# Risk Tolerance Framework in the Reserve Bank of India

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Rohit P. Das
General Manager
Financial Risk Division
Risk Monitoring Department
rohitpdas@rbi.org.in

# *The outline*

- **ERM in the RBI**
- **Risk Appetite: Relevance to a central bank**
- **RBI’s approach to the RTF implementation**
- **Challenges abound**

*Note: The views expressed in this presentation are solely those of the presenter and do not necessarily reflect the views of the Reserve Bank of India.*

# *ERM in the RBI*

- RM in the RBI is as old as the institution itself (if not older)

- 2012 – ERM being implemented for strengthening internal RM systems

- Aimed at identifying, assessing and *managing risks within its risk tolerances*, so as to provide reasonable assurance regarding the achievement of objectives

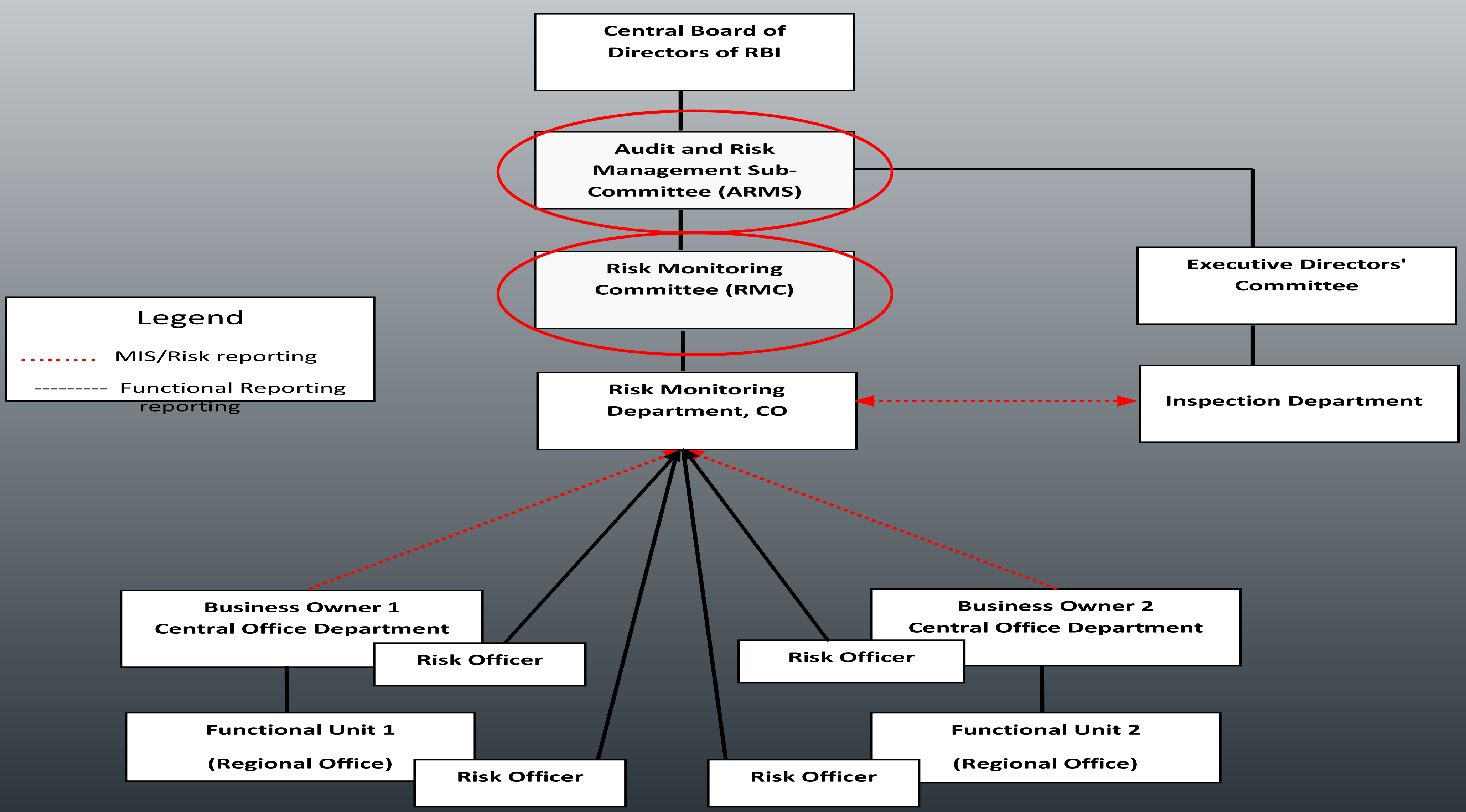
- Phased approach:

  - Phase-I: Focused on moving from silo-based approach to integrated RM approach – strengthening risk governance, ERM policies, developing a balance-sheet risk perspective, Top 10 risks, risk and incident reporting, risk registers, risk culture

  - Phase-II: Roll-out of a formal Risk Tolerance Framework in the RBI

  - Phase-III: Shifting of MO to RMD (?), greater role in Policy Risk

# Role & Responsibilities in the ERM



# ***Risk Appetite: Relevance to a CB***

- Risk appetite is *"the amount of risk that an organisation is willing to accept in the pursuit of its mission, vision, business objectives and overall strategic goals"*

  *(Source: IORWG)*

- Risk Limits are *series of limits which may either be set as not to be breached, or as an alert/early-warning mechanism. Tolerance may be limited by legal or regulatory requirements*.

  *(Source: IORWG)*

- As a public policy institution, can a CB decide on which risks it wants to take and how much, if public interest are involved?

  - CB losses involve costs to the public exchequer – in the form of recapitalisation expenditure, reduced transfer to the Sovereign

  - Certain losses may be more acceptable than others. RTFs articulate this prioritisation.

  - Where the *Principle of Public Policy Predominance* applies, the public objectives are treated as binding to be achieved, while minimising risks

# *RTLs are already all around us….*

- Policy Risk – Leeways in the flexible inflation targetting mandate
- Market Risk - Leeways in the duration/ currency benchmark, VaR limits, etc.
- Credit Risk – Counterparty limit, country limit, issuer limit, issuance limit, etc.
- Liquidity Risk – limits on illiquid holdings, etc.
- Operational Risk – All risk limits, but not quantified in money terms
  - Downtime of IT systems
  - RPO, RTO in Business Continuity
  - Losses acceptable in certain currency operations
  - Differentiation in supervisory inspection cycles
  - Punctuality norms
  - Monitoring period of pending letters

# *RBI's expectations from the RTF*

- It shall reflect and communicate the organisation's risk philosophy;
  - Through the Risk Tolerance Statement

- Be the cornerstone of the broader risk framework, which integrates risk management into the corporate strategy, thereby prioritising risk management on the key risks;
  - Through the articulation of the public policy preferences
  - Detailed risk assessment of corporate objectives/ strategic plan and laying down appropriate strategies

- Provide appropriate risk parameters to govern decision-making across all businesses and risk types;
  - Translation of the Risk Tolerance Statement to risk limits

- Strengthen risk reporting and facilitate a more effective control structure
  - RTF reporting framework

# …RBI's approach to the RTF

- Not to re-invent the wheel –
  - Discuss with other CBs & Business Areas (within RBI) and learn from their experience
- Articulate the Risk Tolerance Statement to bring out our risk philosophy
- Review of RTLs along with BAs to assess:
  - Whether RTLs are required in view of PPPP
  - Review whether in consonance with (i) objectives for which operations are being carried out and (ii) international best practises
  - A thought on Operational Risk
    - Articulate quantitative limits only where applicable
    - OR events in CBs can cause losses far greater than what may be reflected on the CB's B/S e.g. Through systemic disruption due to RTGS failure, lack of adequate skill-sets in policy/ supervisory/ specialised departments, reputation risk, etc.

# *RBI's approach to the RTF*

- Risk Reporting Framework
  - Unifying the incident reporting and reporting of RTL breaches
  - EC reporting mechanisms
  - Reporting of RTL breaches

- Review of Roles & Responsibilities of key stakeholders
  - Particularly, the relationship between the Audit & Risk Management Sub-Committee and the SAA setting body on the RBI

- Tying it up with the risk provisioning framework (ECF) of the RBI

# *Challenges abound…*

- Avoiding re-inventing the wheel - Don't fix what isn't broken, formalise it
- Establishing new working relationships between the risk function and other governance structures/ BAs
- Integrating disparate risk limits built up across the organisation, over decades under a uniform framework
- Translating the Risk Appetite into risk limits, where the extant risk limits are inadequate
- Getting acceptance for the framework across the organisation - ingraining it into risk culture

***Thank You***