Risk Management Practices by Barbadian Banks

by Anthony Wood
and
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Motivation for Undertaking Study

- The economic and financial turbulence over the last four years have brought into sharp focus the management of risk by banks.
The literature on risk management by banks in the Caribbean is quite sparse. The primary objective is therefore to extend Caribbean literature by examining the various types of risk faced by banks operating in Barbados.
Presentation Outline

- Review of Literature, focusing on the empirical literature
- Methodological and Data Issues
- Discussion of Empirical Results
- Summary and Future Work
## Review of Literature

<table>
<thead>
<tr>
<th>Author</th>
<th>Sample Country</th>
<th>Statistical and Review Period</th>
<th>Focus of Study</th>
<th>Methodology</th>
<th>Main Results</th>
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</thead>
<tbody>
<tr>
<td>Hassan (2009)</td>
<td>Islamic Banks of Brunei Darussalam</td>
<td>2006</td>
<td>Assess the degree to which Islamic banks in Brunei Darussalam use risk management practices and techniques in dealing with different types of risk.</td>
<td>The study comprises data collected through primary and secondary sources. Primary data were collected through a questionnaire. The questionnaire is comparable to one provided by Al-Tamimi and Al-Maazrooei (2007)</td>
<td>The study found that the three most important types of risk facing Islamic banks are foreign exchange risk, credit risk and operating risk.</td>
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<td>Christie-Veitch</td>
<td>Jamaica, Trinidad &amp; Barbados</td>
<td>2004</td>
<td>Determine the current status of operational risk management in the Caribbean region.</td>
<td>Interviews were conducted with senior management in sixteen financial institutions in Trinidad, Barbados and Jamaica.</td>
<td>The findings are as follows: the framework necessary to identify, assess, monitor and control operational risk was not evident in the Caribbean region.</td>
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<td>Wood (1994)</td>
<td>Barbados</td>
<td>1991</td>
<td>Review the lending behavior and examine credit risk management practices of Banks in Barbados. Also, examine the nature of the credit rationing process.</td>
<td>The study comprises data collected from six commercial banks and one government owned development bank. Secondary data prepared by the Central Bank were also used.</td>
<td>The results of the study were as follows: (i) banks utilized published and internally-generated information in the process of screening applicants; banks do not use interest rates alone to allocate credit but resort to other means like varying the maturity structure on loans, requesting collateral, utilizing debt covenants and compensating balances in order to offset credit risk; the role of monitoring by banks is essential given the absence of credit rating agencies and lack of an active acquisitions market;</td>
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<td>Wood (1994)</td>
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<td>monitoring activities of banks are characterized by regular (formal and informal) visiting (and telephone contact) between banks and clients and periodic reviews of clients’ accounts; credit rationing in Barbados can be usefully explained by the Stiglitz-Weiss “equilibrium-rationing model” which emphasizes the influence of imperfect or asymmetric information on bank behaviour.</td>
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</table>
The Banks Featured in the Case Study:

- The Barbados National Bank
- Butterfield Bank
- First Caribbean International Bank
- RBTT Bank
- Royal Bank of Canada
- The Bank of Nova Scotia
The Questionaire

- The Importance of Risk Management to Banks
- Risk Identification
- Risk Monitoring
- Risk Management practices
### Analysis of Empirical Results

#### Risk Presenting the Greatest Exposure

<table>
<thead>
<tr>
<th>Risk</th>
<th>Average</th>
<th>Ranking</th>
<th>Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit</td>
<td>1.75</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>Operational</td>
<td>3</td>
<td>2</td>
<td>4</td>
</tr>
<tr>
<td>Country\Sovereign</td>
<td>3</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Interest rate</td>
<td>3.33</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Market</td>
<td>3.33</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Liquidity</td>
<td>3.67</td>
<td>4</td>
<td>3</td>
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Risk Identification

- Banks generally do not experience difficulty in identifying and prioritizing their main risk
Importance of Risk Management Practices

- All risk managers recognize the central importance of risk management to the bank’s performance
Risk Management Practices

- Results reveal that there are adequate arrangements in place, with documented procedures to provide guidance to staff.
Current Measures in Place to Manage and Control Risks

- Credit Risk
- Operational Risk
- Country\Sovereign Risk
- Interest Rate Risk
• Risk Monitoring Analysis
• The Level of Success or Failure
• How Have the Measures Evolved Over the Years
Comparison of Results to Previous Studies

- Foreign Exchange Risk was identified among the greatest risk exposures. However such risk did not figure among the first six in our studies.

- Our study indicates that some measures traditionally used are employed within Barbadian banks.
A number of findings emerged from the study

- Banks perceive risk management as very important and critical to their bank’s performance
- Main types of risk exposures are credit, operational, country\sovereign, interest rate and market risk.
- High level of success with the current risk management practices
• Risk management practices have evolved in line with the changing economic environment and regulatory updates.

• Some of the approaches traditionally used to manage risk are being utilized by Barbadian banks today.

• Overall, the finding suggest strongly that banks are risk-focused or might we say “risk intelligent”
One limitation resulted from the fact that the participating bank personnel were more involved in the area of credit risk and hence lacked knowledge of other risks.
This work should be replicated across the other Caribbean Countries with the view of moving towards a common approach in relation to Risk Management within the Caribbean.