is based on historic evidence, in the absence of adequate database, the statistical modeling will be adversely affected and will be lacking its effectiveness.

14. **Environment Plays a role**: As regards the issues related to clarity of the concepts and preparedness, the mean scores for items complexity and provisions for risks adding to costs of operations, the Indian banks seem to have significantly higher positive responses as compared to the banks
in UAE, thereby underscoring the significance of environment, however, in case of issues related to relevance of Basel II, its impact and benefits in two different environments the item wise differences were more pronounced showing shifting of swings from item to item in either direction, the mean scores for relevance of credit adjudication and relevance of capital allocation processes had significantly higher positive scores as compared to those in UAE while for items such as adequacy of risk management processes, relevance of risk management processes, increase in liabilities of staff on personal level, increase in personal discretion, disclosure of information affecting competence, reduction of risk with specified provisions, environment not suitable for development of credit derivative markets, UAE banks had significantly higher positive scores as compared to banks in India. However, on the issue of implementation status and acceptability no significant difference between the two environments, thereby implying that despite readiness, preparedness, impact assessments and perceived notions about benefits – there is still confusion while implementing the accord.

15. **Does ownership matter?** Most of the times yes! As regards basic understanding of concepts and preparedness the foreign banks seem to be have higher understanding than the government and private banks, in this regard government banks seem to lag much behind. On the issues related to relevance of Basel II, its impact and benefits too foreign banks take the lead while government banks and private banks assume the second fiddle for different items. On the implementation and acceptability front too the foreign banks are on the driver's seat while private banks are on the pillion seat, as regards government banks they can be said to be following the former two on a bicycle.
5.2 Conclusions

1. The study pointed out that there is lack of complete understanding on the main spirit of New Basel Capital Accord through the three pillars specified in the Accord and their implementation in the Banks across India and UAE is half-hearted, for which understanding of the concepts, financial resources, inadequacy of data and prevalent practices related to risk management and credit adjudication are responsible.

2. In both the countries, regulatory authority is exercising greater controls, though in UAE, the grounds are not open for private banks as yet. Though UAE lacks a rich history of commercial banking as compared to India, yet the practices adapted by it and progress made by it are outstanding. Still banking on the burgeoning oil economy, the UAE banks have lesser experience of facing the market adversities as compared to Indian banks. The regulatory guidance of the Indian banks was driven for a long time by the emphasis on long time apart from being a part of mixed economy. However, the common things between these two nations' economy and banking systems may be that both systems are working towards achieving a stable economy.

3. Major areas of concerns/obstacle in respect to implementing the Basel II in the banks with special reference to commercial banks in India and UAE were related to lack of clarity about basic concepts, lack of financial resources, apprehensions regarding dissemination of information leading to competitive disadvantage and doubts related to relevance of various provisions in the Basel II accord, inexperience of working with a systematic and structured approach was also one of the major impediments.

4. Most of the banks in India and UAE follow the standardised approach as per the guidelines of the regulating authority to cover the operational
risk, credit risk and market risk; being it a relatively new field, they are not yet using the more advanced tools, for lack of experience as well as resources – both financial and manpower. However, in the long-term they are inclined to use more sophisticated and advanced tools too; Pillar II of Basel II accord in terms of preparedness and implementation seems to be have no strong hold on the ground, there are a number of laggards both conceptual and perceptual, as well as adequacy of resources and pressure of meeting the deadlines – the building blocks of the Pillar II are being stacked hastily without giving them a concrete basis on which they can strongly hold the weight of the changing banking scenario of tomorrow. As regards Pillar III of the Basel III accord is concerned, there is almost no inclination towards implementing this in its true spirit. The long history of concealing than revealing cannot be changed in a day – meeting the deadlines in this connections seems to be one of the most difficult tasks. It's yet immature to forecast business benefits in such atmosphere filled with utmost confusion and uncertainty, half heartedness and meeting the time frames.