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Analyze the Efficiency of Banking Risk Management in Banks Operating in The Local Environment Through the Application of Basel Standards in Financial Risk Management

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Abstract

This article discusses the challenges facing the banking system in light of the development of the banking industry and the increase in banking competition at the local and global levels. The article notes that banking risks are no longer limited to credit risks, but also include market risks, liquidity, interest rates, operational risks and others. Based on this development, it has become necessary for banking regulators and institutions to apply unified standards for managing these risks in order to protect the financial stability of banks and the financial system.

The article highlights the role of the Basel Committee on Banking Supervision in setting these standards and motivating banks to implement them to ensure the safety of banking systems. The article also notes the importance of bank risk management to enhance the sustainability of banks and avoid the negative effects of risks.

The research aims to review the concepts of banking risks and their importance, identify strategies to deal with them, and the extent to which banks comply with the requirements of the Basel Committee. The research shows hypotheses such as the importance of properly managing banking risks for the success of banks and achieving their goals, and the difficulty of applying Basel requirements in the banking environment.

The study is chronologically limited to the period from 2014 to 2018, and spatially limited to analyzing the reports of the Rafidain bank in Iraq during that period.

Keywords: Financial Risk Management, Basel Standards, Banking Risk Management.

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Introduction

The development of the banking system and the intensification of competition of banks, both locally and globally, has led to an increase in the degree of risks that threaten the safety of these banks. credit risks are no longer the only threat to the stability of the bank, as market risks, liquidity, interest rates, operational risks and others have been added to them, and therefore it has become necessary to have careful follow-up. On this basis, the need was generated to approve unified standards that are binding on all banks operating at the International and local levels as global standards to face and manage those risks to which banks are exposed, headed by the Basel Committee on Banking Supervision, in order to deepen the solvency of banks and upgrade risk management methods while ensuring the stability of the financial system in light of developments at the level of the global banking environment.

On this basis, those in charge of banking institutions should keep in mind the development of special strategies to study this phenomenon, namely the phenomenon of increasing the severity of banking risks and the development of appropriate procedures to identify, measure, follow-up and Control Risks and procedures for reducing, reporting and controlling them .therefore, there is a clear risk has emerged and its effects have been identified on the balance sheet of banks and for the purpose of responding to it, banks have tried hard to focus holistically on control systems and the formulation of risk management strategies of their own for the purpose of achieving their banking objectives and minimizing, reporting and controlling the negative effects of these risks.

In light of the financial globalization and the intensification of competition between banks, banking risks have become significantly high and diverse, and the lack of control over these risks makes banks fall into severe banking crises, the effects of which move from one country to another as a result of the opening of markets to each other, and this is what made since its inception, the Basel Committee has been working to achieve global financial and monetary stability by proposing a set of standards that help reduce risks and urge banks to apply them to ensure the safety of their financial conditions .

The Importance of Research

The importance of the research lies in the important role played by banking risk management, especially with the development of the banking industry and the multiplicity and diversity of risks, so the attention to the process of Banking Risk Management and its development was one of the most important ways to maximize the returns of banks and avoid the occurrence of financial crises, the Basel Committee to establish a unified standard for capital adequacy that would increase the effectiveness and efficiency of Banking Risk Management, as well as the need for Iraqi banks to effectively manage risks that enable them to avoid and control the risks to which they are exposed or even predict their occurrence.

The Search Problem

The problem of the research is the question (that the poor efficiency of Capital Management and the lack of hedging of banking risks by all banks operating in the local environment, which leads to the declaration of bankruptcy, the loss of depositors ' rights, and the failure to achieve its basic goals of covering risks, continuity, and achieving stable bank liquidity).

Research Objectives

The research aims to show the following:

1. A comprehensive review of the concepts of banking risks, their importance and dimensions.
2. A statement of the most important risks facing the bank and identify the most important strategies to reduce the negative effects of banking risks.
3. Indicate the extent to which banks comply with the requirements of the Basel Committee 1 2 3.

Research Hypotheses

1. The answer to this problem, by highlighting the nature of Banking Risk Management in accordance with the decisions of the Basel Committee 1, 2, 3.
2. Managing banking risks in a safe way is one of the main factors in the success of the bank and achieving its goals.
3. The difficulty of applying Basel requirements in the banking environment.

Study Limits

Temporal limits: represents the temporal limits of research for the period from (2014-2018) to the issuance of the Basel II convention in 2004, the issuance of the Basel III Convention in 2010.

Spatial boundaries: represent the spatial boundaries of the research based on the annual reports of Rafidain Bank /General Administration for the years (2014-2018).

Literature Review

First: The Emergence of Banking Risks the Emergence of Banking Risk

In the seventies, the global environment was stable, and several factors helped to achieve this, as the financial and banking industry was subject to strict legal regulation, commercial financial and banking operations were mainly pooling resources, competition was limited, and regulatory bodies were busy with the safety of the industry and control over the creation of money, but the Eighties years saw waves of change in the services offered by banks, as new market products were: The ownership of assets, project financing, marketing, credit cards, financial derivatives and off-balance sheet items is at a rapid rate and financial institutions and banks have entered new areas of business, resulting in their facing risks, as new players such as commercial institutions entered the financial and banking business, the market share of brokerage decreased with the capital markets and competition intensified within the existing market shares, and waves of change have generated these risks. And increased - Risks due to competition, product innovation, the shift from commercial knowledge to capital markets, increasing market volatility and the disappearance of old barriers that limited the scope of operations of various financial institutions. (Abdel Aal, 2003)

Second: The Concept and Definition of Banking Risk Concept and Definition of Banking Risk

The main concern of banks today is not money, but risk, as banks are able to achieve superiority over their competitors by maximizing their returns through the risk (Stott, 1993). given the importance of risk in banking, it is necessary to explain its concept with a clear degree of clarification and analysis, and accordingly we present some concepts of risk:

The risk is also the probability that the results of the predictions will be wrong, and if there is a high probability that the predictions will be wrong, then the degree of risk will also be high, but if the probability is low, the degree of risk will also be low (al-Husseini, & Al-Douri, 2000)

(Weston) believes that banking risk as a concept represents (distrust of the fact of the results of a certain activity and a certain event so that we are not sure what will happen in the future, and accordingly, banking risk arises from the fact that a certain activity can have more than one result in the future) (Weston, 1996)

The term risk was also touched upon by economists that it does not mean just the probability of loss, they use the term to include the probability of gain and loss (Meyer, 2000)

As for Gitman, he distinguishes between the concepts of risk and uncertainty, as the subject depends on the degree of information and historical data available, where the risk can be measured by the availability of information in several years, the uncertainty arises when this information is not available, and therefore resort to making speculative estimates. as for the definition of risk in the field of Finance and investment (Gitman, 2000), there were many definitions of risk, and each definition focused on the meaning and idea that expresses the point of view of its owner, it was defined by the glossary of financial terms defines it as the degree of variation between future returns and their estimated average value and is measured by Variance, standard deviation and coefficient of variation of possible future returns (al-Tuwaijri, 1993) defined IT (Glossary of financial and management accounting terms, 2005) as the risk of a discrepancy between the expected future results and the actual results of the investment.

Banking risk in the financial concept means the volatility and instability of returns or fluctuations in the market value of financial assets(Al-Shammari, 2012) and is also defined as the unfavorable effects arising from expected or unexpected future events affecting the profitability of the bank and its capital(Hindi, 2005: 5) it is also defined as the likelihood of the bank being exposed to unexpected and unplanned losses or fluctuation of the expected return on a particular investment (al-Najjar, 2010). From the foregoing, we note the commonality of the previous definitions that the risk is between the expected and actual return, however, the most important definition of banking risk is as follows:

The banking regulatory and Risk Management Committee of the banking sector authority in the United States of America (Financial Services Roundtable) defined the following risks: - is the probability of loss because there are restrictions that limit the bank's ability to achieve its goals, as such restrictions lead to a weakening of the bank's ability

to continue to provide its business and practice its activities on the one hand and limit its ability to exploit the opportunities available in the banking environment on the other hand(Report of Financial Services Roundtable, 1995).

As for the accounting rule no. 10 of the accounting and supervisory standards board of the Republic of Iraq, it dealt with banking risks as: The risks to which the bank is exposed as a result of its activity, including liquidity risks, risks arising from exchange rate fluctuations and risks of financial failure, although they reflect their impact on the financial statements, however, the administration's giving sufficient explanations and disclosure of risks and related banking operations and ways to control them will make the data clearer and more accurate, and the nature of banking requires Bank departments to conduct some transactions that result in contingencies and financial engagements that form an important part of the bank's work, called off - balance Sheet items that have implications on the level of banking risks, including :(letters of guarantee-credits Documentary evidence) (accounting rule, 1998)

Third: Principles of Banking Risk Management Principles of Banking Risk Management

Risk management in banks requires adherence to the following basic principles

1. Each bank should have an independent committee called (Risk Management Committee) specialized for risk management to implement these policies, as well as monitor and measure risks periodically.
2. Appointment of a Banker (Risk Officer) (key, 2007)
3. Establish a specific system for measuring and monitoring risks in each bank to determine the level of each type of risk that can be accurately measured to determine and determine their impact on the bank's profitability and capital adequacy and determine the precautionary ceilings for credit, liquidity and the market.
4. Evaluation of each bank's assets, especially investment, as a basic principle for measuring risk and profitability; (Ali, 2005)
5. The use of modern Risk Management Information Systems and the establishment of appropriate security controls for them.
6. The need for an independent internal audit unit in banks that directly reports to the bank's Board of directors and performs audits of all the bank's business, including risk management. (Al-Shammari, 2010).

There are some principles common to all banks around the world, and they are considered accredited by the Central Bank of Egypt, and they state the following:

- Maintaining the good reputation of the bank, this depends on several methods, including achieving effective management, control systems and risk control.
- Working to protect the strength of the financial center of the Central Bank of Egypt by controlling all types of potential risks to which the bank is exposed while working to control them in coordination with all other departments of the bank. (Al-Amiri and al-Imam, 2012)

Fourth: Reasons for Increased Banking Risk Reasons for Increased Banking Risk

The increase in risks in the banking sector in the light of financial globalization is due to the following factors:

1. Increasing competitive pressures, which led to encouraging the tendency to take risks to achieve the maximum return on Invested Capital and gain the largest possible share in the market; (Filali, 2011)
2. The expansion of banks ' off-balance sheet business and their shift from traditional businesses to financial markets, which led to their exposure to liquidity crises, in addition to other market risks, inflation and price fluctuations (ALRMIC, 2002)
3. The structural changes that have affected the banking and financial markets in recent years, as a result of the liberation from restrictions on the movement of capital and the opening of local markets;
4. The various forms of risks facing the work of banks have increased to include many types of risks that were not previously of interest. (Qasimi, 2011).

Fifth: Risk Management Ratings Risk Management Ratings

Risk management classifications are based on a scale from 1 to 5 and the inspector must create a classification that matches what was seen during the inspection.

Strong Rating (Strong)

The bank in this group is sound in all respects and generally has components that classify it within Level (1), that is, it has minor or almost non-existent weaknesses, and it can be dealt with in a routine manner by the board of directors as well as the top management of the bank. the banks that fall into this classification are characterized by their strong performance and their ability to face external conditions such as economic instability, are characterized by high

compliance with the laws and legal regulations issued by the supervisory authorities, and possess competent risk management and do not pose any concern to the supervisory authorities represented by the central bank.(Khalil, 2019)

Satisfactory Classification

The bank in this group is basically sound and is classified as a minimum within Level (2), has moderate weaknesses, minor problems, which are under the control of the bank's Board of directors or senior management, is characterized by stability, ability to withstand economic fluctuations, and significant compliance with supervisory laws and regulations, as for Risk Management in general, the practices are satisfactory compared to the size of the bank and the complexity of operations, and there is no concern from the supervisory authorities, so the intervention of the supervisory authorities is often limited, or informally (Jancsova, 2016)

Average Rating (Fair)

A bank that falls within this level is characterized by low control and supervision, and it is tainted by weaknesses that range from moderate to severe, however, it is classified within Level (3) as a minimum and is characterized by a group of exclusions, the lack of bank management or senior management of the ability or willingness to deal with weaknesses from the appropriate time frames, and the bank that falls within this group is less able to withstand business fluctuations, being exposed to external influences, and to a greater degree than banks that fall within Grade (1 and 2) and is less compliant with banking laws and regulations, as for risk management they are less than satisfactory in relation to the size of the bank, the complexity of its operations and the size of the risks To which he is exposed.(Zedan, & Daas, 2017)

Marginal Classification

A bank that is part of this group is often unsafe or sound and has serious administrative and financial weaknesses and problems, which can lead to poor or unsatisfactory performance and has significant weaknesses ranging from acute to critical, placing it within the classification (4) at a minimum, the board of directors does not have the desire and ability to address weaknesses, the bank's inability to withstand business fluctuations and low compliance with supervisory laws and regulations.as for risk management, its performance is unacceptable for the size of the bank and its complexity, and there is no interest in the supervisory and supervisory side.(UFIRS,2016)

Unsatisfactory Rating (Unsatisfactory)

A bank that is in this group suffers from unsafe and sound practices, has very large administrative and financial weaknesses and problems, and poor risk management relative to the size of the bank and the degree of complexity of its operations, and has components that place it within the classification (5) at a minimum, and management does not have the ability or desire to control or conduct corrective operations in order to remedy the situation, and there is a need to help those banks in order to survive and continue, as continuous supervisory attention is an urgent necessity, in order to correct problems, and banks in this group pose a great risk to deposits, and there is a high probability that they will not be retrieved by their owners, and this level of assessment reflects the non - The management finds it difficult to control the situation, so it takes immediate actions such as liquidation, merger, acquisition, etc.(Babar, 2011)

Sixth: Types of Banking Risk Management Types of Banking Risk Management

Banks face many banking risks, the most important of which are:

Credit Risk

Credit risk is defined as the risk of a possible non-repayment by the client or the recipient of the loan of those funds that he borrowed from the bank, since these banks quite often lend money to their clients. As a result, this can lead to disruption of cash flows, increased collection costs and other consequences of the bank not collecting its funds .(Beaver & Parker, 1995)

Market Risks

Market risks arise for sudden changes in market conditions where banks are affected by that change. These risks are divided into.

1. Interest rate risks: these are the risks resulting from the bank's exposure to losses as a result of adverse movements in interest rates in the market, which may have an impact on its revenues and the economic value of its assets.

2. The risks of exchange rate fluctuations: they are caused by dealing with foreign currencies and the occurrence of fluctuations in currency prices, which requires full knowledge and thorough studies on the causes of price fluctuations. (Eahna verma, 2021)

Operational Risks

One of the risks that banks may also face is operational risk, which is defined as the risk of loss caused by inefficient or failed internal operations, people, systems or external events that can disrupt the flow of business operations. Losses can be directly or indirectly financial. (Shahin, 2005)

Reputational Risks

Reputational risk is defined as the damage that can happen to a bank when it fails to meet the expectations of its stakeholders, which affects the business negatively regardless of its size. For example, suppose there is a news story about a bank in which there is administrative corruption, this may damage their relations with customers, cause a drop in the share price, give competitors an advantage, and other damages. (Kolar, 2001)

Liquidity Risk

Liquidity risk can be defined as the risk of incurring losses resulting from the inability to fulfill payment obligations in a timely manner when they become due, since with any financial institution there is always a risk that it will not be able to repay its obligations in a timely manner due to unforeseen claims or the obligation to sell long-term assets at an undervalued price. (Hashad, 2010)

Interest Rate Risk

They indicate the change in the level of interest rates in the market in general. That is, it is a risk that affects all investments, regardless of the nature and conditions of the investment itself. General rule: with other factors remaining the same, there is an inverse relationship between the market interest rate and the market value of traded securities. That is, the fluctuation in the market interest rate affects the expected return on investment and, consequently, the market value of securities. These risks arise when the investor is forced to sell the bonds he owns because he needs ready cash. If the prevailing interest rates in the market are higher than the interest rates charged by his bonds, he will be forced to sell his bonds at less than their face value. The opposite is also true, meaning that he will be able to sell them at higher than their face value if the prevailing interest rates in the market are lower than the interest charged by the bonds. (Ramadan, 2007)

Seventh: Banking Risk Management Strategy Banking Risk Management Strategy

It is the possibility of unexpected losses that affect the achievement of the bank's objectives and the successful implementation of its strategic plans, and may, if it is not possible to control them and their effects, lead to the erosion of the bank's resources and thus its collapse and elimination.

As for strategic risks, they are defined as the risks that affect the basic policies of the bank, which relate to its presence, the nature of its products and services, its competitiveness, weaknesses and strengths, opportunities and threats facing it. The board of directors formulates the necessary policies to manage this type of risk and this cannot be delegated to any other party. It is an independent administrative activity aimed at identifying, monitoring, measuring, reducing and understanding the types of risks that the bank may face or has faced, working to assess those risks, determining the size of the risks that the bank's management is willing to assume, in addition to verifying that the bank has taken the means and controls to control their negative effects and reduce them to acceptable levels to give reasonable assurance about achieving the bank's objectives.

Where Risk Management represents an integrated system of administrative Arts and skills represented by a package of procedures , operations and precautionary controls aimed at addressing current risks and predicting the sources of future risks and putting an end to the negative effects resulting from them, limiting them and keeping them at their controlled minimum and ensuring that they do not worsen or occur in the future, as most banking experts believe that (risk and credit are twins) in the sense of linking each other, this means banks cannot avoid risks 100%.

The work of the central bank aims to establish confidence in the financial and banking system, and the decisions it issues are intended to avoid its banking system any crisis that may affect this system.no central bank can prevent a crisis in a bank, but helps it to control it so that it does not expand and include the banking system as a whole. The greater the independence of the central bank, the greater its ability to maintain the banks entrusted with the national wealth and responsible for economic activity. Each central bank should ensure the involvement of its banking sector in financial globalization, following international standards on the one hand and transparency on the other. All this

justifies the intervention of the central bank in public financial affairs, and one of the core of its work is to defend the banking system.

On the other hand, the central bank can move quickly by issuing preventive decisions to reduce risks. The Basel Committee has performed all its duties and worked independently, and has received local and international appreciation, and the risks have increased and diversified (legal risks, operational risks, market risks, interest rate risks, exchange rate risks, etc.) and the subject of risk classification has become at the heart of banking business. (Grace, 2020)

Eighth: The Importance of Risk Management Importance of Risk Management

Risk management (R,M) is not a new phenomenon, but its importance has grown widely nowadays after the numerous financial crises that have occurred, prompting the supervisory authorities, international supervisory authorities and the International Settlement Bank (BIS) to work hard to reach a well-structured risk management system (system), the Basel agreement has focused on the importance of managing banking risks and being an integral part of its requirements, as the lesson is not to achieve the minimum capital adequacy, but the lesson on how banks manage their risks properly makes them safe from banking crises as much as possible to help in the formation of a clear future vision, based on which it is determined Banking plan and policy . (Al-Ghandour, 2003)

The importance of risks also lies in the following:

1. Developing the management of financial portfolios and working to diversify them through the improvement between risk and profitability.
2. Contribute to the alignment of pricing decisions.
3. Assessing risks and hedging against them in a way that does not affect profits.
4. assisting the bank to calculate the capital adequacy rate according to the Basel proposals. (Al-Khatib, 2005)

Ninth: Steps of the Risk Management Process Risk Management Process Steps

Risk management process steps.

Preparation

It includes planning the process, mapping the scope of work and the basis to be adopted in the risk assessment, as well as defining a framework for the process and an agenda for analysis.

Identification of Risks

It is at this stage that the risks of interest are recognized. Risks are events that, when they occur, lead to problems, and therefore the identification of risks can begin from the source of the problems or the problem itself. When the problem or its source is known, the incidents that result from this source or those that may lead to a problem can be investigated. Common ways to identify risks are:

- Goal-based identification: organizations and teams working on a project all have goals, so any event that puts the achievement of these goals at risk, either partially or completely, is considered dangerous.
- Scenario-based identification: in the process of scenario analysis, various scenarios are created that may be alternative ways to achieve a goal or an analysis of the interaction of forces in a market or battle, so any event that generates a scenario different from the one that was conceived and undesirable, is defined as dangerous.
- Classification-based identification: it is a breakdown of all possible sources of risk.
- Review of common risks: in many organizations there are lists of possible risks. (Abdel Aal, 2003)

Evaluation

After identifying the potential risks, an assessment should be made of them in terms of their severity in causing losses and the likelihood of their occurrence. Sometimes these quantities are easy to measure and other times they cannot be measured. The difficulty of assessing risks lies in determining the rate of their occurrence, since statistical information on previous incidents is not always available. Also, assessing the severity of the consequences is usually difficult in the case of intangible assets.

Dealing with Risks

After the process of identifying and evaluating the risks is completed, all the techniques used to deal with them fall into one or more of four main groups:

- Transfer: they are means that help to accept the risk by another party, usually through contracts or financial hedging. Insurance is an example of the transfer of risk by contracts. The contract may contain a formula that guarantees the transfer of risk to another party without the obligation to pay insurance premiums.
- Avoidance: it means trying to avoid activities that lead to the occurrence of some danger. An example of this is not buying a property or entering into a business to avoid legal liability. Avoidance seems to be a solution to all risks, but at the same time it can lead to deprivation of the benefits and profits that could have been obtained from the avoided activity.
- Minimization: include ways to minimize the severity of the resulting losses. An example of this is software development companies that follow methodologies to reduce risks by gradually developing software.
- Acceptance (detention): it means accepting losses when they occur. This method is considered an acceptable strategy in the case of small risks, in which the cost of insuring against the risk over time is greater than the total losses. All risks that cannot be avoided or transferred must be accepted. War is the best example of this, where property cannot be insured against war. (Artemia, 2003)

Develop A Plan

It involves making decisions related to the selection of a set of methods to be followed to deal with risks, and each decision must be recorded and approved by the appropriate management level. The decision should be made by the senior management, but in the case of decisions related to the information system, for example, the responsibility for the decision belongs to the IT manager. The plan should propose security controls that are reasonable and applicable for risk management. As an example, the risks of viruses that computers are exposed to can be mitigated through the use of anti-virus software.

Implementation

At this stage, the methods planned to be used to mitigate the effects of risks are followed. Insurance should be used in case of risks that can be transferred to an insurance company. Risks that can be avoided without sacrificing the organization's goals are also avoided, other risks are minimized, and the rest is retained.

Review and Evaluation of the Plan

The initial risk management plans are not complete. Through practice, experience and losses that appear on the ground, the need to make adjustments to the plans and use the available knowledge to make different decisions appears. The results of the risk analysis process as well as its management plans should be updated periodically, due to the following reasons:

1. In order to evaluate the previously used security controls if they are still applicable and effective.
2. In order to assess the level of potential risk changes in the work environment, for example, informational risks are a good example of a rapidly changing work environment.

Determinants (Constraints)

If risks are assessed or prioritized inappropriately, this can lead to a waste of time dealing with risks with losses that are unlikely to occur. As well as spending a long time assessing and managing unlikely risks leads to a distraction of sources that could have been exploited more profitably. (Akor, 2014).

Tenth: Banking Risk Management Functions Banking Risk Management Functions

The tasks of banking risk management can be highlighted as follows:

1. Develop a risk management policy and strategy with the preparation of a risk policy and structure internally for business units and work to create an appropriate environment;
2. Cooperation at the strategic and operational level with regard to risk management;
3. Building cultural awareness within the bank, including appropriate education in coordination with various functions in terms of risk management with the development of risk management processes;
4. Preparing risk reports and submitting them to the board of directors and stakeholders; (Rabah, 2011)
5. Detection of risks specific to each economic activity;
6. Analyze each of the detected dangers, find out its nature, causes and relationship with other dangers;
7. Measure the degree of risk, the probability of its occurrence and estimate the size of the loss;
8. Choosing the most appropriate way to manage each of the risks that exist for an individual or an organization based on safety scores (Abdel Moneim, 2008)

Eleventh: Risk Management Objectives Risk Management Objectives

The objective of the risk assessment process is to identify and assess the risk, and then remove that risk or reduce the level of risk by adding the necessary preventive control measures as necessary. By doing this, you have created a safer workplace. (Journal of accounting and Financial Studies, 2012)

Risk management is mainly aimed at:

1. The stability of profits or gains, where risk management contributes to reducing income disparities resulting from losses associated with pure risks to the lowest possible level, in addition, reducing income disparities can help teach tax deductions for losses and reduce taxes on profits.
2. Continuity of growth when growth is an important organizational goal becomes prevention. Threats to growth are one of the most important objectives of risk management, and the risk management strategy is based on preparation to facilitate the continuation of growth in the event of a loss of the bank's economic growth.
3. Maximizing the value of the bank risk management decisions contribute to the education of the market value of the Bank, value maximization is for the organization and is a reasonable criterion for evaluating institutional decisions. (Anointed, 2011)

Decisions of the Basel Committee 1, 2, 3 Basel Committee Decisions

First: Basel Committee 1 Basel Committee

Basel Convention 1 is also known as the Basel Capital Convention, which is the first form of the convention of the Basel Committee on Banking Supervision, which submitted its first report at the end of 1987. its purpose was to support and strengthen the integrity of the global banking system and eliminate unfair competition between banks. it focused on defining and setting a standard for the adequacy of bank capital to achieve financial efficiency, which is the ability of the bank's assets to cover its liabilities. at the beginning of 1988 it was approved and its requirements became binding on banks.(Abdelkader, 2009, 35) Basel 1 was initially concerned with bank credit risks as one of the most important types of risks facing banks and also By helping banks to improve the quality and quality of their assets, as well as the level of allocations that must be formed for assets and their adequacy, as well as dividing the countries of the world into two main groups according to their level of risk and their ability to fulfill their obligations, and the following agencies : (Mahbooba, 2017)

The First Group is low-risk countries and includes Japan, the USA, the EU countries and Switzerland.

The Second Group is high-risk countries and includes all countries of the world except the countries of the first group, and under Basel 1, the minimum acceptable capital adequacy rate for all banks is 8 %, which is measured by the following equation: (Jablecki, 2009).

Capital Adequacy Ratio = (Supporting Capital + Basic Capital) / (Risk Weighted Assets)

Basel 1 also divided the banking capital into two parts, as follows: - (Mohsen, 2018)

- **Basic capita**l: which includes paid-in capital and all types of reserves as well as undistributed profits
- **Supporting or supplementary capital:** This includes reserves for revaluation of assets and reserves allocated to face doubtful debts, as well as general allocations. The committee also developed classifications of banks ' operations based on different degrees of risk, weighted weights of assets were included that differ according to the degree of risk, so assets were not classified, for example, based on the degree of payment obligation, where five types of weights were placed (zero% ،10% ، % 20 ، %50 ، %100) the committee gave the central banks the freedom to control certain weights of assets (Hussein, 2014).

Second: Basel Committee 2 Basel Committee

In 2004, the Basel Committee on Banking Supervision added amendments to the Basel Convention 1, a document was issued entitled international convergence in the standards and measurement of capital, where it was more comprehensive and its goal is to replace Basel 1, and then, specifically in June of 2006, the last document was amended and was approved by the member states until it was applied at the beginning of 2007, it turns out that the goal of issuing Basel 2 is to make banking capital more sensitive to risks and to keep abreast of developments in the financial market, and this is done by strengthening banking supervision systems Basel 2 also emphasized on improving the capabilities of bank departments in measuring and evaluating The regulatory authority has a major role in activating this consistency and ensuring the validity of its application, as well as developing and improving methods of disclosure of capital risks, which is known as market discipline (Al-husseinawi, 2012). Basel 2 also added a new type of banking risk that was not included in the previous Basel 1, namely operating risks, after Basel 1 included only market

and credit risks, new methods of calculating credit risks, namely the standard approach and the approach based on self-assessment, were also developed, which led to a change in the status of the capital adequacy ratio, becoming as follows (Ben Sharqi, 2010):

Capital Adequacy Ratio = ((Supporting Capital + Principal Capital) / (Credit Risk + Market Risk + Operational Risk)

Based on this, Basel 2 is based on three pillars or main axes, namely (Tajuddin, 2012):

The First Axis: minimum capital requirements, as this axis focuses on setting the minimum capital limit to meet credit risks, operating risks and market risks, in other words, linking the capital adequacy ratio with the real risks exposed to the bank to indicate the extent of the bank's ability to measure those risks and pre-hedge them, the minimum limit is 8% of the capital.

The Second Axis: supervisory review and self-assessment processes these processes include a set of basic principles that include guidelines through which the agreement addresses the interest rate risks of the portfolio of securities that are considered among the market risks, and these principles can be clarified by

- Banks should have a comprehensive framework that includes measuring the risks added to Basel 2 and the adequacy of capital to cover them.
- Continuous monitoring of capital to avoid falling below the specified percentage to face risks and provide appropriate plans in the event of a decline.
- Ensuring the bank's ability to properly assess its capital adequacy by the supervisory control authorities.

The Third Axis: is market discipline : this axis is considered complementary to the two previous ones, as discipline is encouraged from the point of view of the Basel Committee through the development of disclosure and transparency requirements that allow financial market participants to access the main information related to the risks they face and their ability to assess them, and therefore this axis helps banks and observers to manage risks and support stability, as well as Help damage market flooding with information that is difficult to analyze and use to find out the amount of real risks(Al-khudairat, 2015)

Third: Basel Committee 3 Basel Committee

It is a reflection or reaction to the global financial crisis that occurred in 2008, one of the main causes of which was the banks ' excessive increase in leverage as well as the shortage of liquidity, which led to a decrease in the level of solvency, which led to a decrease in the level of public confidence in banks, so this agreement focused on increasing the robustness of banking systems in the face of risks that they may be exposed to. Basel III was approved in 2010 by the representatives of the member states, where it dealt with a set of amendments to the third axes of Basel 2 to address the weaknesses it was suffering from, the aim of which is to make the banking system more flexible to absorb or reduce the impact of risks that the bank may be exposed to by strengthening capital through increasing the banks ' own resources in order to restrict leverage (Saleh, 2013).

There are three major amendments made by the Basel III committee that have caused the complexity and difficulty of banking (Ghanaian, 2015: 54) are as follows: -

- Basel III stressed on banks in defining what constitutes banking capital by adding another segment to it, which is the reserve capital to face financial crises, which caused banks to need more capital, and the capital is calculated as a percentage of the risk-weighted asset base.
- Basel III focused on the position of bank liquidity in the short term to make banks more flexible in the face of banking risks, as new controls have been put in place to cover the liquidity ratio based on banks 'stock of high-quality liquid assets, which is meant to be assets that can be converted into cash easily divided by net cash flows within a period of 30 days , and this ratio measures the bank's ability to convert its assets into cash within 30 days, and this ratio must not be less than 100 %.
- The most important adjustment is to achieve the best compatibility between assets and liabilities through a net and stable financing ratio, and this ratio is by dividing the value of available financing by the value of the required financing, and this ratio should not be less than 100%

The requirements of the Basel III committee include the following:

Improving the quality and structure of the banking capital base: Basel III approved increasing the requirements for the first tranche of capital, which includes equity and other financial instruments, from 4% to 6% by increasing the ratio of equity to shareholders from 2% to 5.4%, that is, the basic capital consists of 5.4% equity and 5.1% additional capital, in addition to adding a reserve capital of 5.2% as ordinary shares to prevent excessive credit, which increased

the amount of basic capital held by banks to reach 7% to cope with financial crises, either in the case of The capital adequacy ratio has been raised to 5.10% from 8% by increasing the percentage of shareholders ' equity of the total bank capital, so we note the increase in the capital of the first tranche of the current total from 5.4% to 7%, so banks must increase the percentage of preferred shares three times to reach 7% to face future fluctuations and shocks. (Abu Salmi, 2015).

Relationship of Risk Management and Requirements of the Basel Committee

Risk Management Relationship and Basel Committee Requirements

First: About Rafidain Bank Profile of Rafidain Bank

Rafidain bank was established by Law No. 33 of 1941 and started its business in 19/ 5/ 1941 with a paid-up capital of (50) fifty thousand dinars, the bank went through multiple stages during its historical career, represented first by its presence as the first National Bank practicing commercial banking among many foreign banks, and began to gradually expand within the country, and then went through multiple stages of integration, which began in 1964, including commercial banks that were operating in Iraq, where in 1974 it was unified with Rafidain Bank, which became the only commercial bank in Iraq, where it continued to work alone in the field of banking until 1988, which witnessed the establishment of another government bank, Al-Rasheed Bank, which he started his business with branches Rafidain Bank, which transferred its business to him.

In 1998, the bank witnessed a new development, which is its transformation into a fully state-owned public company in accordance with the provisions of the public companies Law No. 22 of 97, with the aim of contributing to supporting the national economy in the field of commercial banking, investing funds and providing financing to various sectors in accordance with development plans and within the framework of the economic, financial and monetary policies of the state. The bank accepts deposits of all kinds and invests funds and cash surpluses in various aspects of investment as prescribed by law. The credit activity represents the most important investment operations carried out by the bank and is considered one of the basic tasks of its work and growth, as it issued several instructions according to which it was decided to grant medium-term loans for periods ranging from 2-5 years and long-term loans for periods ranging from 5-10 years to those who wish from citizens and companies for the purpose of converting the purchase of machinery, equipment and machinery or the construction of appropriate buildings for various agricultural and industrial purposes, in addition to granting loans to doctors, dentists, pharmacists and engineers according to specific conditions and controls...This framework includes granting facilities in the current account and debiting commercial papers and following them, which are one of the main types of cash credit granted For the bank's customers and customers. The bank stands at the forefront of government institutions in the field of using modern automation in Iraq, represented by the electronic calculator project, which is a huge project parallel to the status of the bank, its business and branches, where it currently has actual systems covering all the bank's activities and systems are constantly being developed and updated information, and also contributes effectively to the development and support of government and private banks in the field of technical banking and investment systems, the number of branches of the bank currently (164) branches inside Iraq in addition to (7) branches abroad, namely : Cairo, Beirut, Abu Dhabi, Bahrain, Sana'a, Amman, Mount Amman . (Cactus, 2001).

One of the most important reasons that increases the credit risks exposed to the bank is its use of the funds available to it in long-and medium-term loans too much, and the risk-weighted assets are revealed after weighing, where the weight of loans and advances according to the weights taken from Basel was 50%, discounted commercial papers weighed 100%, and for investments, won 100% and long-term loans weighed 100%, and finally documentary credits and letters of guarantee weighed 20% after we have extracted the weighted weights of assets within the budget, we will extract the capital adequacy criterion according to the fair equation for research purposes, It is as shown in Table 1:

Second: Capital Efficiency Standard Capital Adequacy Standard

(Proxies Capital Ras +Basic Capital Ras) / (Risk-Weighted Assets) Capital Ras Adequacy Criterion

Table 1: Calculating Weights and Capital Adequacy

Details \ Year	2014	2015	2016	2017	2018
Paid-up capital	4,000,000	10,000,000	10,000,000	25,000,000	25,000,000
Reserves	34,801,000	32,567,000	29,466,000	49,731,000	61,338,000
Regulatory capital	38,801,000	42,567,000	39,466,000	74,731,000	86,338,000

Source: the researcher prepared based on the annual reports of Rafidain Bank /General Administration for the years (2014 - 2018) and the table shows the capital adequacy criterion for risk-weighted assets, The capital adequacy ratio of the bank can be obtained by applying the capital adequacy equation as follows Table 2:

Table 2: Calculating The Bank's Capital Adequacy Standard Ratio

Years	2014	2015	2016	2017	2018
Capital adequacy ratio	0.113%	0.215%	0.283%	0.512%	0.589%

In 2014, the adequacy ratio was 0.113%, which is a very small percentage, and it is the lowest percentage extracted during the research period, as for 2015, it was by 0.2155, as for the adequacy ratio for 2016 by 0.283%, as for 2017, the percentage was 0.025%, and where the capital adequacy ratio for 2018 was by 0.586%, we note from the table that the ratios for 2017 and 2018 are almost close due to the relative stability of the financial situation, however the bank is very far from applying capital adequacy standards, As shown in Figure 1.

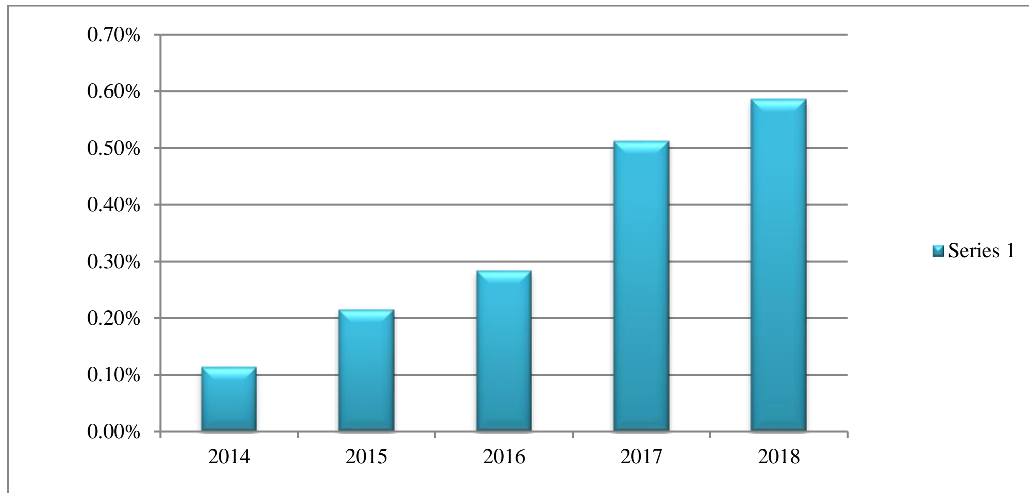

Fig. 1: The Extent to Which Banks Apply the Capital Adequacy Standard

Conclusions and Recommendations

First: The Conclusions

1. Delay in providing data to the monetary authority represented by the Central Bank of Iraq, which reflects negatively on the supervisory process and early diagnosis of risks.
2. Inadequate training and education in banks to develop human capabilities and skills in the areas of: internal credit rating systems, methods for measuring and mitigating credit risks contained in the Basel II Agreement, and determining capital adequacy.
3. The banking system has supervisory policies to cover risks in accordance with the decisions of the Basel Committee and its developments. There is also a department specialized in risk management, in addition to the availability of an internal and external control system that enhances oversight and inspection of operations related to risks (operational, credit, market).
4. Weak interest in providing the necessary training on applying international standards for banking supervision approved by the Basel International Committee.
5. Weak application of good management practices, accounting disclosure and transparency
6. The Board of Directors of banks adopts a strategy for managing credit risks, which includes setting credit policies, identifying credit risks, and methods for measuring, monitoring and controlling these risks.
7. The Basel II Accord came after capital adequacy and market discipline, and to enhance the latter, banks must disclose the method of calculating capital adequacy, as well as the methods of risk assessment.

Second: Recommendations

1. Using technology and modern means of communication, and creating a system to link the bank's branches with the General Administration to facilitate the smooth access of data and information to the General Administration.

2. Increasing disclosure and transparency of financial and non-financial information, especially about the current and potential risks faced by the bank, which motivates banks to improve their business practices, to ensure the strengthening of the safety and soundness of the banking sector
3. Ermey, in addition to choosing an internal risk classification model that suits the nature of the banking system.
4. The boards of Directors of the banks directly supervise the credit and investment policy of the bank and review the reports submitted to them on the credit concentrations and any risks to which the bank, its capital and reserves may be exposed.
5. Maintaining sufficient reserves by the bank as well as allocations to face the risk of
6. Banks are working to improve the management of banking risks in their diversity, which requires banks to adhere to the application of international standards in the areas of capital adequacy, regulatory audit, accounting, transparency and disclosure.
7. The need to provide trained and qualified human resources, infrastructure, information systems and internal control systems to meet the comprehensive approaches included in the Basel decisions || with appropriate sensitivity to the degree of risk involving banks and activities, and another reason the decisions of the Basel Committee || allowed banks that are not active at the global level to build their own models of Banking Risk Management. Therefore, it requires banks and those interested in banking affairs to follow research efforts to reach the best ways to measure risks that are in line with the activity of protected commercial banks.
8. Finally, the two researchers recommend conducting more research on the management and control of banking risks, which was addressed by the new and modified framework for capital adequacy Basel.

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