RISK MANAGEMENT

Managing Risks and UNCERTAINTIES

Robust risk management policies, protocols and processes have enabled us to preserve and generate value for our stakeholders. In FY 2021-22, we initiated the process of expanding our risk management process to assess climate risks to help identify risks and opportunities arising from climate change.

0.64%
Net NPA

23.7%
Capital Adequacy Ratio

Material topic(s) covered

Minimising risk impact of climate change due to investments/ advances

We have instituted an Enterprise Risk Management (ERM) framework that lays the foundation for identification, assessment and management of risk. It facilitates the alignment of risk and capital management with business strategy. The ERM policy sets out the approach for risk management and is adopted by each company in the Group, with suitable modifications, as appropriate for their individual businesses. Our risk governance approach has a 'three lines of defence' (as depicted in Figure 3) structure, which ensures that risk is managed in line with the risk appetite as defined by our Board. The responsibilities for risk management at each line of defence are defined, thereby providing clarity in the roles and responsibilities towards the risk management function.

Our Group annually undertakes the Internal Capital Adequacy Assessment Process ('ICAAP'), which provides management with a view of overall risks, assessment and capital allocated to cover the risks. The ICAAP is linked to overall business planning and establishes a strategy for maintaining appropriate capital levels. The ICAAP outcomes are reviewed by senior management and formally approved by the Board. The ICAAP is periodically enhanced to include greater detail and more in-depth analysis.

Figure 1: Three Lines of Defence

1st Line of Defence	Risk-Taking | Business and Support Units
2nd Line of Defence	Framework, Oversight and Validation Support | Risk Management | Financial Control | Compliance
3rd Line of Defence	Independent Assurance | Internal Audit | External Audit

We have a Board-approved stress testing policy, which is aligned to regulatory guidelines and covers material risks. Stress testing is a key element of the ICAAP and an integral tool in the Risk Management framework as it provides management a better understanding of how portfolios perform under adverse economic conditions. Stress testing is integral to strengthening the predictive approach to risk management and supplements other risk management tools by providing an estimate of tail risks. During the year, the Bank was well above the regulatory and internal target capital ratios under all approved stress scenarios. Further details can be found in the Management Discussion and Analysis section in this Report.

Regular risk management education is provided to our Board of Directors. Along with the executive directors on our Board, three of our non-executive directors also have expertise in enterprise risk management. Further details on risk management including categories of risks assumed, independence of the risk management function, governance structure, risk categories, approach, controls, risk management metrics, stress testing, mitigation and management can be found in the Risk Management section of the Management Discussion and Analysis from page 259 onward.[6,7]

[6]GRI 102-30 | [7]GRI 102-15

RISK CULTURE

We are committed to creating a disciplined risk culture where risk management is perceived as a shared responsibility amongst all our employees. This is enabled through clear communication and appropriate training. A structured induction programme is in place to help new employees identify and mitigate business risks, providing insights on how risk management culture and practices support in building and strengthening the organisation. All our employees are required to be familiar with risk management policies relevant to their roles and responsibilities and are encouraged to escalate any potential risk issues to senior management on a timely basis. The risk culture in the Group emphasises on responsible business practices, prioritisation of customers' needs and appropriate disclosures. The business leaders and senior management receive regular updates on emerging risks for their respective business lines. Risk is a key consideration while formulating business plans and when launching new products. Further, performance review of senior management includes an assessment of risk management performance.
Details of risk culture can be found in the Management Discussion and Analysis section of this Report.

EMERGING RISKS

Geopolitical risk

Geopolitical risk is the risk associated with wars, terrorist acts, and tensions between states that affect the normal and peaceful course of international relations. It encompasses both the risk that these events materialise, and the new risks associated with an escalation of existing events. With uncertainty around international relations and political leadership, geopolitical risk has emerged as a significant risk across the globe. Geopolitical events are bound to create financial market volatility, delay in investment decisions and have an adverse effect on macro-economic outcomes. Geopolitics and regulatory uncertainty can have significant impact on markets at large as it could dampen the risk appetite of investors. There are no reliable historical streams of data that one can easily plug into a model to quantify geopolitical risks. Major geopolitical events can often arise quickly and unpredictably and originate externally, and therefore have limited mitigation options. We use Value-at-Risk (VaR) to quantify the potential price risk in the portfolio. This employs metrics like stressed VaR, and periodic stress testing to measure exposure to market movements. We also have a comprehensive market risk limit framework, including limits on sensitivity measures. Further, an enterprise-wide Early Warning Signal (EWS) framework for credit risk has been instituted in line with RBI guidelines.

Cybersecurity risk

Over the last 18 months, industries have undergone rapid digitalisation especially with the transition to remote or hybrid work environments, which has resulted in the growth of cybersecurity threats. This shift to remote work has accelerated the adoption of platforms and devices that allow sensitive data to be shared with third parties—cloud service providers, data aggregators, application programming interfaces (APIs) and other technology-related intermediaries. Lower barriers to entry for cyber threat actors, more aggressive attack methods and a dearth of cybersecurity professionals and patchwork governance mechanisms contribute to aggravating this risk.

As cyber threats continue to grow, insuring against such risks will become increasingly precarious, with insurers themselves facing retaliatory attacks for attempting to curb ransomware payments. Thus, when an attack occurs, businesses might suffer reputational, financial, regulatory and legal consequences of cyberattacks. Whether it be the personally identifiable information (PII) of customers or proprietary data that gives an edge over competitors, data exposure is a major issue. The impact of disruptive cyberattacks could be financially devastating for businesses that fail to invest in digital infrastructure.

We have established a programmatic approach encompassing a cyber-resilience framework to mitigate threats such as data breaches, malware, denial-of-service attacks etc. We conduct cyber drills to assess the effectiveness of prevention, detection and response controls. We have also invested in best-in-class IT infrastructure to proactively detect malicious behaviour or anomalies. Further details on our approach to cybersecurity can be found in the Governance section.

Climate risk[8]

Climate change has long been a matter of concern for regulators, policymakers and investors. It has emerged as one of the most pertinent risks especially for financial institutions. Climate change risks can result from the physical changes of future climatic conditions as well as due to economies transitioning towards a green and a low carbon future. These physical and transition-related changes also give rise to many climate-related opportunities. Recognising the financial institutions' crucial role in regulating the impacts of climate change, we have initiated a forward-looking, scenario-based climate risk and opportunity assessment in alignment with the Task Force on Climate-Related Financial Disclosures (TCFD) recommendations.

We are employing a two-pronged approach to understand the potential of climate-linked risks impacting our operations and portfolio. A physical risk assessment based on Intergovernmental Panel on Climate Change (IPCC) - Representative Concentration Pathways (RCP) scenarios 4.5 and 8.5 has been initiated. Projected changes in various climatic parameters such as temperature and precipitation are being studied under each scenario to identify risks such as health impacts on employees, increase in operating costs, infrastructure damage and/or service disruption.

In addition to assessing climate risks on our operations, we have also initiated an assessment of climate risks on select sectors in our corporate lending portfolio. For this, we are basing our analysis on Paris Agreement Capital Transition Assessment (PACTA) tool for Banks developed by 2° Investing Initiative. We intend to undertake the analysis in a phase-wise manner in select sectors from the select high emission sectors such as power, oil and gas and coal.

In addition, we also plan to utilise the scenarios provided by the Network for Greening the Financial System (NGFS) to assess the Probability of Default (PD) and Expected Credit Loss (ECL) due to climate risks and vulnerabilities in our portfolio. While these are the tools and methods being adopted for the current assessment, we would modify and adapt the framework for climate risk assessment based on publicly available information and advancement in measurement techniques from time to time.

The outputs from these assessments are expected to provide insights to inform our future decision-making and financial planning with regards to our operations as well as our corporate lending portfolio.

Climate change has emerged as one of the most pertinent risks, especially for financial institutions. We are employing a two-pronged approach to understand the potential of climate linked risks impacting our operations and portfolio.

[8]GRI 201-2

A few climate risks being considered for the climate risk assessment have been enlisted below:

Physical risks

Physical risks cover acute physical risks, such as extreme weather events, which could damage our operations or assets hypothecated as security.

Physical risks would also cover chronic physical risks such as a rise in temperatures, water scarcity, increased demand for energy due to climate events and rise in sea levels, which could affect both our and our clients' operations.

Transition risks

Policy and regulatory risks

Given India's growing policy interventions on climate, the Bank's exposure to companies subject to these evolving policies (such as strengthening energy efficiency schemes, Renewable Purchase Obligation (RPO), the introduction of carbon price) could act as a driver for increase in credit risk.

Reputation risks

In light of growing stakeholder expectations on ESG performance, failure to demonstrate enhanced climate action and relevant disclosures could have an adverse impact on our reputation.

Legal risks

With rising awareness of climate change issues, our borrowers might be exposed to increased climate change litigation, translating into increased credit risk for the Bank.

Technology risks

With new and advanced low carbon technologies impacting the overall cost of production and competitiveness in various sectors, exposure to companies that are unable to transition could result in increased credit losses.

Climate-related opportunities

While climate change could create the risks described above, there could also be opportunities for investments and lending to support the incremental capital expenditure in the transition period. Our risk assessment exercise will help us identify such opportunities in emerging sectors and technologies.