Chapter-6

Recommendations & Suggestions
**RECOMMENDATIONS & SUGGESTIONS**

On the basis of the analysis of the primary data and review of secondary data, the following findings, recommendations and suggestions have been made. At the end of the chapter the impact of Basel-II framework implementation on different stakeholders and limitations of the study have been highlighted and finally the direction for future research has also been given.

### 6.1 Findings & Recommendations

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| 1.    | **Major Industry Concerns - Complexity, Risk coverage and Pillar III** | 1. As Basel II utilizes the advanced statistical modeling tools, which are relatively new to use, appropriate training should be arranged by the regulatory authority.  
2. The distinction between use of traditional methods of risk coverage and those proposed by Basel II should be made emphasizing the evidence-based superiority of Basel II models.  
3. Pillar III is basically concerned with Financial communication and market discipline for which Regulatory authority should make strict rules with constant audits/monitoring. |
| 2.    | **Enhanced competition**      | Newer areas / markets for financial institutions should be identified, awareness regarding importance of quality of service rather than just quantity of service should be created. Banks should understand the relevance of untraditional banking, niche marketing, etc. |
| 3.    | **Low Scores on Basic Understanding of Concepts** | Indian Banking Association should include Risk Assessment in Context to Basel II and Financial Communication and Market Discipline as two papers in its curriculum, etc. |

*Foreign banks having*
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<td></td>
<td>relatively higher scores</td>
<td>Associateship examinations. Similar action is also recommended for the appropriate authority in UAE (Emirates Institute of Banking &amp; Financial Studies) as the situation was similar in both the countries. Inclusion of foreign bank executives as instructor for CAIIB and Banking Diploma programmes in respective countries.</td>
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<td>4.</td>
<td>Relevance of Basel-II, its impact and benefits</td>
<td>In training itself, use of simulated modeling, situational analysis, case studies should be exhaustively done. To promote and create awareness, a special periodical should be published, wherein the contributors should be encouraged to present their views on different aspects of Basel-II. A toll-free help-desk should be established by the regulatory authority wherein doubts related to various aspects of Basel-II could be removed. On the branch levels, Problem Based Learning Model facilitated by Peer Group should be adapted with meetings at a regular interval. A reward system at circle/zonal levels for the branches providing maximum/best solutions should be started. In India, the impact in terms of enhanced personal responsibility and liability is much pronounced – it simply underlines that currently in India banking sector jobs have become less attractive owing to enhanced responsibilities and low remuneration – with increase in responsibilities and liabilities – proper compensation should be ensured. For private banks, a mandatory training programme is recommended at each level, compliance to which should be monitored strictly and should be incorporated in the personnel appraisal system too.</td>
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<td><strong>adequate acceptability on physical facility creation</strong></td>
<td>facilities and forgetting the intellectual facilities, in contrast it depends on use of more of intellectual abilities and thereby reducing dependence on physical facilities. Keeping in view the above observation, Banks should try to attract the best intellectual talent in their fold. Establishment of professional institutions specifically targeted for banking sector should be given priority. Collaboration with existing institutions such as those related to Risk Assessment and Management should also be enhanced with special emphasis on development of curricula for different levels of banking professionals. Study of the practices of foreign banks should also be conducted in order to learn from their experience.</td>
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<td>6.</td>
<td><strong>Low scores on Pricing and Implementation Strategy</strong></td>
<td>Better coordination between various channels involved in strategic decisions will result in having a better pricing and implementation strategy. Both for pricing and implementation issue coordination upto branch level is also necessary. Use of better communication technology is the key. Structuring the pricing processes will reduce reliance on decisions on discretion basis, rather it will result in timely responsiveness to changing environment. UAE banks have better pricing strategies as they were thriving in a burgeoning economy, where they could have charged price for each service offered by them, an international exchange programme will help in understanding the issues involved in determination of a pricing strategy and them applying them effectively.</td>
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<td><strong>Relatively higher scores of UAE banks on pricing strategy.</strong></td>
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6.2 General Suggestions

1. Creation of Awareness, clearing concepts, education regarding the benefits of Basel II implementation should be done more intensely by the appropriate authorities.

2. All the stakeholders should be made aware that risk management should be viewed as an opportunity to increase shareholder value and not just as a loss-avoidance technique.

3. A comprehensive plan of action to capture risks not captured under Pillar I should be made in order to recognize the indigenous risk effectively.

4. The regulatory authority must provide detailed guidelines and facilities for successful implementation, not only targeted towards creation of physical facilities and IT solutions rather on the acceptance aspect too.

5. As the basic understanding of Basel II is still unclear amongst the bankers, the steps towards implementing it might lack the right direction, an effort should be made to clarify the basic concepts.

6. Basel II must be viewed as an ongoing process for improvement, which is not the end but a beginning in the direction of minimizing the risks and enhancing the total value.

7. A centralised database should be created with mandatory updation by all the banks.

8. There is a need to change the legal framework substantially for speedy liquidation of collaterals of defaulters.

9. Workshop, seminars and conferences for motivating and changing the mindset of concerned persons should be organised to ensure the pillar III implementation.
6.3 Challenges Ahead

I. Meeting the Deadlines: Basel II implementation is a time-bound process involving fulfilment of each stage in the given time frame. As in present study, it was revealed that status of preparedness for implementation is beyond satisfactory level in majority of banks in either country. Thus even if creation of physical resources for implementation is complete by the specified date, there are doubts that the system so developed will be fulfilling the very objective of the Basel II i.e. reducing the financial risk and making the banking safer for the common man.

II. Implementation of Pillar III: Though both in India as well as in UAE, the banking industry is highly regulated financial industry, yet in both countries the traditional approach of concealing more and revealing less is in regular practice, thus naturally there are more doubts than confidence that the implementation of Pillar III will take place smoothly.

III. Enhanced reliance on Superior Intellectual Inputs: Basel II is the start and not the end to better banking practices with reduced risk, however, in highly dynamic environment in which the banks have to function, the nature and magnitude of risk will be changing thus giving rise to requirement of high intellectual inputs who are conversant in assessing the changing environment and who can determine the course through which the banks can respond to changing environment. This needs both use of human intelligence as well as artificial intelligence (information technology).

IV. Capital Requirement: Due to additional capital charge for operational risk and increased capital requirement for market risk, the scarcity of resources (of raising capital) will add to the existing competition of
business growth. Highly rated corporates (needing lower amount of capital) may exert pressure on already declining interest spread.

V. **Collection/Compilation of Data:** The models under advanced approaches require a lot of historical data. However, with no data warehouses in the banks (especially public sector banks), collection of data is a formidable task.

VI. **Differentiation and Distinction:** In the growing competitive environment being ruled by a common regimen of risk management, the burden of being different from others and distinct will be falling on the banks, especially small and middle banks will have to work hard to maintain their distinct identity.

VII. **Litigation Processes:** With the litigation processes taking too much of time, the liquidation of collaterals is often a big challenge for the banks. In a model where everything has to be weighed and counted, the uncertain and unending litigation might work as a factor with no weighted risk, hence to make the legal systems speedier and effective amendments in law are also a big challenge for the banks.

VIII. **Limited Rating Agencies:** The risk associated with credit is often dependent on the rating of the borrower. While calculating a risk under Basel II regimen, it is one of the major criteria. However, in UAE as well as in India there are no/limited credit rating agencies to perform this task.

IX. **Market for Credit Derivative Products:** For effective management of credit risk and to get full benefit of risk mitigation evolution of developed market for credit derivatives is necessary. However, both UAE and India do not have direct markets for credit derivative products.

X. **Technological Challenge:** No single IT supplier can provide all-round risk management solutions. However, 100% internal development may
be too costly because risk management methodologies tend to involve complex computation. Integrating various external systems into one platform is the major challenge. Flexible customisation of external systems is important. Risk methodologies and business processes are evolving. The technologies adopted must be flexible for future changes.

6.4 Impact Assessment

The impact of Basel-II has been tried to be explored in two directions:

I. Impact on Banking industry

II. Impact on Environment

I. Impact on Banking Industry

Impact on banks has been explored in functional terms. The impact assessment has been done by using observational technique on the basis of primary as well as secondary data. The impact study has been divided into three parts:

1. Impact on Human Resources

2. Impact on Marketing

3. Impact on Finance Function

1. Impact on Human Resources: There would be a drastic change in human resource structure of the banks. From the earlier emphasis on having more clerks, more authoritative officers in a bureaucratic system will be replaced by a highly skilled executives and intelligent decision-makers working in a transparent system. Prior to implementation, the roles of the personnel were not clear, their discretionary powers were high, thus the personnel are going to lose their discretionary powers, earlier the responsibilities were not clear, but now the responsibilities are quite clear, roles are much clearly defined, however, there is an apprehension amongst the workers that with the responsibilities being
clearly defined their job will not be secured. Thus there is an uneasiness amongst the banking sector. At the same time losing discretionary powers for some people means loss of authority. The growing emphasis on use of information technology and modern communication technology, the middle aged employees are feeling uneasy owing to their belief that they cannot adapt to the change. As a matter of fact, every change is followed by some resistance, which can be seen in the uneasiness of the bank employees. Apart from those who are currently employed the job description of the employees has also changed radically. Now the emphasis is more on having people with higher intellectual abilities. With the processes becoming structured, the older emphasis of having clerks for every other job has been shifted to one who can decide. Now the focus is not on doing alone rather the focus has shifted to doing it efficiently with the use of intellectual abilities of a person. The impact on human resources would be visible in a positive manner once the transition phase is over as the banks will now be having people with better intellectual ability and who are more ready to take the responsibility and then living upto it.

2. Impact on Marketing Function: Everyone is agreed that implementation of Basel-II accord will eventually lead to growing competition amongst the banks. Growing competition means taking the marketing aspect more seriously. One will have to always look for new markets, new offerings, newer ways to express and distinguish oneself from the others. Banking is not going to be same after Basel-II framework. You can see niche banking, “Banks for Ladies”, “Banks for Children”, “Banks just dealing with Consumer Finance”, “Banks specializing in Asset Management” and so on. No wonder if next time you go to a bank you can get your favourite pizza too. Banks will have to adopt newer marketing strategies to attract new customers while at the
same time it will have to respond to the marketing strategies of the competitors in order to retain its existing base of customers. But how can we say that it will only happen because of Basel-II, simply because with the structuring of processes, adopting similar strategies to measure the risk, adopting similar credit adjudication processes, one cannot expect to distinguish oneself from the others, rather it can differentiate from the others not from what it does but how it does the same thing.

3. **Impact on Finance Function:** With the capital adequacy being boldly underlined in Basel-II framework, it is obvious that the banks will be at first going to suffer some crunch of resources, however, with that particular aspect becoming the feature of entire industry, there is no competitive disadvantage. At first there would be some crunch in liquidity of banks owing to capital adequacy clauses. However, in the long-term with the coverage of risk with this capital, efficient adjudication of non-productive assets, the liquidity will be restored. Currently a large chunk of banks' assets is blocked in so-called non-productive assets, which Basel-II proposes to wipe out completely. Eventually, the days of hardship are counted while the silver lining is quite evident in long term.

II. **Impact on Environment**

The impact on environment has been studied under three major heads:

1. Impact on Regulatory Authority/Government

2. Impact on creditors

3. Impact on depositors and Shareholders

1. **Impact on Regulatory Authority/Government:** Basel-II has defined the roles of regulatory authority and government more clearly. In order to facilitate a better environment, these two have to be always on
constant move. For ensuring proper liquidity and adjudication of non-productive assets, the regulatory authority/government will be required to provide enough legal framework under which the banks can reduce the burden of bad debts and liquidate the collaterals in order to survive and work competitively. In the growing competition, the regulatory authority/government will have to play the role of a "watchdog" to ensure that no malpractices take place in the name of competition. The regulatory authority will have to also monitor and check the compliance of Basel-II framework, especially the aspects related to Pillar III.

2. **Impact on Creditors:** The creditors will have to have better credentials than ever, however, having better credentials this time will also prove to be advantageous. The credit processes being structured, well-defined, objectively screened and being transparent would ultimately result in a better deal for the creditors. The days of credit adjudication taking months are going to be counted. Now one will oneself knowing one's credit worthiness. Finally, the creditors are also going to gain.

3. **Impact on Depositors & Shareholders:** With the risks being minimized, operations being smooth and information being available transparently, it is the depositors who are ultimately going to get benefit. With the short span of transition from older system to Basel-II, where the depositors and shareholders might have to face some dark phases owing to strain on capital and change in procedures, finally the Basel II framework is going to provide them more returns.

6.5 Limitations of Study

There have been few limitations to the study which are described as given below:

1. The reluctance of bankers to participate in the study had been a limiting factor in conducting this study as a survey, and the same has to be done only
using sampling technique only. Inadequate representation of all types of
ownerships in both the environments is also a limiting factor.

2. The study has been academic in nature. Hence, the sample size chosen has
been one based on feasibility. The study could been more extensive.

3. The sample size chosen for the study could be a limitation.

4. Lack of availability of published books in UAE libraries has been a
handicap.

5. Time and cost have been limiting factors.

6.6 Conclusion

Though transition phase does not seem to be smooth, it does not mean
that there is no desire to change and reach to a better situation. Despite some
laggards, in principle the Banks are readying themselves to be more responsive
in a fast changing world. We can only expect a better banking environment in
the years to come.

6.7 Direction for Future Research

It therefore seems an ideal time to gather additional empirical data and
start assessing the real impact of introducing Basel II on developing
economies; this would, for example, give elements to evaluate whether (or
which) of the problems listed above, or more broadly in the literature, are
emerging as really important. This would then provide a strong base to make
policy proposals for both modifying Basel II, its implementation in developing
economies, and – where this is not feasible – calibrate the need for
compensatory policy actions. This may provide even additional empirical basis
for elements of a proposal for a development and financial stability friendly
Basel III. With this new empirical evidence and proposals for a Basel III,
researchers, civil society and developing country regulators could more
forcefully demand international changes, as well as take more targeted policy actions.

To limit the scope of the analysis, it could focus on two or three developing economies with different characteristics (e.g. relating to scale of presence of foreign banks, economic size, others). Data could be obtained from a variety of sources – the BCBS itself, national Central Banks or bank regulators, IMF, or in some cases even the banks themselves. Institutions like the Association and the IMF have offered to provide data.

Related research could examine the political economy of trying to achieve change in Basel II. This research could compare successful attempts of changes (like the improvement treatment for SMEs achieved after lobbying by certain developed country governments) with attempts that have not yet yielded sufficient fruit (such as trying to introduce benefits of international diversification, supported by academics and several developing countries or measures to smooth pro-cyclicality). The study would be carried out jointly by an economist(s) involved both in the analysis of the issue and in the lobbying and a political economist who could carry out the analysis of bargaining power, political context etc. It could draw on personal experience of the researchers in the dialogue with BCBS, country regulators and banks, review available written material and in-depth interviews with key actors in the negotiations, several of which are known to the researcher. The results of the study would not just be of academic interest, but, by linking quality of outcome within Basel II to representation on the BCBS, could provide a powerful analytical and lobbying tool for modifying the governance of the Basel Committee Banking Supervision. More ambitiously, it could help provide a model for analysing the link between quality of decision-making in international financial institutions or committees with the bargaining process and especially with the underlying governance structure of those institutions.