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A STUDY ON RISK MANAGEMENT STRATEGIES OF NATIONALISED AND PRIVATE BANKS

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ABSTRACT

The main aim of the study is to know the risk management initiatives taken by commercial banks and compare risk management policies of nationalised and private banks. The secondary data relevant to the study have been gathered from published sources like the RBI publications such as reports on trends and progress of banking in India, statistical tasks relating to banking in India, RBI Annual Report, RBI Bulletins and Report on Currency and Finance, besides Books, Annual Reports of Commercial Banks, Reports of various Committees appointed by RBI and articles published in various Standard textbooks, Journals and Magazines. The papers presented by experts in various conferences have also been reviewed for the purpose of analysis and suggestions. It is found that almost all the banks have put in place adequate risk management architecture in response to BASEL II guidelines. In compliance with RBI guidelines for appropriate risk management structure, most of the banks have taken several initiatives to manage the risks. It has been observed that most of the banks have put in place Internal Capital Adequacy Assessment Process (ICAAP) to deal with exceptional risks peculiar to bank while others are developing their capabilities to improve risk management process. So, overall commercial banks in India have developed requisite risk management framework to tackle the risk issues with a view to adopt Basel II in line with RBI guidelines.

KEYWORDS: Risk management initiatives, Risk management policies, Risk management structure and Risk management architecture

INTRODUCTION

The commercial banks have been working on several initiatives to streamline and upgrade the existing risk management system to bring them in tune with prevailing international best practices in risk management and also cover the entire spectrum of various risks to which banks are exposed to. Commercial banks in India are acting proactively in identifying, managing and controlling risk by building a sound risk management architecture keeping in mind guidelines issued by RBI and BASEL II guidelines.

STATEMENT OF THE PROBLEM

Banking sector more specifically, started facing the hurdles of increased interest rate structure and the heightened level of loss of asset quality and the associated consequences. If the bank assets become sour, then entire economy can be at snag. The need of the hour is the concept of risk management should be viewed as 'highly- strategic unit' in lieu of cost centre. The foremost among the challenges faced by the banking sector today is the challenge of understanding, quantifying and managing the risk.

The Indian financial system consists of Financial Institutions, Financial Markets, Financial Instruments and Financial Services. The Commercial Banks are the major constituents of the Indian Financial System, which plays a major role by transacting the money from the surplus units to deficit units. The Commercial banks are functioning in the competitive environment where one bank competes with another for its survival and its success. The survival of the Financial Institution in general and banks in particular is largely depending upon their performance and the profit earning capacity. The profit earning capacity of banking business is influenced by a number of factors; one of the important factors which have a bearing on the profitability of the banks is Credit risk.

OBJECTIVES OF THE STUDY

- ✓ To know the risk management initiatives taken by commercial banks.
- ✓ To compare risk management policies of nationalised and privatebanks.

METHODOLOGY

The secondary data relevant to the study have been gathered from published sources like the RBI publications such as reports on trends and progress of banking in India, statistical tasks relating to banking in India, RBI Annual Report, RBI Bulletins and Report on Currency and Finance, besides Books, Annual Reports of Commercial Banks, Reports of various Committees appointed by RBI and articles published in various Standard textbooks, Journals and Magazines. The papers presented by experts in various conferences have also been reviewed for the purpose of analysis and suggestions.

ANALYSIS AND INTERPRETATION

Several measures and initiatives taken by nationalised and private sector banks in India to identify and manage risk as per Basel II are shown in the Table 1.

Table 1
Risk Management Initiatives Taken by Commercial Banks

Name of Banks	CRMC	MRMC	ORMC	RMC/RMS/ RMCD	Stress Testing	RBIA	ALCO, ALM Policy	RCSA	ICAAP	Others
Private Banks										
South Indian Bank Ltd	√	√	√	√	√	√	√	√		Risk Based Pricing Model, Disaster Recovery Management
Jammu & Kashmir Bank Ltd	√	√	√	√	√	√	√	√	√	CRM, ORM, MRM Structure
Karur Vysya Bank Ltd			√	√			√		√	
Development Credit Bank Ltd	√		√	√	√	√	√	√	√	Credit Risk Analytics Monitoring Unit (CRAM)
Dhanalakshmi Bank Ltd	√		√	√	√	√	√		√	“OpRisk SCORE” software for loss Data, RBS
Catholic Syrian Bank Ltd	√		√		√	√	√		√	
Federal Bank Ltd	√		√	√	√	√	√		√	
City Union Bank Ltd	√		√		√	√	√		√	
HDFC Bank Ltd	√		√	√	√		√		√	Risk Monitoring Committee,

										CRM Framework
ICICI Bank Ltd	√	√	√	√	√		√		√	GRMG, ORM Framework
ING Vysya Bank										Risk Management Review Committee
Karnataka Bank Ltd	√		√	√	√	√	√	√	√	
Kotak Mahindra Bank Ltd	√		√	√	√	√	√	√	√	CRM Policy
Lakshmi Vilas Bank Ltd			√	√	√	√	√		√	ORM Policy, CRM Policy
Tamilnad Mercantile Bank Ltd	√		√	√		√	√		√	ORM Policy, CRM Policy, RBS
Nainital Bank Ltd							√		√	Credit Policy, Committee, Credit Risk Taking
Ratnakar Bank Ltd	√		√	√	√	√	√		√	ICMC
YES Bank Ltd	√		√	√	√	√	√		√	Risk Monitoring Committee
Axis Bank Ltd	√		√	√	√	√	√		√	
Indus Ind Bank Ltd	√	√	√	√	√	√	√	√	√	Disaster Recovery Plan
Nationalised Banks										
Allahabad Bank	√		√	√		√	√		√	
Andhra Bank	√		√	√	√		√		√	CRM, ORM, MRM Policy
Bank of Baroda	√		√	√	√	√	√		√	Setting Various Risk Limits
Bank of India Ltd	√	√	√	√	√	√	√		√	Credit Monitoring Department
Bank of Maharastra	√			√	√	√	√		√	ORM Policy, Risk Based Supervision, RBS

Canara Bank	√	√	√	√	√	√	√		√	SCDRM, “CORDEX” Software for loss data
Central Bank of India	√		√	√	√		√		√	“CORDEX” Software for loss data, CRM, ORM, ORM Policy
Corporation Bank				√	√	√	√		√	CRM, ORM, MRM Structure, Disaster Recovery Management
Union Bank of India	√		√	√	√	√	√	√	√	Risk Based Pricing Frame work, “CORDEX” Software
UCO Bank			√	√	√		√		√	CRM Policy
IDBI Bank Ltd				√	√	√	√	√	√	“ORBIT” (Operational Risk Business Management tool) Software
Dena Bank	√		√	√	√	√	√		√	CRN, ORM, MRM Structure
Indian Bank			√	√	√	√	√		√	
Indian Overseas Bank	√		√	√			√			
United Bank of India				√	√		√		√	CRM, ORM Policy
Oriental Bank of Commerce	√		√	√			√			“CORDEX” Software for loss data
State Bank of India	√	√	√	√		√	√	√	√	CRM Policy, ORM Policy, MRM Department
Punjab National Bank	√		√	√	√	√	√		√	
Syndicate Bank	√			√	√	√	√	√	√	Risk Assessment Model
Vijaya Bank	√	√	√	√	√	√		√	√	

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Table 2
Comparison of risk management policies of PSBs & PvtSBs

Policies/Committees	**PSBs (%)**	**PvtSBs (%)**
CRMC	75.00	85.00
MRMC	20.00	25.00
ORMC	75.00	95.00
RMC/RMS/IRMD	95.00	85.00
STRESS TESTING	85.00	85.00
RBIA	75.00	80.00
ALCO, ALM Policy	95.00	100.00
RCSA	25.00	30.00
ICAAP	90.00	95.00
Mean	**70.56**	**75.56**
SD	**8.94**	**8.81**
CV	**12.67**	**11.65**

Analysis of Result

From the analysis of results depicted in Table 2, it is clear that almost all the banks have put in place adequate risk management architecture in response to BASEL II guidelines. In compliance with RBI guidelines for appropriate risk management structure, most of the banks have taken several initiatives to manage the risks. Risks must not be viewed and assessed in isolation, only because a single transaction might have a number of risks but also one type of risk can trigger other risks. While assessing and managing risk, the management should have an overall view of risks the institution is exposed to. This requires having a structure in place to look at risk interrelationships across the organization.

For measuring and managing of various categories of risk, approximately 95% in PSBs and 85% in PvtSBs have set up separate Risk Management Committee (RMC) or Integrated risk management Department (IRMD) as shown in table, with primary responsibility of laying down risk parameters and establishing an integrated risk management framework and control system. Every bank is exposed to credit risk in its lending operations. It is the risk of loss that may occur from the failure or unwillingness of any counterparty to meet commitments in relation to lending, trading, settlement and other financial transactions as per terms and conditions of the contract. To maintain bank's overall credit risk exposure within the parameters set by the board of directors, the importance of a sound risk structures, it is important that such structure should be in accordance with institution's size, complexity and diversification of its activities. So, to manage the credit risk in an appropriate manner, banks have framed comprehensive credit risk management structure. Credit risk management involves proper appraisal of loan applications, monitoring of borrower accounts and appropriate recovery measures. Weakness in any of these areas will diminish the effectiveness of credit risk management. Table 2 shows that out of 40 banks covered under the study, approximately 75% in PSBs and 85% in PvtSBs has constituted a separate Credit Risk Management Committee (CRMC) to monitor credit risk on a bank-wide basis and ensure compliance with limits approved by the Board.

Another major risk faced by a bank apart from credit risk is the Market risk. Market risk is potential for loss resulting from adverse movement in market risk factors such as interest rates, forex rates, currency valuations, equity prices and commodity prices.

For envisaged market risk management nearly 20% in PSBs and 25% in PvtSBs have set up Market Risk Management Committee (MRMC) responsible for setting policies guidelines for market risk measurement, management, reporting and responsible for reviewing and approving market risk limits, including stop losses for traded and accrual portfolios, another essential element for management of market risk is the Asset Liability Management (ALM) in which banks endeavours to match their assets and liabilities in various time buckets. Whenever, mismatches are noticed, remedial actions are taken.

Nearly 95% in PSBs and 100% in PvtSBs per cent banks have framed Asset Liability committee (ALCO), a senior management level committee responsible for management of Market Risk, that keep an eye on the structure of bank's assets and liabilities and decide about product pricing for deposits and advances and monitors and controls the strategic position, interest rate risk position and is endowed with the responsibility of management of balance sheet of banks with a view to manage the market risk exposure assumed by banks.

The third major risk covered by Basel II is the Operational risk which did not find its place in Basel I but is explicitly covered under new framework. BCBS has defined operational risk as risk of loss resulting from failed or inadequate internal processes. It is the risk of loss arising from the potential that inadequate information system; technology failures, breaches in internal controls, fraud, unforeseen catastrophes, or other operational problems may result in unexpected losses or reputation problems (BIS 2006). Operational risk is inherent in the banks' business activities. The objective of operational risk management is to find out the extent of the financial institution's operational risk exposure; to understand what drives it, to allocate capital against it and identify trends internally and externally that would help predicting it.

For the purpose of robust quality of Operational Risk Management, separate Operational Risk Management Committee (ORMC) has been put in place by nearly 34 out of 40 banks as an integral part of risk management framework. One of the important tools for assessing the Operational Risk i.e. Risk Control and Self Assessment (RCSA) has been undertaken by nearly

25% in PSBs and 30% in PvtSBs percent banks to counter the risks faced by these banks. For effective operational risk management IDBI banks has also used software like "ORBIT" (Operational Risk Business Management Tool).

Nature and intensity of risks may vary from bank to bank. Therefore, RBI requires all the banks in India to prepare a self-analytical framework called "Internal Capital Adequacy Assessment Process" (ICAAP) document duly approved by the Board of Directors. The Internal Capital Adequacy Assessment Process (ICAAP) is a self-revelatory exercise that augments quality of management and covers identification and measurement of risks other than Pillar I risks (i.e. Credit Risk, Market Risk and Operational Risk), to meet the requirements of Pillar 2 of Basel II norms (Annual Report, Bank of Maharashtra, 2011).

Nearly 90% in PSBs in PvtSBs percent of banks have evolved and put in place a Board approved Internal Capital Adequacy Assessment Process (ICAAP) framework.

With a view to enhance risk assessment, banks are using stress testing which provide a better understanding of the likely impact in extreme circumstances. Stress testing defines a scenario and uses a specific algorithm to determine the expected impact on a portfolio's return when such a scenario occurs (http://en.wikipedia.org /wiki/Stress testing).

The process of Stress Testing involves identifying the potential movements, including which market variables to stress, how much to stress them and by what time frame to run the stress analysis over. It enables the banks to evaluate their financial position under scenario of varying severity and to control business risks. This exercise is expected to render an objective basis for decision making both to the control function and to the entire institution and also for assessing the performance of the independent control function (Annual Report, Reserve Bank of India, 2013).

It has been observed that nearly 85% in PSBs and 85% PvtSBs banks have adopted Stress Testing Policy or set up comprehensive Stress Testing framework as a multi-dimensional risk management tool. Periodical stress tests are being carried out by banks for credit risk, market risk, liquidity risk and interest rate risk. RBI had issued broad guidelines to banks in December 2002 on (RBIA) Risk Based Internal Audit to undertake an evaluation of the risk management systems and control procedures prevailing in branches as well as in other functional areas.

Risk-based auditing extends and improves the risk assessment model by shifting the audit vision. Instead of looking at the business process in a framework of internal control, the internal auditor views the business process in an environment of risk. It is that part of internal audit that focuses on risk thus, adds more value to the organization than an audit focusing only on controls. Task Force for Risk Based Internal Audit (RBIA) has been developed by approximately 75% in PSBs and 80% PvtSBs percent banks for the purpose of identification, measurement, monitoring and management of risks to mitigate their adverse impact on their financials. The regulators have introduced a Risk Based Supervision (RBS) model for supervision and regulation of the banking and financial sector. Risk Based Supervision (RBS) is a system based inspection by regulator/supervisor. The RBS process involves continuous monitoring and evaluation of the risk profiles of banks' in relation to their business strategy and exposures based on a risk matrix for each institution (http://bankingindiaupdate.com). Some banks have put in place an effective institutional mechanism for Risk Based Supervision (RBS). For the purpose of loss data collection, software like "CORDEX" is being used by Canara Bank and Central Bank of India, Union Bank of India and Oriental Bank of Commerce and "Op Risk SCORE" being used Dhanlakshmi bank. In order to monitor various categories of risk in an efficient and effective way separate Risk Monitoring Committees have been framed by few banks.

From the above discussion, it can be interpreted that nationalized and private banks in India have taken significant and structural initiatives to develop risk management infrastructure in their organization structure. As almost all the banks have formed desired committees, most of the banks conduct stress tests and gap analysis periodically and many of them have incorporated risk feature in their internal audit. Some of the banks have also subscribed sophisticated software like "CORDEX" for collection of loss data.

It has been observed that most of the banks have put in place Internal Capital Adequacy Assessment Process (ICAAP) to deal with exceptional risks peculiar to bank while others are developing their capabilities to improve risk management process. So, overall commercial banks in India have developed requisite risk management framework to tackle the risk issues with a view to adopt Basel II in line with RBI guidelines.

SUGGESTIONS

- ✓ Formulation of a comprehensive credit insurance scheme particularly for the priority sector and government sponsored schemes will help in focussing on the losses which can arise in this sector on account of NPAs.
- ✓ More recovery camps, Compromise Settlement Schemes and Lokadalat's should be organised to recover the amounts lent on time and prevent NPAs.
- ✓ Banks should set up early indicators or warning signals for prompt detection of NPAs at the earliest and take necessary actions.
- ✓ Banks should also take steps in identifying those loans where recovery is affected due to

temporary situation of the borrower or some natural cause and take necessary steps like rescheduling and restructuring their recovery so as to prevent their slipping into the NPA category.

CONCLUSION

It has been observed that most of the banks have put in place Internal Capital Adequacy Assessment Process (ICAAP) to deal with exceptional risks peculiar to bank while others are developing their capabilities to improve risk management process. So, overall commercial banks in India have developed requisite risk management framework to tackle the risk issues with a view to adopt Basel II in line with RBI guidelines.Effective strategic risk management is crucial in banks and contributes to the success of a bank. This study has established existence of strategic risk management practices by large commercial banks. Similarly, specialized training for practitioners has been identified as a key challenge. There is need for a professional body of strategic risk practitioners who can train experts who will in turn streamline strategic risk management in banks. This will help ensure that the level of appreciation for strategic risk fundamentals is heightened.

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