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A review of threats to financial stability in modern world: An Indian perspective

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Abstract: Financial stability and sustainability of financial exchange mechanisms have attracted global research attention, especially in aftermath of crises and pandemics. Financial stability (Aikman, Haldane, Hinterschweiger, Kapadia, 2018) is often witnessed as the ability of the mechanisms or system to withstand the challenges and shocks in the working perspective. As per Asian Development Bank, financial stability involves the mitigation of disruptions in the financial intermediation process. This is deemed essential to facilitate a consistent flow of savings to the profitable investment opportunities across the monetary system in question. As per ECB financial stability review, financial stability could emphasize the focus on balance across various participating stakeholders to contain and manage the risks. Financial stability (Gupta, Kashiramka, 2020) is thus being interpreted as involving the aspects of consistency and discipline in the flow of money from across the system. Financial stability (Bordo, 2017) has been a hallmark across studies on political power hood and economic supremacy, and capitalistic manufacturing focus worldwide.

Introduction

Financial stability and sustainability of financial exchange mechanisms has attracted global research attention especially in aftermath of crisis and pandemic. The financial stability(Aikman,Haldane,Hinterschweiger,Kapadia, 2018) often witnesses as the ability of the mechanisms or system to withstand the challenges and shocks in the working perspective. As per Asian Development Bank, the financial stability involves the mitigation of disruptions in the financial intermediation process. This is deemed as essential to facilitate consistent flow of savings to the profitable investment opportunities across the monetary system in question. As per ECB financial stability review, financial stability could emphasize the focus on balance across various participating stakeholders to contain and manage the risks. Financial stability(Gupta,Kashiramka, 2020)is thus being interpreted as involving the aspects of consistency and discipline in the flow of money from across the system. The financial stability(Bordo, 2017) has been a hallmark across studies on political power hood and economic supremacy and capitalistic manufacturing focus worldwide.

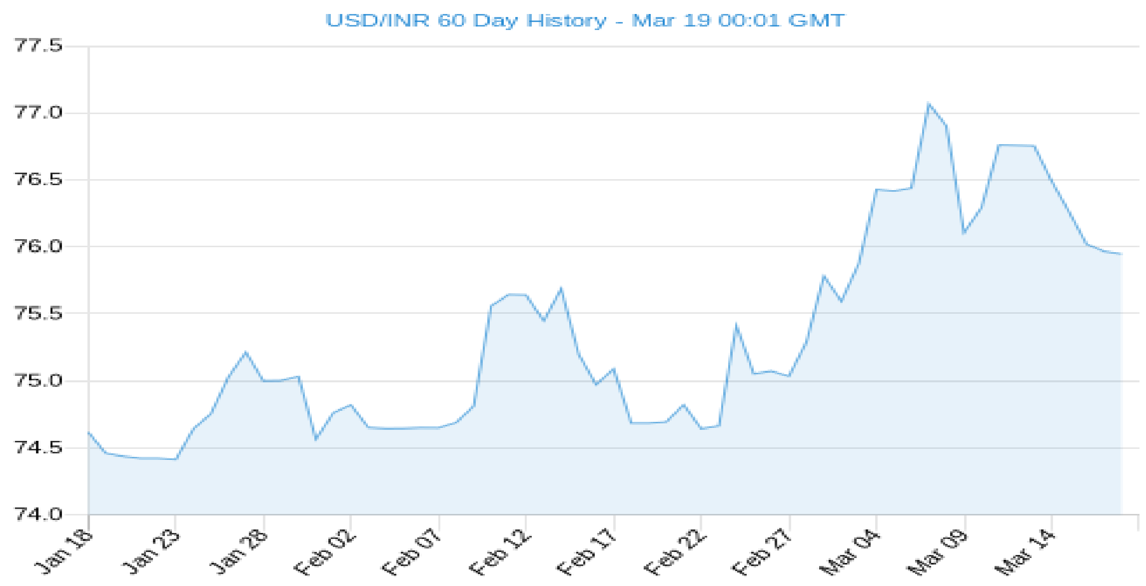
Literature

The measures of financial stability(Gadanecz,Jayaram, 2008) encompass the focus on price level stability, limited volatility in real economy(Aikman,Haldane,Hinterschweiger,Kapadia, 2018), prevention and management of financial crises and respective faith in functioning of the financial institutions. Yet the stability and consistency of flows(Shaidullin,Zhuzhoma, 2019) are always susceptible to the learning curves of central banking staff, the respective malpractices across any of the financial intermediaries and the respective system based defaults. The man-made errors and natural events also seem to possess a strong intent to shape the outcomes vis a vis financial stability. The turbulence(Gupta,Kashiramka, 2020) could arise from any of the actors- individual savers, regulators, central bankers, global central bankers, software glitches, financial disruption, angel investors , aggregators , Google like information technology innovation hubs, banking organizations, non-banking organizations, foreign exchange dealers, brokers, government policy coordination, financial prudence measures and watchdogs, to name a few. Liquidity creation(Gupta,Kashiramka, 2020) and maintenance is an essential policy pursuit that needs immediate and utmost attention in the aftermath of fishy environmental moves. The paper hence enlists a plethora of contextual, contingent, environmental and individual stakeholder driven agents and agencies as shaping the financial stability or instability in post pandemic world.

Geopolitical events and developments

The geographically scattered events(Gupta,Kashiramka, 2020), political balances of power and power games often influence the regional, national and global monetary flows. First it was Iraq war, now the Russian-Ukrainian crisis is casting its impact on the global financial flows and exchanges. The circular impact is evident from the foreign exchange based variations to the domestic currency based fluctuations. The geo-political wars(Zung,Lee, 2021) and events often seem to cast their shadow on the equity markets, currency markets, foreign exchange markets and the currency spot markets. The impact could however vary from country to country and from geography to geography. The respective impact(Petrov,Hentov,Zumbo, 2018) was visible in the aftermath of the Ukraine and Russia crises and in aftermath of the American attack on any nation in the history. The crude induced fluctuations(Sahay,Mitra, 2015) and supply inconsistency have their own impact on the economy's functioning. The cross border impact and especially the payments markets have started witnessing the changes as Russian-Indian trade exchanges remains cut off from SWIFT and MASTERCARD payment platforms. The financial instability generated from closure of payments gateway is leading to chaos and instability and situation for export and import based transactions has turned worrisome. The INR-Dollar exhibited expected speculation before and across geo strategic turbulence in Central Asia. The Indian UPI payment gateway is touted to experience external threats as this is going to be implemented in Russian territory as well.

Figure1: INR-Dollar fluctuation



Financial Exclusion and institutional voids

The financial inclusion(Sahay,Mitra, 2015) and exclusion of masses also pose a critical threat to financial stability. Unlike the developed economies, the developing economies witness significant changes with regard to continuity and consistency of the flow of aid and other policy measures uptill the grass roots level. The literature even calls for institutional inclusion(Achugamonu,Akintola, 2020) and institutional voids(Liedong,Peprah, 2020) as playing a major role in shaping the financial stability in an economy. The exclusion(Alfred,Stefan, 2010) simply derives the poor or the down trodden to benefit from the merits of the financial system and their savings and financial needs cannot be formalized in near future altogether. The institutional voids(Liedong,Peprah, 2020) and their prevalence in the low to middle developing economies often lead to disrupted supply chains and resultant dismal flow of goods and money. The presence of financial exclusion(Alfred,Stefan, 2010) often exhibit as involving the informal money flows and lending mechanisms instead of formalized money flows. Despite the plethora of war footing policy making, the RBI's report (2020-2021) revealed that Indian financial inclusion is just 53.9 percent till end of March 2021. In nominal terms, the excluded masses could be a potential source of threat for monetary policy coverage, institutional finance, credit lending, formalized monetary system and its evident stability. The latest report on financial stability in Indian enlists the exclusion despite PM Jan Dhan Yojna and compulsory insurance; as key deterrent for financial stability and downward flow of fiscal and monetary incentives to down trodden.

Lesser Extent of women participation at top echelons in financial system

Women participation(Sahay,Mitra, 2015) in boards and governance mechanisms across financial institutions has been observed to lead to more stability in financial outcomes. The study(Sahay,Mitra, 2015) across 800 banks spread across 72 nations revealed that the presence of women CEOs or women member sin supervisory boards entail the features of sustainability, sensitivity and rationality to social concerns and inclusive policy making. The study further established the incidence of marked changes in quality of supervision and respective prospects for banking sector stability. The positive correlation was observed across levels of financial access, governance indicators, levels of bank based non-performing assets and the respective control of bank over qualitative banking assets. The financial stability(Gadanecz,Jayaram, 2008) especially with bank's role was observed as getting a boost from the women's presence in bank's supervisory boards. The relative gender diversity(Gadanecz,Jayaram, 2008) also points towards prevalence of better monitoring mechanisms for banking safeguard against instability and shocks from outside the environment. An ADB funded study across global perspective(Qian, 2016) revealed the significant differences with regard to gender diversity in India and Asia. The study figured that a mere 5.2 per cent female representation was observed across Indian boards as mentioned in figure 2 and 3 below.

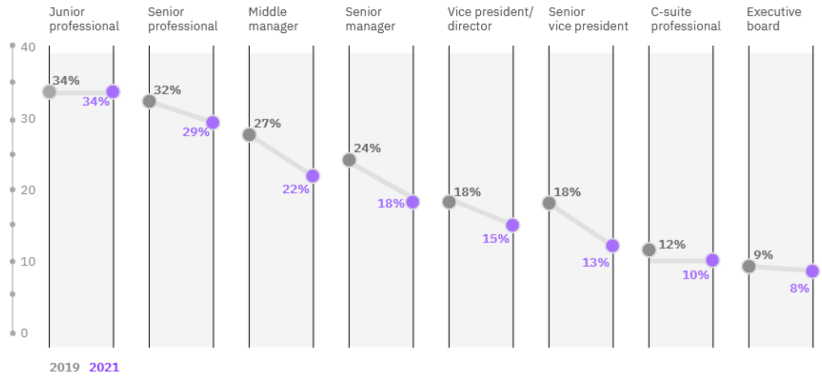
Figure 2: Female representation in boardroom

Female Representation in Boardrooms		Female Representation in Senior Management	
Economy/Region	(%)	Economy/Region	(%)
Western			
United States	16.9	United States	22
United Kingdom	20.7	United Kingdom	20
European Union	16.6	Denmark	14
Finland	26.8	Germany	14
Norway	40.5	Holland	10
Sweden	27.0	Switzerland	13
Asia / Pacific / Mideast			
People's Republic of China	8.5	Thailand	33
India	5.2	India	14
Republic of Korea	1.9	Philippines	40
Malaysia	8.6		
Singapore	8.3		
Japan	2.0	Japan	9
Hong Kong, China	9.6		
Indonesia	11.6	Indonesia	41
Australia	18.2	Armenia	35
New Zealand	14.8	Georgia	35

Source: (Qian, 2016)

As per IBM research institute report(Kralingen, 2021), the women inclusiveness and lack of inclusiveness is potential threat for overall financial stability of system, organizational survival as well as performance in long term scenario. The study further classified the stability as natural outcome of the women's inclusiveness across middle to senior levels yet the gross review of changes from years 2019 to 2021 revealed that women presence across executive suite and across executive board has rather declines from 2019 to 202. A recent address by honorable IMF deputy director Antoinette Sayeh focused on the gender balanced leadership as crucial for change management, adapting to environmental dynamics and becoming more ecology sensitive. The women's wholesome and autonomous participation is thus detrimental to safeguarding financial stability. Some of the prominent women leaders in banking industry like Naina Lal Kidwai, Kalpana and Shikha Sharma have proven their mettle in aligning banking goals with inclusiveness, sustainability and consistency during their tenures.

Figure 3: Transition in women representation in Indian boards and levels:2019-2021



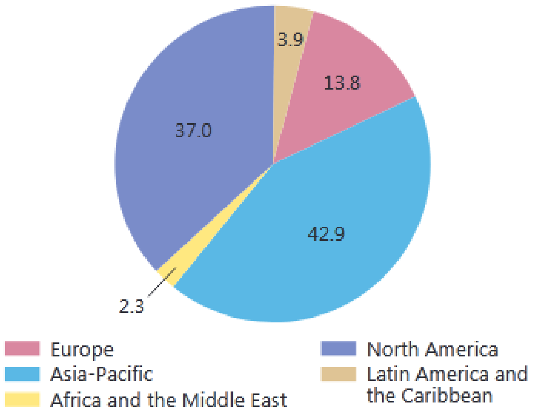
Source: (Kralingen, 2021)

Cyber risks and technological innovations

The threat of cyber risks(Aikman,Haldane,Hinterschweiger,Kapadia, 2018), malware and virus recognizes as the most potential threat from the increasing reliance of banking mechanisms and transactions on ICT tools and applications. The threat especially China borne attacks on the passwords figures as most prominent threat to consistency and encryption of online transactions. The recent data and advisory from National Payments Corporation of India and individual advisory by banks like State Bank of India hints at tremendous risks from cyber-attacks, account theft and identity stealing in name of fake KYC[1] protocols.The technology life cycle(Bordo, 2017) and respective emergence of fintech platforms and aggregating technology driven platforms do shape the implications for stability and non-stability of the financial products and services. The pandemic witnessed the rapid and unilateral transition from physical banking to faceless and digital banking and involved the threats of hacking(Furr,Eggers, 2020), loss of identity or mis-directional flow of transactions. The pace of change of technology from mobile banking to block chain derived financial transactions(Gadanecz,Jayaram, 2008) fostered the new and novel threats to financial stability and security of transactions. The evident changes in ICT scenario, emergence of internet of things, hyper connectivity and glolocalization technologies and virtual reality and emergence of digital currencies pose grave risk to stability of traditional financial instruments, mechanisms, and protocols (figure 4and 5).

[1] KYC=Know Your Consumer

Figure: 4: Geographical divide of big tech payments gateway adoption



Source: (BIS, 2019)

Figure 5: Big Tech firms and their global spread

	Main geographical area of activity	Payments	Money market funds and insurance	Credit
Emerging market economies				
Alibaba/Alipay, Tencent	China	△	△/√	△
Baidu	China	△	△/√	√
Vodafone M-Pesa	East Africa, Egypt and India	△		√
Mercado Libre	Argentina, Brazil and Mexico	△		△
Samsung	Korea	√		
GO-Jek, Ola Cabs	Southeast Asia	△		
Grab	Southeast Asia	△	√	△
KT	Korea	√	△	△/√
Kakao	Korea	△/√		△/√
Advanced economies				
Google	Worldwide	√		△/√
Amazon, eBay/PayPal	Worldwide	√		√
Apple, Facebook, Microsoft	Worldwide	√		
Orange	France	√		√
Groupon	Worldwide	△		
Line, Rakuten	Japan	△	△	△
NTT Docomo	Japan	△	△	√

△ indicates new entities and operations introduced outside the traditional financial and banking network. √ indicates the provision of services as overlays on top of, or in collaboration with, existing financial institutions (especially banks and credit card providers).

Source: (BIS, 2019)

Bad loans and pressures on bank capitalization

The accumulation of bad loans(Shaidullin,Zhuzhoma, 2019), non performing asset bases and accumulation of liabilities in bank balance sheets along with the changes in bank the governance mechanisms could be sources of instability altogether. Bank's balance sheets and fault lines, liquidity mismatches, risk weighted capital constraints;

could possibly lead to the collapse of system. The other potential sources of evident danger to financial stability could be the banks board of members and their biases in decision making. The tools and policy measures of modern risk management(Sahay,Mitra, 2015) in banking industry need to undergo a change as per the evolving scenariosAs per financial stability report of RBI[2], the bad loan comprises a sizable 8.1 per cent of total assets and exhibited a rise from 6.1 per cent in September 2021. This is an awakening call for ensuring financial stability in Indian monetary system.As per RBI report on trends in banking in India 2021, the frauds stood at 14158 crore as against 32290 in fiscal 2020. The majority of the identified and reported frauds were related to payment default or transaction failure and even credit default. As per RBI report on trends in banking, for 2018-2019, 2019-2020, the bank based frauds relate to off-balance sheet operations, foreign exchange transactions, deposit accounts, cyber activity indulgence, telecom SIM based as well as OTP[3] based. The banks reported losing INR 109 crores in 2017-2018 which marks an increase against reported loss of 42 crores in previous year. The bad loans (figure 6) further lead to uncovering of systemic frauds like the 13000 crore Punjab National Bank fraud. The YES Bank fiasco identified as another blot on Indian banking credibility. The Indian Banking Association has underlined the need for cross security checks involving international IT transactions.

Figure 6: Year bound preview-Bad Loans reported

Entity	2017-18	2018-19	2019-20
State-Owned Banks	38260.87	63283.00	148400.00
Private Banks	2478.25	6742.00	34211.00
Foreign Banks	256.09	955.00	972.00
Financial Institutions	164.70	553.00	2048.00
Small Finance Banks	6.19	8.00	11.00
Payments Banks	0.90	2.00	2.00
Local Area Banks	0.04	0.02	0.43
Total	41167.04	71543.02	185644.43

Source: RBI Annual Reports

Media

The evolving media programming(Shaidullin,Zhuzhoma, 2019), social media structures, meta-verse experiments by Facebook and omni-channel flow of information, information driven asymmetries and over load of information is fueling a new kind of turbulence across the financial investors(Shaidullin,Zhuzhoma, 2019), market participants and pose a new kind of threat to financials stability. The transformation of media platforms(Furr,Eggers, 2020) pose a never before threat to the stability and circulation of the bank based information being promoted. The credibility of media, presence of fake news, fake posts across Facebook, data management for political elections, are all instances of media s shaping biased perceptions of citizens(Bidwai, 2011). The media based framing of the fake support for a cause and prevalence of fake news seem to hamper the free monetary exchanges and social exchanges.

[2] RBI=Reserve Bank of India
[3] OTP=One Time Password

Artificial Intelligence

The robo-advising platforms, algorithm guided risk management and risk mitigation modeling needs to be tuned to the realities of evolving contingent environment and need to incorporate the human thinking rather than algorithm driven platforms. The artificial intelligence driven platforms matter as they constitute a bulk of individual decision makingexercise in the global perspective. These platforms seem to hamper individual participation and mindset leverage. The intent to leave the risk management(Bhattacharya,Chandwani, 2021) to quantitative models and mathematical programming yielded reliance on computer programs to justify risk without any human intelligence for the active and proactive risk gauging. The data science driven mathematical models(Gadanecz,Jayaram, 2008) can predict states of low or intense volatility or liquidity yet cannot predict the cyclic trends, systemic failure or collapse of monetary system(Habersang,Reihlen,Seckler, 2019) and state of massive illiquidity in near future across evolving product life cycles. The mathematical modeling induced control illusion(Liedong,Peprah, 2020) somewhat derailed the precise estimation of asset pricing and price discovery and underlying risk. The Indian markets have reported extensive reliance on the robo-advising apps and websites like Upstox, Groww, Infoline and Dhani; which devises algorithm driven advisory; which can be biased and self-fulfilling at times.The data from National payments corporation of India hints at extensive changes in way the payments are being made and executed as well as investment decisions are being made in time following COVID pandemic in India. This identifies as crucial deterrent for financial stability and long term perspective.

Inconsistencies under pandemic

The systemic inconsistencies and imposed lockdown like measures and respective articulation of corporate interest across 'for profit' organizations(Garicano, 2015) seem to possess extensive implications for the working of economy and respective transfer of risk and threat across the system. The studies even correlate the systemic failures and managerial thinking as overall context of decision making. The health(Varman,Vikas, 2007)issue driven priorities;also casted immense impact on the functioning of economy and respective monetary systems worldwide. The cognitive biases of decision makers(Toshino,Suto, 2004)also seem to cast a significant impact on the risk transfer, risk circulation and containment of risk in the system. The measures of financial stability(Gadanecz,Jayaram, 2008) encompass the focus on price level stability, limited volatility in real economy, prevention and management of financial crises and respective faith in functioning of the financial institutions.The industrial engineering(Bhattacharya,Chandwani, 2021) practices and respective attempts at product life cycle management also influences the financial stability or instability.

Legitimacy of financial innovations and public acceptance

The fragility and susceptibility of the financial markets(Sahay,Mitra, 2015)and financial asset(Gupta,Kashiramka, 2020) classes to the innovated financial products often casts larger than life threat on the viability and prudential working of the system. The extent of public acceptance of the financial innovations also determines the scope for economies and monetary systems to stay afloat and retain functioning in maximum proportion. Financial innovation and disruption economics often cast a shadow on the manner in which markets, intermediaries interact and rely on infrastructure to access funding for the activities and invest the respective savings. The public acceptance of financial innovation is a matter of intense research attention worldwide. The intent to give back to society(Bordo, 2017) and inclusive policy making(Friedland,Alford, 1991) also seem to pose consequences for financial stability and risk containment .The corporate social responsibility measures seem to cushion the divides in the society. The structured product, risk transfer based financial products, mismatch across maturity cycle in bank's off-balance sheet vehicles and rating of financial products; formed the basis for financial crisis.The organizational failure(Habersang,Reihlen,Seckler, 2019) to revive, to bounce back or to survive and seek renewal also seem to influence the scope for survival and systematic revival. The big technology and changing future of financial intermediation(Frost,Gambacorta,Zbinden, 2019) in India and world, is matter worth consideration as this is bound to possess implications for legitimacy regime, acceptance, scope for hacking and ill-warranted siphoning off of funds from banking system. As per report by RBI, the issues of privacy, anti-trust rules, data theft, cyber security are prominent and threats to sustainability cannot be given a miss(figure). The report further pointed to the evolving mess that is over riding the existing governance structures, presence in financial and non-financial lines of business, ability to overcome and override the limits to scale, backed by extensive funding; as prominent threat areas. The challenges are grim as they could evade money laundering checks and could possibly lead to terrorism finance in disguise(figure 4). The crypto currency is still observed as a threat to national currency and the fluctuations and systemic loopholes in management of BITCOINS still render them non grant of legitimacy in Indian annual budget. As per economic survey for 2021-2022, these are probable illegitimate money considerations.

Conclusions

The research reflected on the plethora of contextual, contingent, environmental and individual stakeholder driven agents and agencies as shaping the financial stability or instability in post pandemic world. The research figured out the role of diverse stakeholders and their possible contribution in shaping the risk containment and ensuring financial stability.Liquidity creation(Gupta,Kashiramka, 2020) and maintenance was observed as a vital policy pursuit that needs immediate and utmost attention in the aftermath of fishy environmental moves. The stability and consistency of flows(Shaidullin,Zhuzhoma, 2019)was observed as an outcome of the learning curves of central banking staff, the respective malpractices across any of the financial intermediaries and the respective system based defaults. The man made errors and natural events also seem to possess a strong intent to shape the outcomes vis a vis financial stability. The turbulence(Gupta,Kashiramka, 2020)was observed to emerge from any of the actors-individual savers, regulators, central bankers, global central bankers, software glitches, financial disruption, angel investors , aggregators , Google like information technology innovation hubs, banking organizations, non-banking organizations, foreign exchange dealers, brokers, government policy coordination, financial prudence measures and watchdogs, to name a few.

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