Emmanuel Tumusiime-Mutebile: Risk management in the banking industry in Uganda

Remarks by Prof Emmanuel Tumusiime-Mutebile, Governor of the Bank of Uganda, at the Banking Industry Stakeholders' Roundtable Forum, Kampala, 24 March 2010.

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Introduction

In the past decade, rapid innovations in the banking sector and the internationalization of financial flows have changed the face of banking almost beyond recognition. The changed environment in which banks find themselves today presents major opportunities for banks but also entails complex and variable risks which challenge the traditional approach to bank risk management. The situation is exacerbated by technological advancement and deregulation which have come with new arrays of banking risks. Traditional banking practice based on deposits and the granting of loans is today only one part of a typical bank's business and in the developed countries is often the least profitable[1]. Whilst these changes are necessary to satisfy customers' sophisticated needs, they have come with increased risks in the banking industry. What needs to be done is for banks to improve their financial risk management capabilities in order to survive.

Risk appetite

While there are increasing incidences of frauds in the banking industry, it is important to note that fraud is a derivative risk. Fraud occurs because either gaps exist in the organization's internal controls or the mechanism of monitoring such controls is compromised. In this regard, as bankers, we must revisit our appetite of taking on high risks in anticipation of high returns. Prudential balance between the risks and potential returns to shareholders and safety to our depositors' funds should always guide banks in the conduct of banking business. However, this does not preclude action by the authority on other external factors like provision of an adequate legal framework and a national identification system.

The role of Bank of Uganda in risk management in financial institutions

As Bank of Uganda we have, on a continuous basis, issued risk management guidelines to the Supervised Financial Institutions (SFIs). The latest revised guidelines were issued in February 2010. At the centre of these guidelines is the importance of good ***"corporate governance"*** which stresses the role of the board of directors in setting the tone at the top. Corporate governance requires directors to play a significant rather than peripheral role in risk management in banks. In order to discharge this function the board must possess a reasonable knowledge of the risks specific to the entire spectrum of the bank's activities. Additionally, the Bank of Uganda is increasing its oversight surveillance capacity through new methodologies of risk based supervision. There are periodic off-site and on-site examinations of banks' performance based on internationally accepted benchmarks. In addition, the Bank of Uganda in its effort to mitigate risks in the banking sector introduced the Credit Reference Bureau (CRB) and we would like to request that all SFIs ensure that their borrowers register as this will create a database for managing some of the banking risks.

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[1] Hennie Van Greuning: Analyzing banking risk – a framework for assessing corporate governance and financial risk management.

Way forward

Given the challenges faced by the banking sector with respect to frauds, the measures envisaged to improve the risk management systems and maintain a strong vibrant financial sector could be twofold; those that can be done within the banking industry and its players, and those that can be initiated from outside the banking sector.

Internally, the banking sector players should rethink the strategy of elevating the level of scrutiny on their employees or what has become known as ***"Know Your Employee"*** or KYE. Available statistics indicate that most of the bank frauds are internally perpetrated by employees who exploit weaknesses / lapses within the organization. The electronic era has made life better for banks in the area of transaction processing and timely delivery of value but has also introduced new types of risks and exposures. Information systems that have an element of cyber or internet connection may potentially be open to the whole world and computer hackers have often used this route to cause financial loss to some financial institutions around the world. Additionally, Banks should enhance risk profiling of their customers. They should go beyond the traditional ***"Know Your Customer"*** (KYC) to Enhanced Customer Due Diligence (ECDD). Banks should be prepared to invest in the training of their employees so as to accumulate adequate human capital for managing those risks associated with the changing banking environment. Most importantly, banks much exhibit high standards of good corporate governance.

Externally, the dearth of punitive legislation has been sighted as one of the major factors promoting frauds. As long as fraudsters know that even when sentenced, their illicit assets remain intact, they will continue in this business. Enactment of laws like the Anti-Money Laundering Bill that provides for the seizure of such assets may serve as a deterrent. To facilitate faster administration of justice, the Government could create specialized financial investigative sections of police. The Government should revive its project of establishing common infrastructure like the National Identification Card to facilitate identification of customers.

I thank you very much for your attention.