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Presentation of a Conceptual Model for Central Bank Supervision over Banks with a Grounded Theory Approach

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ABSTRACT

Objective: The aim of this research was to present a conceptual model for Central Bank supervision over banks with a grounded theory approach.
Method: In this study, the grounded theory research approach based on parametric methods is employed. The statistical population of this research comprises experts and professionals in the field of central banking, capable of providing valuable information to the researcher. Sampling in this research has been conducted purposively. For this purpose, the qualitative samples of this research consist of 15 experts and professionals knowledgeable in the field of central banking. Data analysis of this research has been performed following the procedures of Strauss and Corbin (2011) at the Central Bank.
Findings: According to the findings of the current research, factors such as government ownership in banks and changes in bank ownership, the impact of general economic conditions, the role of governance and government in supervision, government intervention in decision-making and management of the banking system, and the necessity of consistency and unity of approach in supervision are influential as intervening conditions on the strategies of the supervisory model. Further, the readiness of managers and experts in the banking system to accept the model, creating economic and social conditions meaning stability in the economic situation based on macroeconomic variables, attention to the characteristics of the banking industry as intermediaries in allocating surplus resources of some economic sectors to others in need of financial resources, and defining a suitable position for the supervisory institution in terms of ensuring the independence of the supervisory body, and providing sufficient authority in supervision were contextual conditions. Then, strategies for the success of the supervisory model were presented, including the identification and assessment of major risks in the banking industry such as credit risk, liquidity risk, market risk, and operational risk, in terms of structure and risk management methods, related analyses, and their impact on the future outlook of each bank's activities.
Conclusion: Strategic analyses regarding the distribution of granted loans, commitments, investments in affiliated companies, and the status of bank reserves, assets, and collaterals, and the presentation of precautionary plans during economic shocks or potential crises are among the strategies of each bank.
Keywords: *Supervision, Banking, Central Bank, Grounded Theory*

1 Introduction

Supervision of the banking system is an integral aspect of modern economic systems and primarily comprises mechanisms for overseeing the performance of banks to ensure the financial security of depositors, the government, and the economic system as a whole, thereby preventing the collapse of the banking system and its consequences (Grilli et al., 2014; Lastra, 1992; Yazdani et al., 2015).

The link between monetary and banking issues with the national economy raises the question of how to employ the most appropriate mechanisms for supervising banks and financial institutions; since whenever an economic crisis or financial corruption occurs in society, all or part of the problem is attributed to the supervision of financial institutions and banks. The discussion of supervision over the banking system and financial institutions in the country was first raised in the country's Banking and Monetary Law of 1960 and was entrusted to the Money and Credit Council; while this council is also responsible for monetary and financial policy-making in the country (Afrouzi et al., 2023; Khatabi & SeifiPour, 2006; Rahmani & Amir Sadeghzadeh, 2011; Yazdani et al., 2015). In the Banking and Monetary Law of 1972 and its amendment in 2015, the responsibility of supervision over the banking system and financial institutions was delegated to the Central Bank. Additionally, reference can be made to the Law on Regulating the Unorganized Money Market of 2004 and the Fifth Five-Year Development Plan Law of the Islamic Republic of Iran of 2010, regarding the delegation of supervision over the banking system and financial institutions to the Central Bank. A common feature of these laws is the consolidation of monetary and banking policymaking and supervisory roles in one institution; without providing a precise definition of the concept of supervision, its objectives and importance, and the scope of authority and responsibilities of the supervisory institution in overseeing banks and financial institutions. In this context, the proponents of the proposed transformation plan in the banking system have delegated the definition and concept of supervision and its method to the Central Bank, which will be approved by the Council of Ministers through a bylaw (Mostafapour, 2017; Rahmani & Amir Sadeghzadeh, 2011).

One of the fundamental criticisms of the structure of the Central Bank, which is responsible for supervising the banking system and financial institutions, is its lack of independence and its reliance on the executive branch. From the appointment of the Central Bank's president to complete adherence to the economic policies of the executive branch, the principle of the Central Bank's independence as the supervisory institution over the banking system is violated and is a fundamental challenge for this institution. With the implementation of Article 55 of the Constitution, banks were the first institutions to be separated from the government's body, and private or non-governmental banks and financial institutions were established (Mostafapour, 2017).

According to the country's laws, the establishment and operation of any type of bank and financial institution are subject to the authorization of the Central Bank. What has happened in practice in recent years is the mushrooming growth of private banks without obtaining permission from the Central Bank and operating in the banking sector without compliance and observance of the laws and regulations set by the Central Bank. Money laundering, the expansion of unhealthy competition among banks and financial institutions outside the regulations and norms of banking, creating economic and social crises, overlooking the rights and interests of depositors, and the Central Bank's inability to supervise these institutions and banks for various reasons, including the lack of defined supervisory duties, lack of independence, and lack of necessary supervisory tools, have harmful and negative effects on society and the country's economy (Jafari Samimi & Ahamdi, 2002; Kianpour, 2010; Rahmani & Amir Sadeghzadeh, 2011).

Regarding the existing problems in the supervisory realm of Iran's banking system, legal weaknesses and gaps arising from legislation should be considered the most fundamental challenges. A clear example of the exercise of supervision is Clause B of Article 99 of the Banking and Monetary Law of the country enacted in 1972. According to this clause: "Supervision over banks and credit institutions, according to the regulations of this law, is the responsibility of the Central Bank"; however, there is no clear explanation of the concept of supervision and its objectives, supervisory institutions, their authorities, and limits. There is also a dispute over whether the supervisory institution is only responsible for monitoring the market and reporting to the competent authorities or whether it has the power to penalize specific banks, which exacerbates instability in the supervisory realm (Yazdani et al., 2015; Zarineghbal et al., 2018).

The significance of legislation is such that issues like the superficiality of banking operations and the lack of serious confrontation with them, non-disclosure of real financial statements by loan applicants, etc., arise from legal gaps in the mentioned matters; because banks, after granting loans, have minimal intervention or supervision in concluded

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contracts, and lack of supervision leads to the excessive consumption of banks' resources for unrealistic goals, contributing significantly to the creation of production stagnation, inflation, unemployment, and the blocking of national capital in unfinished projects that lack economic justification (Khatabi & SeifiPour, 2006).

Alongside legal problems and gaps in the supervisory realm, our country's banking system also has weaknesses in assessing banks' internal control systems; due to the lack of necessary human, software, and hardware capacities in this area and the discovery of errors. If banks do not provide relevant information systematically to the Central Bank or send incorrect information, the supervisory authority will not have the necessary efficiency to exercise supervision (Yazdani et al., 2015).

Therefore, presenting a clear and purposeful framework for forming an optimal organizational structure that allows the supervisory authority to act effectively is accomplished through a concept known as corporate governance. Corporate governance ensures that innovations, programs, and policies of senior bank managers, etc., are implemented and executed within a standard and framework that always takes into account the most important risks of bank management. Moreover, the lack of effective religious supervision in Iran's banking system should also be considered one of the most important supervisory challenges. Despite the establishment of jurisprudential and economic committees and councils in the Central Bank, little attention is paid to religious supervision in practice, and the issue of supervision does not have a specific official and legal guardian. Even in political supervisory packages, it is not given importance. Therefore, in this research, the researcher intends to address the model of Central Bank supervision over banks with an approach to electronic banking.

2 Methods and Materials

2.1 Study Design and Participants

The present study is foundational in terms of data analysis methods. This study employs a grounded theory research approach. Grounded theory is a qualitative research method used to identify the underlying categories of the phenomenon under study. The primary method of data collection in this approach is various types of interviews, and through analysis and coding of interview texts, a paradigmatic model is presented. This study is descriptive-exploratory in terms of its overall objective. The discovery process in this study is based on expert opinions. Finally, the tools and methods of data collection in this study are based on semi-structured interviews.

The statistical population of this research comprises experts and professionals in the field of central banking. Sampling in this research was conducted purposively. In qualitative research, data collection ceases when information about all categories under consideration is saturated, and this occurs when the theory or subject of study is complete and no new information related to the study subject is obtained. Thus, in qualitative research, the sample size is determined by data saturation. In this regard, the qualitative samples of this research consist of 15 experts and professionals knowledgeable in central bank supervision.

2.2 Data Collection

In this study, in the data collection part, the interviews were initially typed as texts without any changes; then, a multitude of open codes were identified. By reading and reflecting on the initial codes, codes that were conceptually related were combined to form similar concepts (axial codes), and the axial codes then formed the selective codes. Corbin and Strauss (2008) suggest acceptability as a criterion for evaluating grounded theory theory processing research instead of traditional validity and reliability standards. Acceptability means that the research findings are credible and believable to the extent they reflect the experiences of participants, researchers, and readers regarding the studied phenomenon. Ten indicators for the acceptability criterion have been introduced, five of which were used in this research to enhance scientific accuracy and validity.

2.3 Data Analysis

The data analysis was carried out according to the procedures of Strauss and Corbin (2011). This method includes three main stages: open coding, axial coding, and selective coding, eventually leading to the expression of the qualitative research model. Therefore, the researcher addresses the relationship between concepts derived from interviews (initial coding) and the fundamental bases of the research, striving to create a comprehensive, complete, and integrated connection between the said categories, to develop axial coding, and finally present their model in the field of central bank supervision over banks.

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3 Findings and Results

After a complete review of the interview texts with professors and experts in financial and banking sciences and the process of open coding, 95 concepts were extracted. The extracted concepts were re-examined, and an attempt was made to merge those that were somewhat similar. At this stage, after reviewing and merging the extracted concepts, the number of concepts was reduced to 61. The extracted concepts in the open coding stage, related categories, and the number of repetitions of each are presented as follows:

Table 1

Summary of Qualitative Analysis

Row	Open Code	Primary Concepts (Open Coding)	Categories	Frequency
1	c01	The Necessity of Establishing Adequate and Appropriate Laws	Setting Adequate and Appropriate Laws and Regulations, and Enforcement Guarantees for Laws and Regulations	105
2	c02	Existence of Multiple Regulations		
3	c03	Establishing Laws Contradictory to Risk-Based Supervision		
4	c04	The Necessity of the Possibility of Supervision According to the Laws		
5	c05	Weakness of Supervision in Certain Banks		
6	c06	Establishing Necessary and Mandatory Standards by Banks		
7	c07	Establishing Prudential Regulations		
8	c08	Inadequacy of Comparative Supervision	Inadequacy of Supervision	10
9	c09	Retrospective Nature of Supervision in Current Conditions		
10	c10	Wide Range of Activities of Government Banks	Role of Bank Ownership (Governmental and Private)	13
11	c11	Diversity and Changes in Bank Ownership		
12	c12	Composition of Bank Shareholders		
13	c13	Shortage and Inappropriate Allocation of Resources	Shortage and Inappropriate Allocation of Resources	11
14	c14	Wide Economic Needs and Limitations of Banking Resources		
15	c15	Application of IT-Based Supervision	Information Technology	27
16	c16	Use of Information Systems		
17	c17	Gathering of Suitable Information and Reporting	Appropriate Reporting	21
18	c18	Accuracy and Timeliness in Reporting		
19	c19	Integration of Reporting Systems		
20	c20	Establishing a Suitable Control System	Establishing a Suitable Control System	14
21	c21	Effectiveness of the Internal Control System		
22	c22	Allocation of Specialized Human Resources	Allocation of Specialized Human Resources	14
23	c23	Training and Development of Human Resources		
24	c24	Role of Independent Auditors	Role of Independent and Internal Auditors	56
25	c25	Role of Internal Auditors		
26	c26	Conflict of Interests among Stakeholder Groups	Conflict of Interests among Stakeholder Groups	56
27	c27	Establishment of a Credit Assessment and Rating System	Credit Assessment and Rating	7
28	c28	Implementation and Warning of Preventive Actions	Adopting an Appropriate Approach Before and During Crises	17
29	c29	Implementation of Corrective Actions During Crisis Periods		
30	c30	Implementation of Punitive Actions		
31	c31	The Role of the Government in Crisis Situations	The Role of the Government and Sovereignty in Supervision	7
32	c32	Attention to the Role of Other Governance Sectors		
33	c33	Government Intervention in Effective Supervision		

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34	c34	Overall Economic Situation and Its Mutual Impact on Banks	Overall Economic Situation and Its Mutual Impact on Banks	14
35	c35	Government Intervention in Decision-Making and Bank Management	Government Intervention	6
36	c36	Independence of the Supervisory Authority	Defining a Suitable Position for the Supervisory Authority	36
37	c37	Authority of the Supervisory Authority		
38	c38	Support for the Supervisory Authority		
39	c39	Conflict of Interests of Stakeholder Groups	Corporate Governance	56
40	c40	Role of Internal and Independent Auditors		
41	c41	Establishment of a Bank Credit Assessment and Rating System	Credit Assessment and Rating	7
42	c42	Implementation of Preventive Warning and Action	Adopting an Appropriate Approach Before and During Crises	17
43	c43	Implementation of Corrective Actions in Critical Situations		
44	c44	Implementation of Punitive Actions		
45	c45	The Role of the Government in Crisis Situations	The Role of the Government and Sovereignty in Supervision	7
46	c46	Attention to the Role of Other Governance Sectors		
47	c47	Government Intervention in Effective Supervision		
48	c48	Overall Economic Situation and Its Mutual Impact on Banks	Overall Economic Situation and Its Mutual Impact on Banks	14
49	c49	Government Intervention in Decision-Making and Bank Management	Government Intervention	6
50	c50	Independence of the Supervisory Authority	Defining a Suitable Position for the Supervisory Authority	36
51	c51	Authority of the Supervisory Authority		
52	c52	Support for the Supervisory Authority		
53	c53	Stability and Health of Banks	Stability and Health of the Banking System	17
54	c54	Supporting the Interests of Depositors and Stakeholders	Supporting the Interests of Depositors and Other Stakeholders	10
55	c55	Enhancing Transparency	Transparency	27
56	c56	Increasing Accountability Capacity	Accountability	8
57	c57	Defining Risk Limits	Establishment of a Risk Management System	53
58	c58	Risk Identification		
59	c59	Risk Measurement and Assessment		
60	c60	Approaches to Risk Management		
61	c61	Consistency and Unity of Procedure in Supervision	Unity of Procedure	6

After reviewing the concepts extracted in the open coding stage, the category "Establishment of Central Bank Supervision over Banks" was considered as the central category, and axial coding was conducted accordingly. In this phase, causal conditions as factors influencing the central category were considered, followed by the determination of intervening and contextual conditions based on which the Central Bank's supervision model over banks was presented, and subsequently, the outcomes and outputs resulting from the introduced model were defined. Also, after collecting articles and research related to the subject, library study and review of theoretical literature related to the research topic from accessible research references, some components were considered in the final model, and ultimately, the visual model of bank-based supervision is presented as follows:

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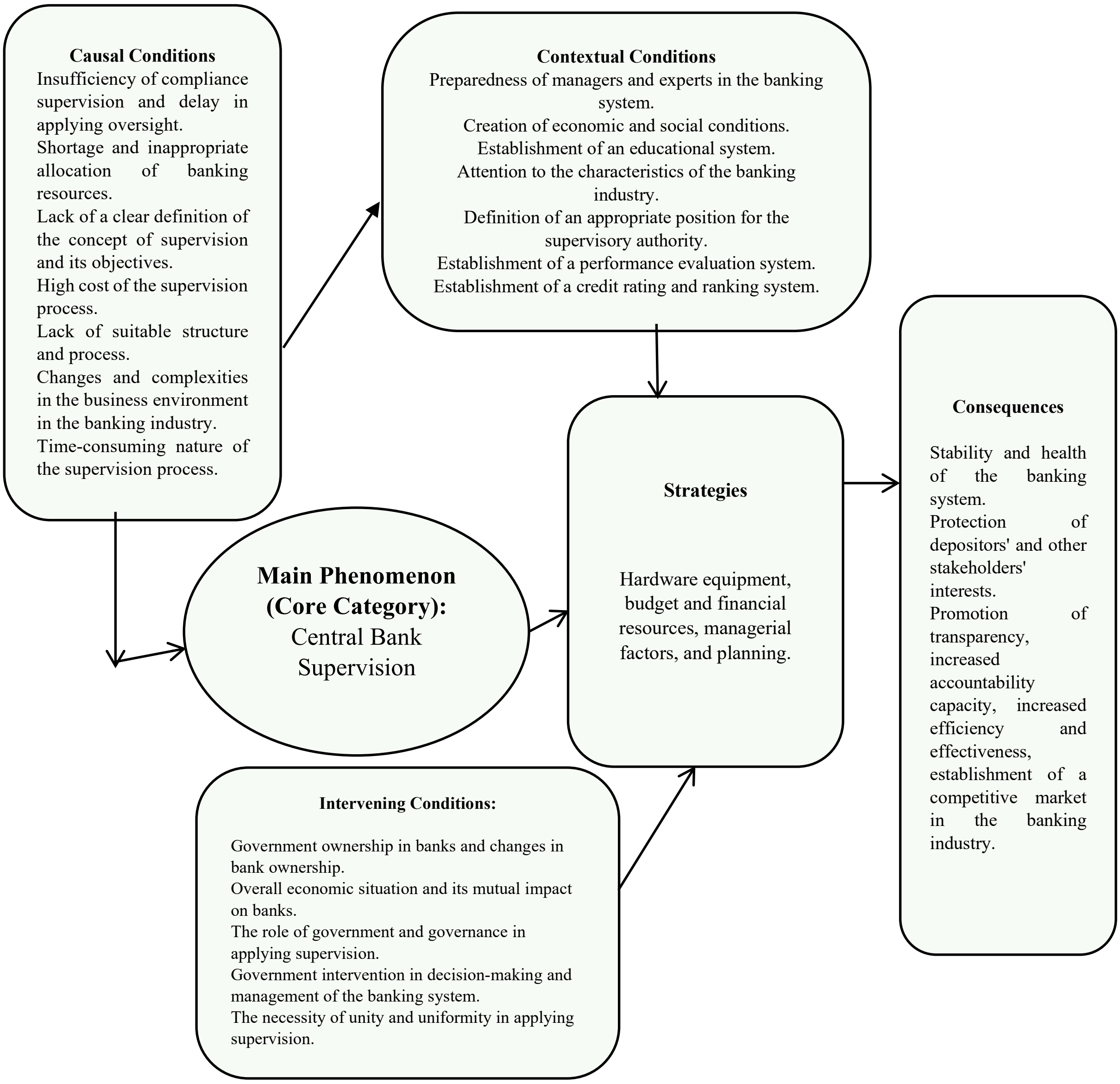
Figure 1

Paradigm Model



4 Discussion and Conclusion

The aim of this research was to present a conceptual model for Central Bank supervision over banks with a grounded theory approach. This issue causes disharmony between the supervised organization, the supervisory institution, and decision-making authorities. Moreover, the inadequacy of the current supervisory situation, due to the retrospective nature of the existing supervisory framework, has led to dissatisfaction with the output of the current supervisory framework at a low level. The sole reliance on a comparative supervisory approach and the lack of attention to future risks and forecasting, as well as the absence of an appropriate process and structure in the exercise of supervision, necessitates Central Bank supervision over banks (Mohammadkazemi et al., 2022; Moser et al., 2021; Sodoma et al., 2019). Additionally, the shortage and inappropriate allocation of banking resources, along with the extensive changes and complexities of the business environment in the banking industry, high costs in applying supervision, and its time-consuming nature, justify the need to establish a supervisory model over banks. The present research, in pursuit of presenting the Central Bank's supervisory model over banks, offers strategies influenced by intervening and contextual conditions, as well as a review of the research literature that has been formed. Based on the findings of this study, factors such as government ownership in banks, changes in bank ownership, the impact of overall economic conditions, the role of governance and government in exercising supervision, government intervention in decision-making and managing the banking system, and the necessity of consistency and unity in applying supervision are influential as intervening conditions on the strategies of the supervisory model. On the other hand, factors such as the readiness of managers and experts in the banking system to accept the model, creating economic and social conditions meaning stability in the economic situation based on macroeconomic variables, attention to the characteristics of the banking industry as intermediaries in allocating surplus resources from some economic sectors to others in need of financial resources, and defining a suitable position for the supervisory institution in terms of ensuring the independence of the supervisory body and also providing sufficient authority in supervision, can be considered as contextual and groundwork conditions for the implementation of the model. Influenced by the aforementioned causal, intervening, and contextual conditions, strategies for the success of the supervisory model were presented, including the identification and assessment of major risks in the banking industry such as credit risk, liquidity risk, market risk, and operational risk, in terms of structure and risk management methods, related analyses, and their impact on the future outlook of each bank's activities. Additionally, strategic analyses regarding the distribution of granted loans, commitments, investments in affiliated companies, and the status of bank reserves, assets, and collaterals, and the presentation of precautionary plans during economic shocks or potential crises are among the strategies of each bank. If effectively pursued and implemented, these strategies will enhance transparency and establish a responsive system in the banking network, ensuring the stability and integrity of the banking system and protecting the interests of depositors as one of the active pillars in the banking industry.

Success in establishing a supervision system requires attention to components such as a suitable internal control system, the presence of specialized human resources, attention to the role of independent and internal auditors, and the importance of conflict of interest among stakeholder groups on one hand, and defining a proper relationship between management, ownership, customers, and the Central Bank as the supervisory institution in the form of corporate governance requirements in the banking network on the other (Daryaei et al., 2020).

For the success of the supervision system, supervising throughout the life cycle of banks and credit institutions from the acceptance of establishment requests, during operation, to the dissolution phase and thereafter is essential due to the sensitivity of the banking industry in the economic cycle. Appropriate decisions and actions by the supervisory institution, including warnings and preventive measures to avoid exacerbating the risk situation, as well as corrective and punitive actions to prevent crises in the banking industry, are imperative.

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Declaration of Interest

The authors of this article declared no conflict of interest.

Authors Contributions

All authors have contributed significantly to the research process and the development of the manuscript.

Ethics principles

In this research, ethical standards including obtaining informed consent, ensuring privacy and confidentiality were observed.

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