

## **INSTITUTE OF INSURANCE AND RISK MANAGEMENT**

### **Convocation Address delivered by Shri C. B. Bhawe, Chairman, SEBI**

Shri J Harinarayan, Chairman, IRDA and IIRM, Shri Vepa Kamesam, Managing Director, IIRM, Members of the Board of Directors of IIRM, Members of the Advisory Board, Parents, students, Ladies and Gentlemen:

It gives me a great pleasure to be here amongst you on the occasion of the convocation ceremony of the 2008-09 batch. I am grateful to Mr. Harinarayan and Mr. Kamesam for inviting me to deliver the convocation address. The growth of the insurance industry during the past nine years has been particularly rapid. Consequently, the need for specialists who can work in the insurance industry and the area of risk management can not be overemphasized. India has set up regulatory bodies in different areas as we moved from substantial government dominance to significant role for the private sector. While setting up these bodies our legislature namely, Parliament has put the development of the market as an objective of the regulatory institutions along with the duty to regulate. In its developmental role, IRDA deserves congratulations for fulfilling the need for trained manpower by setting up this successful institution. I congratulate all the students who are graduating today and add my words of welcome to the new batch which is embarking on its education now.

Management of risk is at the heart of insurance business. We deal with risk every step of the way in our lives, sometimes consciously sometimes unconsciously. We know that risk cannot be eliminated. It can be managed, it can be contained, it can be minimized, but it can never be eliminated. While we do possess this knowledge that risk cannot be eliminated, human beings as we are, we at times tend to behave as if there are some activities in life that are without risk. Our sensitivity to the existence of risk can become dull especially when the times are good. This area has come into particular focus during the financial meltdown in the west.

It is noteworthy that in this financial meltdown some very big financial institutions got into serious trouble because they ignored risk. It is not that these institutions did not have risk management teams with professionals trained in risk management issues. However, as more and more evidence becomes available it appears that these risk management teams did warn their managements about the risk that the businesses were exposing themselves to. It appears that in most of the cases such warnings were ignored or the risk management teams were told to keep quiet.

Those of you who have chosen to specialize in the field of risk management are lucky that expertise in this area is in great demand at the present juncture. As a category, risk managers are perhaps the only ones who have not lost their jobs on account of the melt down. However, the attitude to risk and attention paid by the management to the risk managers can change very quickly. In times of disasters you will be most wanted, in times of roaring business you may be told that you belong to the quiet corner. Your real test will be in the good times when you will be considered a nuisance. You will pass the test if you make such a nuisance of yourselves that the management ultimately pays attention to your warning calls.

Those of you who have chosen to specialize in life or non life insurance businesses you may have to make sure that you do not err on the other side. Your employers business will depend on selling insurance. You may be tempted to exaggerate the risk perception in the minds of your clients so that they buy more and more insurance for risk that may or may not exist for their businesses. So you will face the challenge of not miss-selling the products of your employers, and the challenge of not designing the products that are unsuitable for your clients.

The two conflicts that we have talked about are neither new nor peculiar to insurance or risk management. When we embark on our life, we face these kinds of conflicts. A time comes in all our lives, when we need to decide whether our convictions and our ethics will prevail or our desire for short term gains. For a mind which is eager to be successful and has the impatience of youth, this can be a challenge. The only word of advice that I

can give you is to never allow your conscience to be side-stepped by considerations of short term gains. Real gains in life are achieved through patience and hard work.

The area of risk management is proving to be a challenge for the managements and regulators alike. While managements need to worry about risks arising from their respective businesses, regulators worry about challenges to the system from the behaviour of individual entities. It is interesting to note that in the recent crisis, big financial institutions got into trouble because they had assets that could not be valued properly because the assets were traded in Over The Counter (OTC) markets that provided no transparency in pricing and did not require adequate margins to be posted against such positions. At the same time, despite the volatility and steep fall in the exchange traded assets all over the world, no clearing corporation got into any difficulty. Exchange traded assets were cleared and settled through clearing agencies in a hassle free manner.

Risk management by its very nature is an unglamorous area. However, the impact of good risk management on the system can be substantial. If you asked a randomly selected sample of one thousand investors whether they had heard of a stock exchange or the index probably all of them will answer in the positive. The visibility of a stock exchange or the index is tremendous. Stock exchange is a place where brokers buy or sell stocks on our behalf. A mere contract to buy or sell is not enough. It is necessary to ensure that it is settled by the seller getting money and the buyer getting the stocks he or she bought. If a broker were to become bankrupt after entering into a transaction but before settlement, how will the counter party broker and his client have his transaction settled? In a physical market where brokers met each other, we could operate a system of trust. Brokers know each other and conclude transactions only with such parties as they believed were capable of settling the transaction. This was very risky. In an electronic system that provides access to brokers from all over the country it is not possible to choose your counter party. The risk of failure to settle in an exchange is managed through an institution called a clearing corporation which becomes the counter party to all the transactions. Thus at the end of the day, the broker's transaction is not with another

broker but with the clearing corporation. The clearing corporation has a fairly detailed system of margining which makes sure that if a broker fails to settle his transactions the clearing corporation can step in and use the margin make sure that the counter party does not suffer. The clearing corporation also has a settlement guarantee fund to back up its obligation to ensure settlement. This is at the very heart of a successful exchange. No investor would be comfortable trading at an exchange if settlements are not guaranteed. India did not have clearing corporations till 1995. A few brokers used to default once every two or three years and it was not unusual to receive complaints from investors that they suffered losses on account of a broker default. With SEBI insisting and succeeding in requiring the exchanges to set up clearing entities and prescribing a scientific risk management system, broker defaults have become very rare and the counter parties in the market do not suffer if a broker fails to settle. This has resulted in the stock exchanges becoming safer places to trade and has been one of the reasons why the trading volumes on the exchanges have grown more than 100 times in the last 15 years. Even in a complicated area like derivatives our clearing corporations have been able to manage risk successfully. Our settlements have been conducted in a smooth and non disruptive manner not withstanding the fact that during the last year the market fell by more than 60 per cent. Now if you went to the same sample of a thousand investors and asked them if they had heard of a clearing corporation it is quite likely that only a handful of them will give a positive response. So much for the glamour of risk management! At the same time it is at the core of successful systems. Clearly some of you have chosen careers that may keep you away from limelight but will enable you to engage in very meaningful work.

Ladies and Gentlemen, we saw that risk containment is possible while risk elimination is not. This is not to argue that risk serves no useful purpose. Entrepreneurs and enterprises add value by taking risks. In fact the progress of mankind has been achieved through risks taken by human beings from time to time. By containing and managing risk we seek to create a better balance between the ability to take risks and the actual risks taken. This is a continuing endeavor. In a larger sense life is about getting a better balance. It would not be out of place if I talked to you about some aspects of our lives where we need to seek a better balance.

You will now embark on your careers. All of us legitimately desire to advance in our careers and would work hard. It is possible to overdo your devotion to work. It is necessary to get the balance right here. You will invariably have jobs that mean very little physical exercise. But our bodies need maintenance, and if we ignore them they will make us pay the price. Youth might carry you on for some time despite neglect but not for very long. We invariably find the excuse of lack of time or the lack of facilities. Believe me, these are not good enough. If nothing else, you can do Yoga. Yoga needs no facilities. It does not need too much time either. It only requires the understanding that you need to balance the demands on your time with your physical well being.

You have worked hard to go through this course and will deservedly get good salaries. You will have your own ambitions to acquire various comforts. This is but natural. At the same time you must consciously think of the society in which we live. We live in a society where more than 30 per cent people do not get two square meals a day. Can we balance our ambition to live a good life with doing something for those who are less fortunate than us? There are plenty of opportunities if we look around. There are institutions which work for the visually challenged, mentally challenged, institutions that work in areas of health, education, empowerment of women. I could go on. You can take your pick. You can decide the contribution you want to make, your money, your talent, your time – again the choice is yours. Do not worry about the quantum of contribution you can make. Even a little bit matters. Get into the habit of doing this, the habit will not leave you. You will be the better off for it. You just have to decide that you want to find the right balance in life. With these words, may I congratulate you again and wish you all the very best in your lives?

Thank you.