Original Article

Journal of Social Welfare and Management
Volume 10 Number 2, May - August 2018

Risk Management in the Banks: An Analysis

C. Sri Ramya[1], G.V. Abhinav Kumar[2]

Abstract

The goal of risk administration isn't to preclude or anticipate risk taking, however to guarantee that the risks are intentionally taken with full learning, clear reason and seeing so it can be estimated and moderated. In the event that a bank can go for broke all the more deliberately; envision unfriendly changes and could support likewise; Risk Management turns into a well spring of upper hand, as a bank can offer its items at a superior cost than its rivals. For planning viable Risk Management methodologies, we have to create different Risk Management Committees like Credit Policy Committee, Asset Liability Management Committee, and a proficient Management Information System. Other than this, a goal and dependable information base must be developed for which bank needs to dissect its own past execution information identifying with advance defaults, exchanging misfortunes, operational misfortunes, and so forth., and turn out with benchmarks in order to set themselves up for the future risk administration exercises. In light of these realities the present paper presents the idea of Risk Management, its segments and the related issues. It at that point evaluates the different Risk Management systems being taken after and the methodologies proposed and actualized by banks world over and which are additionally in accordance with the Basel Committee suggestions. The information utilized, has been gathered from auxiliary sources. The majority of the data was gathered from productions of different National and International Organizations. The data gathered has been grouped and investigated for research.

Keywords: Risk Management; Banking.

Introduction

The banks in India have been truly in the trap of consistently rising Non-Performing Assets for quite a while. This has prompted a considerable lot of the banks playing a wary amusement by putting resources into the most secure endeavors, subsequently limiting risk. Be that as it may, benefitting without presenting to risk resembles attempting to live without being conceived. Development and improvement of any business association relies upon its risk administration and benefit producing limit. Subsequently risk isn't to be kept away from yet to be overseen. Both risk and benefit have time measurement, which drives us to future projections. These future projections have a component of vulnerability since future isn't generally splendidly unsurprising. This component of vulnerability offers ascend to risk, which, thusly, influences benefits. For guaranteeing long haul survival of banks, the risk measurement of managing an account must be tended to fittingly. The significance of risk administration in the present day managing an account industry is gotten from the expanding challenges reserved by the deregulation and progression of the money related framework.

Author's Affiliation: [1&2]Research Scholars, PGDM-Banking, Insurance and Financial Services, Institute of Public Enterprise, Hyderabad, Telangana State, India-500101.

Reprint's Request: G.V. Abhinav Kumar, Research Scholars, PGDM-Banking, Insurance and Financial Services, Institute of Public Enterprise, Hyderabad, Telangana State, India - 500101.
E-mail: 1603001@ipeindia.org

Received on 12.06.2018, **Accepted on** 18.06.2018

© Red Flower Publication Pvt. Ltd.

Study of Literature

Culbertson propounded the hypothesis of 'Term structure of Interest Rates' which was a short time later also called the hypothesis of 'Risk Averseness'.

As indicated by the hypothesis the most ideal approach to limit risk is to coordinate developments of advantages and liabilities or to coordinate developments with holding periods. On the off chance that a moneylender knows precisely to what extent his cash will be accessible for venture, he can choose the development date of the claim such that he runs neither the pay risk nor the capital risk.

Summon Kumar Bhaumick and Jenifer Piesse have created a perfect work of art take a shot at risk revulution by banks. Their examination is an eye washer which demonstrates that private proprietorship, albeit regularly may enhance allocative effectiveness as against people in general segment banks, typically thought to be less productive, in the credit showcase, it might be impeding to credit disbursal, if the risks related with this are fundamentally high. Likewise remote banks will take critical exposures to the Indian borrowers, they are probably going to limit their introduction to blue chip borrowers and not misuse the maximum capacity of the assets, including delicate quality of administrative requirements, available to them. Significantly, the aftereffects of both this paper and Bhaumik and Dimova (2004) demonstrate that the local all over again banks outflank the others concerning both productivity and specialized effectiveness as for credit disbursal.

Risk Management and Related Issues

Risk Management is the helpful control of risk levels in order to restrict the drawback impact of the hidden activity inside the capacity and ability to hold up under this impact, while enhancing the profits from the activities for which the risk is accepted. Risk Management is tied in with overseeing risk and not killing it. The primary goal of Risk Management is 'Introduction by Choice and not by Chance'. It includes the setting down and consistence of risk strategies, setting up of control and observing instruments, setting up risk mitigates, upgrading risk remuneration, putting aside cash-flow to meet sudden misfortunes, and so on. The procedure incorporates the use of measurable and scientific models, other than subjective investigative methods.

Approaches to Risk Management

One could approach risk in a latent, receptive, intuitive or proactive way. Quickly these could be compressed as:

- Inactive risk administration: when the bank just disregards the thought of risk issues by any stretch of the imagination. The bank does not try to address or even worry about the likelihood that things may not turn out as was proposed. This situation isn't as implausible as no doubt. Indeed, even today, there are various banks which don't have a formal framework to manage such indispensable inquiries.
- Reactive risk administration: when there is a posthumous push to enhance the impacts of risk that have emerged. It at that point ends up being an emergency administration exertion.
- Interactive risk administration: This is the point at which the bank is worried about risk all through every one of its different life-cycles.
- Proactive risk administration: This is the point at which the bank designs and tries to figure risk potential and after that receives different measures that would control, to the degree conceivable, risk possibilities.

Components of Risk Management

- Risk recognizable proof
- Risk evaluation or estimation
- Risk control

Risk recognizable proof comprises of naming and characterizing every one of the risks related with an exchange or a kind of bank item or administration. In the wake of finishing the lattice for all results of administrations, one can read over a specific sort of risk, say, 'credit risk' push and can get a photo of items that are wellsprings of credit risk. The totality of credit risk might be named as a 'pool of risk'. Risk estimation alludes to estimation of the size, likelihood and timing of a potential misfortune under different situations. Resource obligation administration is a decent case of risk estimation and resource obligation investigation can give a gauge of the potential impact of the adjustments in the financing costs on the main issue of the banks. Risk control is looked on as the whole procedure of arrangements, methodology, and frameworks and establishment needs to oversee judiciously every one of the risks coming about because of its money related exchanges and to guarantee that they are inside the bank's risk craving.

Risk Management Measures

- Preventive measures, and
- Curative measures.

Preventive measures are principally pertinent for incomplete alleviation of credit risk and a few types of market risk. Appropriate choice of customers, reinforcing of free data accumulation frameworks for proposed borrowers, fortifying of evaluation framework, close confirmation of end-utilize, and so forth., are preventive measures of relief of credit risk.

Curative measures incorporate 'risk supporting' and 'risk sharing'. Supporting is a system by which risk is exchanged to a counter gathering. Banks and monetary organizations, the world over, utilize different types of subsidiary instruments like alternatives, prospects, swaps, and so forth, for risk supporting. Risk sharing as a vital idea is utilized fundamentally in the event of financing framework and vast center division extends by banks and budgetary establishments, wherein the risks engaged with financing are shared by banks/FIs with different gatherings like development temporary workers, O and M contractual workers, input (fuel) providers, purchasers (SEBs), and so on., at various phases of the undertaking life cycle.

Banks in created nations make utilization of Standardized or Customized scientific models and procedures for risk administration. The institutionalized strategies utilized are:

Nature of Risk	Techniques Used
Credit Risk	Sensitivity Analysis
	Decision Tree Analysis
	Simulation
Market Risk	GAP Analysis
	Duration Analysis
	Duration GAP Analysis
	Value Risk Analysis

For Credit Risk Management, Sensitivity investigation is normally directed by most Indian Financial establishments. The choice tree and recreation systems convey change over the affectability method to the degree that while in the affectability procedure, the risk related variety of any of the key determinants is figured, the other two strategies endeavor to survey risk engaged with the credit proposition, should in excess of one key determinants fluctuate at the same time.

Market risk is tended to by a procedure known as "Resource Liability Management". A monetary foundation for the most part partitions its portfolio into two bits: (1) the exchanging segment and (2) the non exchanging segment.

Objectives of the Study

In light of the above certainties, it can be expressed that Risk Management is a basic piece of the budgetary framework and henceforth requires due weightage in the strategy arrangement for what's to come. However the present examination fundamentally is focused on two vital issues:

- To ponder the idea of Risk Management as a piece of Banking System and its parts.
- To think about the current methodologies hypothetically to Risk Management as being used universally and which are in accordance with the Basel Committee proposals. This would help us to assemble a few benchmarks in the keeping money part division and would likewise carry us at standard with the worldwide level, subsequently giving us the quality of intensity.

Developments in Credit Risk Management

Risk administration and innovation: National Institute of Bank Management (NIBM), with its involvement in Information Technology and fund answers for the Banking business has proposed a Business-innovation demonstrate named as Enterprise Maturity Model which gives a structure to a staged presentation of the Executive Information System (EIS). The Enterprise Maturity Model has five layers with characterized business targets at each level beginning with expanding operational effectiveness and driving upto considerably more key goals like boosting riches and partner esteem.

The IT Strategies of a bank can go about as empowering agents in the accompanying three regions like

- Credit Information Systems
- Analytical Tools
- Level of work process mechanization

The goal of a Credit Information System is, to improve the estimation of information by giving exact

and auspicious data, in this manner altogether adding to better arranging and basic leadership on the credit portfolio. Credit Information Systems and Credit Risk Management Information Systems ought to be intended to defeat the issue of totaling information crosswise over different sources and specialty units.

Analytical Tools

At each phase of overseeing risk in the credit portfolio, various investigative devices should be utilized to upgrade the procedure of basic leadership. The graph beneath portrays a portion of the Analytical Models utilized as a part of Credit Risk Management.

Fig. 1: Stages in Credit Risk Management: Analytical Model and Benefit
(*Source*: Introducing IT in Banks, NIBM Research Papers, 2002)

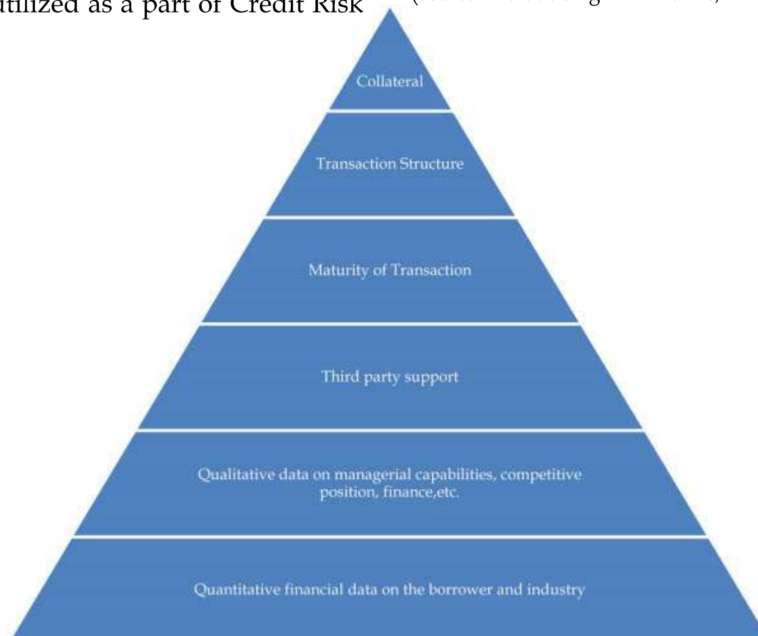

Fig. 2: Data Requirements for Credit Risk Management
(*Source*: Introducing IT in Banks, NIBM Research Papers, 2002)

Fig. 3: Integrated CRM Process

Source: Integrating IT Strategies with Business Strategies, NIBM Research Papers, 2002

Internal Ratings for Credit Risk Management: Basel Accord

It is apparent that Basel has given much thought of the linkage between use for rating models and validation of internal ratings. The Basel Committee on Banking Supervision has brought unprecedented focus to issues relating to consistency and robustness of financial institutions' internal credit risk system management processes in its first consultative paper, A New Capital Adequacy Framework, in 1999.

Basel Committee listed a wide range of practices that were employed for the risk management of other product types. Basel classified these approaches into ***judgmental, constrained expert systems, and statistical modeling.***

Fig. 4: Spectrum of Internal Rating Procedure

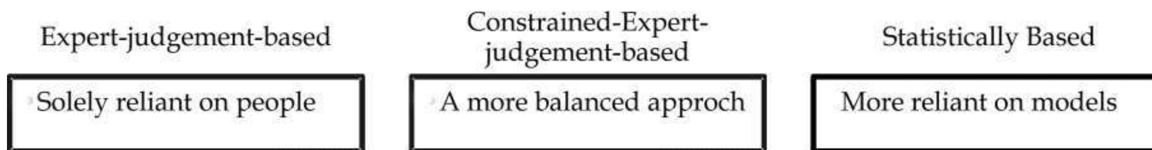

Fig. 5: Process Flow Diagram for Rating Model Development

Input Data	Model Generation	Model Validation	Model Sign-off	Model Validation
Key Risk Indicators Default Experience	Identity Components	Quantitative Assessment	Agreement in Rating Forum	Inclusion of New Data
Benchmarks (rated & unrated)	Explain Components	Expert Evaluation		Performance vs. Benchmarks

Source: Banks and Risk Management, CSFB, December, 2003

Market Risk Managemnt and Asset Liability and Management

ALM can be characterized as 'evaluating the effect of changing profile of different risks particularly showcase risk on the banks monetary record and currently modifying the structure of the advantage and risk portfolio to improve the benefit position of banks.' Liberalization of financing costs and business exercises has expanded the loan fee affectability of banks' advantages and liabilities in this way expanding the defenselessness of banks main concern on showcase rate changes. Resource Liability Administration is a key accounting report administration of risks caused by changes in the loan fees, trade rates and the liquidity position of the bank. The rules of RBI on ALM are fundamentally meant to empower banks to handle the liquidity risk and financing cost risk.

The three ways to deal with ALM rehearses took after by banks typically are:

- The Maturity Model,
- The Duration Model, and
- The Repricing or the Funding Gap Model.

For liquidity risk administration, the benefits and liabilities of the bank are isolated into various gatherings in view of their development profile. In view of the development profile, the Statement of Structural Liquidity should be set up by the banks. What's more, to screen the fleeting liquidity, the banks are required to set up the Statement of Short-term Dynamic Liquidity.

For dealing with the loan cost risk, the RBI rules recommend the Gap Analysis. In light of the affectability of the advantages and liabilities to the financing cost vacillations, they are grouped into various development cans. The Rate Sensitive Gap (RSG), which is the contrast between the rate touchy resources (RSAs) and the rate delicate liabilities (RSLs) empowers the banks to evaluate the effect of the rate variances on their net premium edge (NIM).

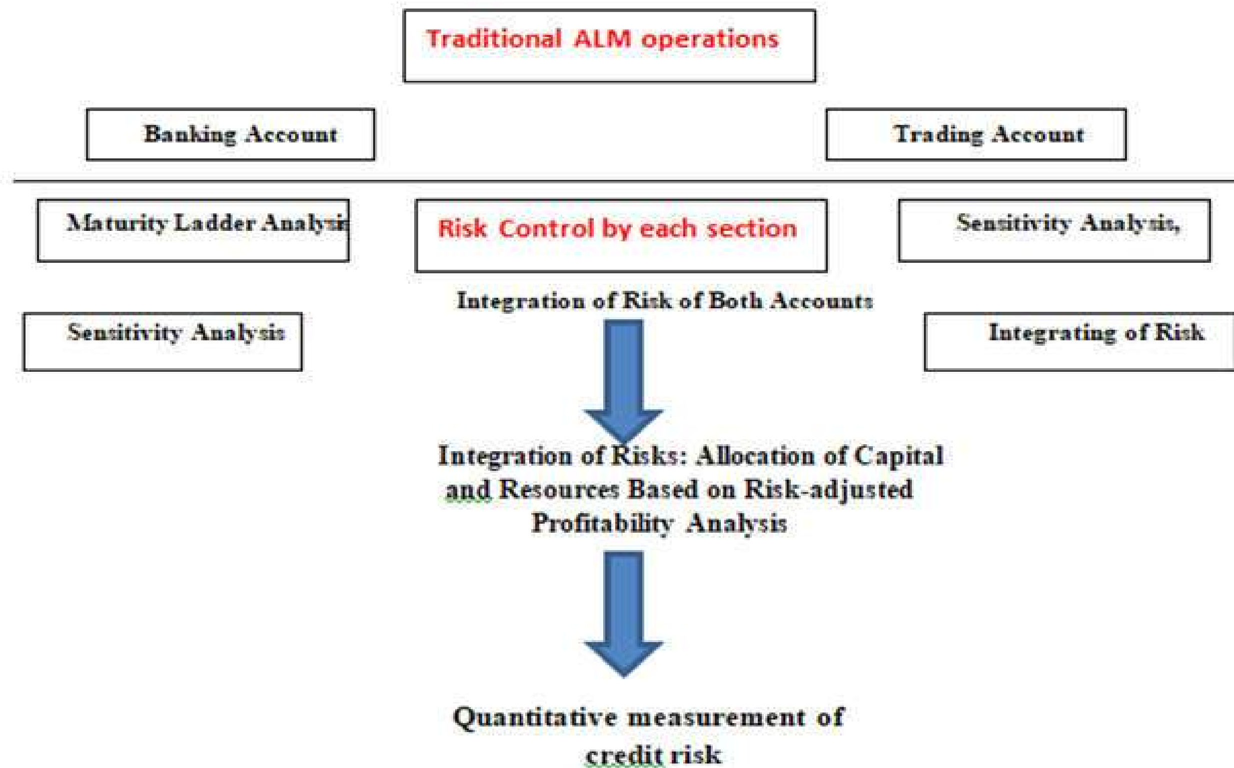

Fig. 6: Integrated and Active ALM Operation

Source: Integrating IT and Business Strategies, NIBM Research Papers, 2002

Conclusion

Risk Management enables banks in avoiding issues to even before they happen. In overseeing risks, the Board of Directors and Senior Management should assume a successful part by defining clear and exhaustive arrangements. The Risk Management System, which coordinates (i) reasonable risk limits, (ii) sound risk estimation methodology and data frameworks, and (iii) constant risk checking and visit announcing is said to be productive one. The distinct fascination taken by the Reserve Bank of India in this setting should be valued and bolstered at all levels.

There are different new perspectives to the risk administration which are taking the front line in the up and coming business and keeping money world. These arrangement with creating frameworks and techniques for dealing with appropriately and all the more wisely the different sorts of risks to maintain a strategic distance from any sort of misfortunes later on. Hardly any imperative angles related essentially to Credit Risk Management and Market Risk Management which have created and picked up significance in the current past have been broke down in this investigation. The significant issues secured are: Risk administration and innovation: National Institute of Bank Management (NIBM), with its involvement in Information Technology and back answers for the Banking business has proposed a Business-innovation display named as Enterprise Maturity Model which gives a structure to a staged presentation of the Executive Information System (EIS).

Internal evaluations for Credit Risk Management-Basel Accord: It is clear that Basel has given much thoroughly considered the linkage between use for rating models and approval of interior appraisals. The Basel Committee on Banking Supervision has conveyed phenomenal concentration to issues identifying with consistency and heartiness of money related establishments' interior credit risk framework administration forms in its first consultative paper, A New Capital Adequacy System, in 1999. Development of a coordinated ALM for overseeing particularly the market risk: There has been a move far from a straightforward ALM activity in the tight sense to one which depends on loan fee expectations. It likewise analyzes the likelihood of an Integrated Risk Management System covering both Banking and Trading accounts.

References

1. Bank for International Settlements: *Annual Report, BIS, Switzerland. 2001.*
2. Bhattacharya, S. and A. Thakor. Contemporary Banking Theory. *Journal of Financial Intermediation,* 1993.
3. Blum Jurg. Do capital adequacy requirements reduce risks in banking?. *Journal of Banking and Finance* 1999;23:755-71.
4. Culbertson J.M. The term structure of interest rate, November 1957, *Vol. LXXI.*
5. Daripa A., P. Jackson and S. Vorotto. The Pre-Commitment Approach to Setting Capital Requirements, *Financial Stability Review*, Autumn, 1997.pp.42-50.
6. D M Nachant, Aditya Narain, Saibal Ghosh, Satyananda Sahoo: Bank response to Capital Requirements, *EPW,* January 27, 2001.
7. Government of India. Report of the Committee on Banking Sector Reforms (Chairman: M Narasimham), *GOI, New Delhi*. 1998.
8. *American Economic Review*, 90;147-165.
9. Reserve Bank of India, *RBI Guidelines on ALM* (September 1998).
10. RBI Bulletin, 25 September, 2000: Prompt Corrective Action, Bank Capital and Risk: An Empirical Analysis of Public Sector Banks.
11. Narasimham, P.V., Risk Management. *Prajanan, Vol. 25*.
12. Reserve Bank of India. Risk Management Systems in Banks – Guidelines, *Reserve Bank of India, Mumbai*. 1999.