NOLEGEIN Journal of
Business Risk Management

ISSN: 2582-287X
Volume 5, Issue 2, 2022
DOI (Journal): 10.37591/NJBRM

http://mbajournals.in/index.php/JoDBCM/index

Review NJBRM

A Study on Risk Management Practices in Cooperative Banks in India

Neetu Koolwal

Abstract

Banking Industry has done wonders for the global economy. The banking business merely takes money from savers in the form of various deposits and then gives the same money in the form of loans to borrowers. Banking activities promote and encourages the flow of money for investment to productive use this helps in development of economy to grow. It cannot be denied that the cooperative banks have not only contributed to the development of the banking system by connecting the common people in the villages and towns of the country but also played an important role in the development of the country's economy. Banking industry is facing various type of risk and Risk Management is the Process to plan, lead, organize, and control various types of risks which are faced by a cooperative Banks. Credit risk is one of the main cause of banking failure such as When a bank lends money to one of its clients, the client defaults on the loan, causing the bank to suffer a financial loss. Risks associated with the banking industry include liquidity risk, interest rate risk, market risk, credit risk, and operational risk in various forms. .All of these risks have one thing in common: they could have a negative influence on revenue of banking industry. For all banking organizations, the totality of risk-effects is a crucial variable. In this paper identify the different risks faced by the cooperative banks and the process of risk management. This paper also studied the different techniques implemented by cooperative banks for risk management. The goal of risk management is to identify business activities and opportunities that are connected to the organization's objectives and to manage the risks associated with those actions in order to take advantage of the chances. For the financial risk management process a cooperative banks must control financial risk by proper identification of various risk, timely assessment and monitoring of risk and risk reduction. This study explores framework of risk management in Cooperative banks.

Keywords: Cooperative Banks, Financial Risk, Banking System, Risk Management.

INTRODUCTION

A cooperative bank refers to small financial institutions that provide loans to small businesses in both urban and non-urban areas. Co-operative banks are registered and controlled under the Co-operative Societies Act. Co-operative banks provide banking as well as various financial services which include provide lending; accept deposits and bank account etc. to their members. It is noteworthy that the primary objective of a cooperative bank is not to make maximum profit but to provide the best products and services to its members.

The Banking Regulation Act of 1949 and the Banking Laws Act of 1965 both apply to cooperative banks, which are governed by the Reserve Bank of India (RBI).

Risk is an integral part of every business, actually every sector and especially the banking or financial sector. This is the most critical risk associated with

***Author for Correspondence**
*Author for Correspondence
Neetu Koolwal
E-mail:neetukhandelwal02@gmail.com

[1]Supervisor, Faculty of Commerce and Management, Apex University, Jaipur, India
[2]Research Scholar, Faculty of Commerce and Management, Apex University, Jaipur, India

Received Date: March 02, 2023
Accepted Date: March 23, 2023
Published Date: April 10, 2023
Citation: Neetu Koolwal. A Study on Risk Management Practices in Cooperative Banks in India. NOLEGEIN Journal of Business Risk Management. 2022; 5(2): 32–39p.

the banking sector and if managed properly could lead to a banking crisis in the form of an increase in NPAs or bad assets thereby reducing the profitability of the bank which could lead to bankruptcy or merger of the bank. To understand Banking risk it can be classify into three categories:

1. Credit risk (Non performing asset)
2. Operational risk (System related) and
3. Market risk (Interest rate)

Financial risk management is the planned practice of dealing with uncertainties in daily operationsby landing the money to minimize the impact of risks. Looking for a 100% safe method or alternatively avoiding risk will not help in minimize the risk in the long run. The goal of risk management is to identify hazardous business ventures and opportunities associated with banking operations and to control the risks in those ventures in order to capitalise on the opportunities [1].

Therefore, the logical steps are to identify risks is to assess the likelihood of an incident, measure its consequences, development of mitigation strategies, regular monitoring to mitigating risks, avoid risk , shift or accept risks.

For regulating the risk various Laws are made by legislation and regulations are made by government-appointed regulators. For smooth operations and operating procedures, bank policies are determined by the banking organization, including top management's compliance with laws and regulations. Apart from rules and regulations imposed by the RBI, there are some other factors such as corporate governance, corporate ethics and ethical standards are also considered for the management of financial risk in cooperative banks. In good times the business may be able to take more risks and adopt a dynamic style [2].

OBJECTIVE OF THE STUDY

1. To study financial and non financial risk in Cooperative Banks.
2. To identify Sound Risk Management Practices for monitoring and control the risk
3. To study the Risk Management process in Cooperative Banks.
4. To examine the various techniques adopted by Cooperative Bank for risk management.

RESEARCH METHODOLOGY

The present research study exclusively relies on the secondary data. The necessary data hasbeen collect from various reference books, magazines, recently published journals and RBIreports [3].

STRUCTURE OF RISK MANAGEMENT IN BANKS

As per the recommendation by the Basel Committee and RBI instructions risk management structure was implemented by the cooperative banks. According to RBI guidelines, an independent risk management structure should be maintained by each bank. To achieve financial risk management process a cooperative banks must control financial risk by proper identification of various risk, risk assessment and risk monitor and risk control. Enabling risk identification and management at the source, from business units to the operational level with technology as the main driver [4].

The risk management includes the management of credit risks, market risks, and operational risk management. Therefore under the control of the chief risk management officer Risk management department as well as the Basel Norms implementation department and the information security department should integrate the board for Risk management in the bank (Figure 1).

a. Credit Risk Management

1. The bank will have a strong credit assessment and risk assessment practice. Banks can use different internal credit risk assessment models to assess credit risk exposure under different segments. Internal ratings in the bank should be subject to a comprehensive rating verification framework [5].

2. The Credit Risk Management Department will track sectors such as telecom, electricity, coal, aviation, textiles, iron and steel and disseminate data to operational staff for making informed decisions. Some Special investigations and various studies may also be conducted on banking companies as directed by the bank's board.
3. The bank will take steps to adopt "based on internal valuation approach" for credit risk. The creation of a Risk Management Committee is essential in order to gain approval for rules governing the prudent management of debt risk. The governance structure will be strengthened for effective implementation of internal ratings.
4. To calculate the expected default one has to develop a model for estimating the probability of default, default on default and probability of default on default.
5. The Bank regularly updated to accommodate industry best practices and changes in macroeconomic variables for its loan portfolio .
6. To review various risk policies, industry conditions and risk criteria the Bankshould orgaised Credit Risk Management Committee meetings and Board Risk Management Committee Meetings on Regular basis.

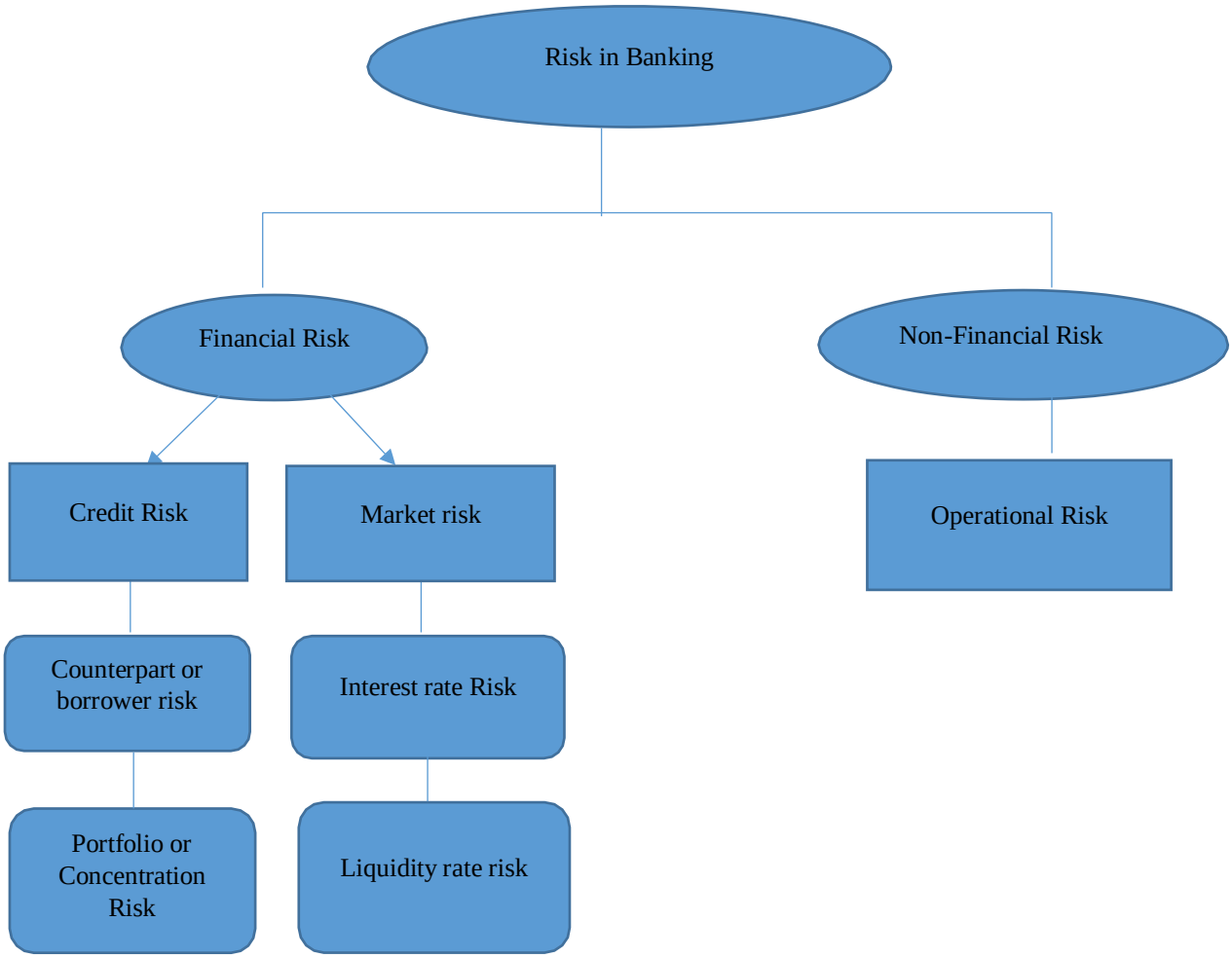

Figure 1. Financial Risk.

b. Market Risk Management

1. Market risk management, or MRM, is the process of controlling financial loss that may result from changes in market factors such exchange rates, interest rates, stock value, etc. Market risk management comprises recognizing potential danger, evaluating risk levels, implementing command systems, monitoring habits, and spreading information about the situation. One crucial

aspect of the process of managing market risk involves identifying and measuring potential risks, implementing control measures, establishing monitoring protocols, and setting up reporting systems. Banks typically use a standardized measurement method to compute market risk capital. Banks will have to move to an advanced Basel-II approach for market risk. Internal model approach. It is a tool for monitoring the bank's business portfolio based on value at risk (VaR). The VAR methodology will be supplemented by carrying out stress tests at quarterly trading intervals [6].

2. The Market Risk Management Committee, as well as the Boards Risk Management Committee, will be responsible for overseeing and evaluating market risk.

Non-financial risk

c. Management of operational risks

The modernization of the banking industry and financial markets, which brought about structural changes, greater transaction volumes, and complicated support systems, gave rise to operational risk Market risk and credit risk cannot categorize operational risk The peril associated with payment settlements, disruption of business operations, and legal and administrative risks can all be categorized as market risk [7].

Since operational risk includes risk related to business disruption or problem it can trigger market or credit risk. Therefore, it is crucial for banks to develop more sophisticated methods for measuring and managing operational risk, as well as ensuring that they have adequate internal controls and processes in place to mitigate potential losses. This will not only help protect individual banks from financial harm but also contribute to the overall stability of the banking system as a whole [8].

1. This lack of scientific methods to measure operational risk in Indian banks can lead to potential losses and negative impacts on the overall financial stability of the banking system. Without proper measurement and management of operational risk, banks may not be able to accurately assess their overall risk profile and make informed decisions about their business activities.Operational risk should be assessed and reviewed at regular intervals and recommend appropriate control/mitigate measures for operational risk management in the Bank.
2. For Bank's Operational Risk Management there should be continuous monitoring and control of the system, creating awareness of operational risk across the bank, ensuring risk ownership, aligning risk management activities with business strategy and compliance with regulatory requirements ensuring that the key elements of operational risk management.
3. The operational risk management framework should include regular risk assessments and stress testing to identify potential vulnerabilities and areas for improvement. The operational risk measurement system should be regularly reviewed and updated to ensure it remains effective in identifying and measuring risks.
4. The High Value Fraud Committee should have a clear mandate, reporting structure, and adequate resources to effectively monitor and control high value frauds. The committee should also work closely with other departments within the organization, such as legal and compliance, to ensure a coordinated approach to fraud prevention and mitigation [9].
5. Regular training and awareness programs should be conducted for employees at all levels of the organization to help them identify potential fraud risks and take appropriate action. Finally, there should be a strong culture of ethics and integrity within the organization, with clear policies on whistleblowing and zero tolerance for fraudulent behavior.

RISK MANAGEMENT IN BANKS

The Bank's Risk Management team is responsible for identifying potential risks that may arise from the bank's operations, investments, and other activities. They measure the impact of these risks on the bank's financial health and reputation, and monitor them closely to ensure they are within acceptable limits [10].

If a risk exceeds the bank's tolerance level, the Risk Management team takes steps to mitigate it. This may involve implementing new policies or procedures, reducing exposure to certain types of risk, or transferring risk to another party through insurance or other means.

The Bank's overall risk philosophy is shaped by its willingness to take risks in pursuit of its business objectives. This includes balancing the potential rewards of taking on risk against the potential costs of losses or damage to the bank's reputation [11].

These efforts will help understand the nature of risks, the reasons why risks will be triggered, risk quantification and risk management.

i. Regular training and development programs should be conducted for employees to enhance their skills and knowledge in risk management.
ii. The bank should have a robust system for monitoring and reporting risks, including the use of key risk indicators (KRIs) and internal controls.
iii. The bank should conduct regular stress tests to assess its resilience to adverse situations and ensure that it has adequate capital and liquidity buffers.
iv. The board of directors should regularly review the bank's risk management policies and procedures to ensure that they remain effective and up-to-date.
v. The bank should have a strong compliance culture, with clear policies on anti-money laundering (AML), know-your-customer (KYC), and other regulatory requirements.
vi. The bank should have a well-defined process for identifying, assessing, managing, and reporting operational risks, including technology risks.
vii. Finally, the bank should have a comprehensive insurance program to protect itself against various types of risks, including credit risk, market risk, operational risk Internal and external audit should not only concern the accuracy of the transaction, but also the level of risk involved. It should be proper audit. The audit should note and suggest system and process inadequacies and inefficiencies and staff shortages.
viii. Bank management should Determining risk appetite, tolerance levels and risk reporting methods which are important components of bank risk management.

RISK MANAGEMENT STEPS

- Risk Study: In this step It covers the chances and reasons of bank risk and consequences of the various risk.
- Risk Assessment: It Includes
  a. Identification of risk
  b. analysis of risk and
  c. evaluation of risk
- Risk Analysis: In this step Identifies the source of the risk and the consequences of the risk. Analysis can be quantitative or qualitative, while quantitative is numerically based, qualitative is generally influential.
- Probability Analysis: This will be based on historical data, forecasts and expert opinions.
- Risk Mitigation: Costs of risk mitigation will need to be investigated whether they are too high or normal. It is usually impossible to reduce the risk to a zero level and therefore requires decision-making at the optimal level of risk. Errors in judgment are possible when seeking answers to the above questions.

There are two types of errors:

1. Rejection of correct views and opinions or
2. Reckoning with inaccurate perspectives necessitates prudently evaluating the matters in dispute.

RISK MANAGEMENT TECHNIQUES

Gap analysis is a tool for managing assets and liabilities that can be used to evaluate interest rate and liquidity risk.

A method for evaluating liquidity risk in the banking industry is gap analysis. The majority of cooperative banks use it. a bank's risk of having assets and liabilities that don't line up because of either liquidity issues or fluctuations in interest rates. Basically, to differing degrees, both assets and liabilities are sensitive. In order to match the same groups of assets with liabilities, it is important to determine the interest rate sensitivities between various groups of assets and liabilities. Gap is often exclusively utilised to assess rate-sensitive groups in the ALM process (compared to rate-insensitive liabilities such as current deposits, floating funds, etc.).

In other words, GAP is the "excess capacity" of interest-sensitive liabilities or vice versa, if risk-sensitive liabilities and risk-sensitive assets are equal, when the difference between the two (RSA-RSL GAP) becomes NIL, the net margin (NIM).) is unaffected by interest rate movements.

Essentially, gap analysis provides insight into how changes in interest rates will affect a bank's net income.

RSA = Rate Sensitive Assets

RSL = Rate Sensitive Liabilities

Essentially, gap analysis provides insight into how changes in interest rates will affect a bank's net income. Because the change in interest income is larger than the change in interest expense and vice versa, a positive GAP suggests that an increase in the future interest rate would boost net interest income. (2002) Cumming and Beverly

Cost of Risk (CaR):

One of the more recent risk management tools is it. The "market-to-market" practise of using permitted assets depending on maturity and yield is modified by this technique. The Value at Risk (VaR) study examined how much a business might lose or make with a particular probability over a specific period of time.WhileVaR is used to measure market risk in general, it includes other risks such as foreign currency risk, commodity risk and equities. (Jorion, 2001).

Risk-adjusted rate of return on capital (RAROC):

Risk-adjusted return on capital (RAROC) is a modified return on investment (ROI) that takes into account elements of risk. The formula used to calculate RAROC is:Where:

Income from capital = (capital charge) x (risk free rate)

Expected loss = Expected average loss over a specified period

In financial analysis, projects and investments with higher risk levels should be evaluated separately; RROC accounts for changes in the investment profile by discounting risky cash flows against low-risk cash flows. Risk-adjusted return on capital (ROARAC) is used in financial analysis, in which the rate of return is calculated, where projects and investments with high levels of risk are evaluated based on the amount of capital.

SECURITIZATION

The term "securitization" describes a transaction in which financial securities are issued in exchange for cash flows produced by a group of assets. To service interest and finance securities, cash flows from interest and principle repayments are used. Typically, SPVs—Special Purpose Vehicles—are constructed for this use. The parent bank, or the bank that originally generated the assets, gives the SPV ownership of those assets. The interest and repayment of the financial instruments an SPV issues are its responsibility.

The parent bank passes the credit risk to the investors in the course of this method. In a securitization deal, a bank can additionally invest and tackle credit risk. A simple securitization is a form whereat at fewest two distinct stratified risk positions or losses with numerous levels of credit risk are mirrored in the cash flows from the underlying portfolio of exposures. Rather than being created from fall within the competence of the organisation that produces those risks, payments to investors are as said by the performance of particular underlying risks.

CONCLUSION

In order to reduce the growing risk in the banking sector, the related rules need to be tightened and expanded. Because many customers are hurting the banking sector by using flexible rules etc., which increases the NPA of banks. Banks are strict and detailed; it will take people related to the sector to regulate them. The total risk profile of the bank will be subject to a thorough risk assessment. RBI operationalized the risk profile model to enable banks to conduct self-assessment.

RBI will also prepare a risk profile of banks based on which they can finalize the control and supervision programme. For banks with a high risk profile, this will motivate individual banks to identify problem areas and take the necessary corrective measures. This would encourage individual banks to identify areas of concern and implement the appropriate corrective steps with relation to banks with high risk profiles.

This will serve as an extra instrument in the Basel II criteria's implementation. The new approach is to evaluate how well banks are managing risks. Offsite inspection and routine audits under the categories (capital adequacy, asset quality, management, income, liquidity, and systems) will be more important for risk-based supervision than on-site inspection.

Underperforming Credit Risk Management (CRM) loans and Capital Adjustment Ratios (CDRs) have an impact on banks' ability to produce money, as evidenced by return on equity (ROE) and return on assets (ROA), according to the study. Risk-based supervision will depend on off-site inspections and regular camel-led audits (capital adequacy, asset quality, governance, income, liquidity and systems) and less on on-site inspections.

Efficient loan disbursement is a fundamental mechanism to build a quality portfolio and retain our clientele. Adequate flexibility has been given in the loan policy to develop a viable business proposition. The policy also lays down the appropriate procedure for approval/permission of innovative products. While the Bank is making efforts to establish risk management measures as a continuing practice, it will also lay due emphasis on initiating a paradigm shift / transition towards a fully integrated risk management system.

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