Swaminathan J: Supervision amidst emerging risks

Opening remarks by Mr Swaminathan J, Deputy Governor of the Reserve Bank of India, at the "High-Level Policy Conference of Central Banks in the Global South", organised by the Reserve Bank of India as a part of commemoration of its 90th year, Mumbai, 22 November 2024.

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Esteemed delegates from across the world, respected Governor, Deputy Governors and all my colleagues from the Reserve Bank of India, ladies and gentlemen. A very good afternoon to you all.

It is indeed my honour to deliver the opening remarks before such a distinguished panel comprising Dr. John Mushayavanhu, Governor, Reserve Bank of Zimbabwe; Mr. S. S. Mundra, former Deputy Governor, RBI; Mr. Jay Surti, Division Chief, Financial Supervision and Regulation Division, Monetary and Capital Markets Department, IMF; Mr. Krishna Sastry Pendyala, Partner, Cyber Security, E& Y and the moderator for the panel, Mr. M. Nagaraju, Secretary, Department of Financial Services, Government of India.

The supervision of banks and financial institutions, as we understand it today, is a relatively recent development-dating back around fifty years[1]. However, the concept of overseeing banks is embedded in the very foundations of central banking. From the early days, central banks have fulfilled their role as the lender of last resort, ensuring that financial institutions remained solvent and protected against systemic crises. Indeed, supervision has been the keystone[2] that has supported the integrity and stability of the financial system, by protecting depositors' interests, and thereby fostering trust in the banking sector.

As the world rapidly evolves, so does the nature of risks confronting the financial sector. Technological advancements have brought incredible efficiencies but also significant vulnerabilities, such as cybersecurity threats and risks stemming from third-party dependencies.

Climate change, once considered a distant concern, now poses immediate and material risks to institutions and economies alike. Added to this are the complexities of geopolitical uncertainties, volatile markets, and shifting macroeconomic trends. Thus, the task of supervision has become more dynamic and critical than ever before.

Supervision, therefore, needs to evolve with the times and can no longer be just about enforcing compliance. Instead, it needs to anticipate risks, respond swiftly to both foreseeable and unforeseen risks and foster resilience in the financial system.

Let me take a moment to clarify what resilience means. While stability ensures that the financial system can withstand shocks without losing its capacity to function, resilience goes a step further. Resilience indicates that in addition to weathering the storm, the financial system is able to adapt to the newer realities and thrive in it[3] so that it remains a pillar of trust and stability.

To build financial resilience, supervision must be proactive, continuous, forward-looking, and risk focused. An effective banking supervision system requires[4] the supervisor to maintain a continuous, forward-looking assessment of the risk profiles of individual banks, aligned with their systemic significance. Supervisors must be able to identify, evaluate, and address risks both within individual institutions and across the entire banking system. This also includes having a well-defined framework for early intervention and clear contingency plans to ensure that non-viable banks can be resolved in an orderly and efficient manner. For that, supervisors must possess the resolve to act swiftly and decisively when necessary.

In recent years, we have worked to reposition the RBI's supervisory framework to better align with this objective. Our supervisory initiatives aim to identify risks and vulnerabilities early, establishing a structured framework for early intervention to mitigate these risks. We have shifted our focus from merely addressing the symptoms of vulnerabilities to identifying and addressing their root causes, while also harmonizing supervisory rigour across various segments of the financial system.

We have designed and implemented a Calibrated Supervisory Approach, which provides the flexibility and scalability needed to focus more effectively on high-risk institutions and practices. At the heart of this approach is a proactive off-site surveillance mechanism that enables us to detect emerging risks and assess vulnerabilities across the supervised entities, ensuring timely action to mitigate or manage these risks before they escalate.

To further strengthen our supervisory capacity, we are also investing in initiatives such as the College of Supervisors, which seeks to enhance the skills and expertise of our supervisory staff. In addition to building capacity, we are increasingly focusing our efforts on improving the risk and compliance culture within supervised entities, ensuring that these institutions not only meet regulatory requirements but also foster a proactive, robust approach to managing risk and compliance at all levels.

While we, as supervisors, strive to perform our duties to the best of our abilities, it may be worthwhile to recall what Charles Goodhart aptly said[5], "-the conduct of supervision is a thankless task, one that is all too likely to tarnish the reputation of the supervisor. The best a supervisor can hope for is that nothing untoward happens. Supervisors are only noticed when their actions anger the regulated entities, whether through restrictive or intrusive measures, or when they are criticized after a failure, such as a financial institution collapse or customer harm. Despite the discussion around the need for allowing some degree of freedom for institutions to fail, supervisors inevitably face negative press when such events occur, regardless of the circumstances."

Be that as it may, to conclude, while the task of supervision may be challenging but it is also essential for ensuring the stability and resilience of the financial system. As supervisors, it is through our vigilance, proactive measures, and continued evolution of supervisory frameworks that we can create a financial environment where institutions not only survive but continue to thrive in the face of emerging risks.

As part of our vision for the next decade, RBI@100, the Reserve Bank of India aims to further engage with the central banks of the Global South. We are dedicated to establishing a global model of risk-focused supervision, one that emphasizes strong risk discovery and compliance culture, and builds a "through-the-cycle" risk assessment framework. Additionally, we are working towards creating a robust data analytics ecosystem to support our supervisory functions, ensuring that our approach remains forward-looking and agile in a rapidly changing world.

With these thoughts, I look forward to an engaging and insightful panel discussion that will explore the evolving role of supervision in the face of emerging risks. Thank you!

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[1] Masciandaro, D and M Quintyn (2013) "The evolution of financial supervision: The continuing search for the Holy Grail", SUERF 50th Anniversary Volume Chapters: 263-318.

[2] A keystone is the wedge-shaped piece at the crown of an arch that locks the other pieces in place

[3] Mary Dowell-Jones & Ross Buckley, Reconceiving Resilience: A New Guiding Principle for Financial Regulation?, 37 Nw. J. Int'l L. & Bus. 1 (2017). http://scholarlycommons.law.northwestern.edu/njilb/vol37/iss1/1

[4] Principle 8: Supervisory Approach of the Basel Core Principles states An effective system of banking supervision requires the supervisor to develop and maintain a forward-looking assessment of the risk profile of individual banks, proportionate to their systemic importance; identify, assess and address risks emanating from banks and the banking system as a whole; have a framework in place for early intervention; and have plans in place, in partnership with other relevant authorities, to take action to resolve banks in an orderly manner if they become non-viable.

[5] Goodhart, C.A.E. (2000). The Organisational Structure of Banking Supervision. FSI Occasional Papers, Financial Stability Institute, No. 1, November. pp. 20–21. Available at: https://www.bis.org/fsi/fsipapers01.pdf.