RBI switches 30 banks to risk-based supervision

The Reserve Bank of India, scrapping its age-old practice of CAMELS inspection, has switched 30 banks to risk-based supervision, indicating what could be the beginning of the regulator's micro management of banks.

The CAMELS (capital adequacy, asset quality, management, earnings, liquidity, and system & control) framework was developed in the early 1970s by the US Federal Reserve to assess the health of a bank.

Under this, banks were rated largely on financial parameters and performance. Post the 2008 global crisis, regulators across the world have begun shifting to risk-based supervision to ensure banks do not take undue risks to maximise profits and boost performance.

"In the inspection for the financial year 2014, the RBI identified 30 large private, foreign and public sector banks that were put through the risk-based supervision," said the MD and CEO of a private sector bank.

"Senior supervisory managers, or SSMs, from the RBI have been scrutinising the banks' books. They are focused on risk framework and capital comfort of the bank. They are looking at credit, market, operational and management risk. The SSMs are also studying the composition of bank boards and commenting on them," he said.

Former RBI deputy governor KC Chakrabarty in 2012 had submitted a report on the review of supervisory processes for commercial banks, and had suggested replacing the present compliance-based and transaction testing approach (CAMELS) with the risk-based supervision (RBS) system. Several jurisdictions across the globe have adopted variations of the risk based supervision.

The RBI had, in the past, made several failed attempts to migrate to the RBS supervision. It had first tried to introduce it in 2003-04, but the banking system wasn't up to it.

"The primitive risk management systems at banks, low levels of technology, inadequate human resource capabilities, and above all, lack of patronage from the board and top management were amongst the primary reasons that led to stalling of the project in our maiden attempt," admitted former RBI deputy governor Chakrabarty in a speech in March last year.

"In risk-based supervision, there's no emphasis on earnings and focus is on the process and policies that a bank adopts to achieve growth," said the chairman and managing director of a public sector bank.

"Under CAMELS inspection, a bank could attain high rating based on earnings, but if it was taking undue risks to achieve higher profitability, it could expose the bank to operational risks," he said. "RBS will bring uniformity in reporting but would enable RBI assess and manage individual banks based on its risk profile and capital levels," the CMD said.

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