HISTORY AND GROWTH OF CO OPERATIVE MOVEMENT IN INDIA - AN EMPIRICAL STUDY

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ABSTRACT

This paper explores the risk management system practiced in Co-operative Banks of Karnataka. The major concern of the co-operative bank is the mounting amount of Non-performing assets (NPAs). Hence banks should adopt a systematic risk management system to manage the overall risk exposure associated with banking operation. The present study attempted to analyse the various aspects of the risk management system practiced in Co-operative Banks in India.

Keywords: *Risk management; Credit risk; Liquidity risk; Interest Rate Risk; Non-performing assets.*

RISK MANAGEMENT STRUCTURE

2.1 The primary responsibility of understanding the risks run by the bank and ensuring that the risks are appropriately managed should clearly be vested with the Board of Directors. The Board should set risk limits by assessing the bank's risk and risk- bearing capacity. At organisational level, overall risk management should be assigned to an independent Risk Management Committee or Executive Committee of the top Executives that reports directly to the Board of Directors. The purpose of this top level committee is to empower one group with full responsibility of evaluating overall risks faced by the bank and determining the level of risks which will be in the best interest of the bank. At the same time, the Committee should hold the line management more accountable for the risks under their control, and the performance of the bank in that area. The functions of Risk Management Committee should essentially be to identify, monitor and measure the risk profile of the bank. The Committee should also develop policies and procedures, verify the models that are used for pricing complex products, review the risk models as development takes place in the markets and also identify new risks. The Committee should also monitor compliance of various risk parameters by operating Departments.

3. OBJECTIVES OF THE STUDY

a. To explore the overview of Risk Management System in India
b. To explore the various kinds of risk management system adopted in Co-operative Banks in India in general and particularly in Karnataka.

4. METHODOLOGY USED IN THE STUDY

The data used for the research has been extracted from reports generated from official website of RBI and Ministry of Finance. For fulfillment of objectives, the researcher had a review of various published papers to assess and explore the risk management system in Co-operative Banks in India.

5. CREDIT RISK IN OFF-BALANCE SHEET EXPOSURE

Banks should evolve adequate framework for managing their exposure in off-balance sheet products like forex forward contracts, swaps, options, etc. as a part of overall credit to individual customer relationship and subject to the same credit appraisal, limits and monitoring procedures. Banks should classify their off-balance sheet exposures into three broad categories - full risk (credit substitutes) - standby letters of credit, money guarantees, etc, medium risk (not direct credit substitutes, which do not support existing financial obligations) - bid bonds, letters of credit, indemnities and warranties and low risk - reverse repos, currency swaps, options, futures, etc.

6. INTER-BANK EXPOSURE AND COUNTRY RISK

A suitable framework should be evolved to provide a centralised overview on the aggregate exposure on other banks. Bank-wise exposure limits could be set on the basis of assessment of financial performance, operating efficiency, management quality, past experience, etc. Like corporate clients, banks should also be rated and placed in range of 1-5, 1-8, as the case may be, on the basis of their credit quality. The limits so arrived at should be allocated to various operating centres and followed up and half-yearly/annual reviews undertaken at a single point. Regarding exposure on overseas banks, banks can use the country ratings of international rating agencies and classify the countries into low risk, moderate risk and high risk. Banks should endeavour for developing an internal matrix that reckons the counterparty and country risks.

7. MARKET RISK

Traditionally, credit risk management was the primary challenge for banks. With progressive deregulation, market risk arising from adverse changes in market variables, such as interest rate, foreign exchange rate, equity price and commodity price has become relatively more important. Even a small change in market variables causes substantial changes in income and economic value of banks. Market risk takes the form of:

1) Liquidity Risk
2) Interest Rate Risk
3) Foreign Exchange Rate (Forex) Risk
4) Commodity Price Risk and
5) Equity Price Risk

Capital for Market Risk

The Basle Committee on Banking Supervision (BCBS) had issued comprehensive guidelines to provide an explicit capital cushion for the price risks to which banks are exposed, particularly those arising from their trading activities. The banks have been given flexibility to use in-house models based on VaR for measuring market risk as an alternative to a standardised measurement framework suggested by Basle Committee.

Operational Risk

Managing operational risk is becoming an important feature of sound risk management practices in modern financial markets in the wake of phenomenal increase in the volume of transactions, high degree of structural changes and complex support systems. The most important type of operational risk involves breakdowns in internal controls and corporate governance. Such breakdowns can lead to financial loss through error, fraud, or failure to perform in a timely manner or cause the interest of the bank to be compromised.

Measurement

There is no uniformity of approach in measurement of operational risk in the banking system. Besides, the existing methods are relatively simple and experimental, although some of the international banks have made considerable progress in developing more advanced techniques for allocating capital with regard to operational risk.

Measuring operational risk requires both estimating the probability of an operational loss event and the potential size of the loss. It relies on risk factor that provides some indication of the likelihood of an operational loss event occurring. The process of operational risk assessment needs to address the likelihood (or frequency) of a particular operational risk occurring, the magnitude (or severity) of the effect of the operational risk on business objectives and the options available to manage and initiate actions to reduce/ mitigate operational risk.

Risk Monitoring

The operational risk monitoring system focuses, *inter alia*, on operational performance measures such as volume, turnover, settlement facts, delays and errors. It could also be incumbent to monitor operational loss directly with an analysis of each occurrence and description of the nature and causes of the loss.

Control of Operational Risk

Internal controls and the internal audit are used as the primary means to mitigate operational risk. Banks could also explore setting up operational risk limits, based on the measures of operational risk. The contingent processing capabilities could also be used as a means to limit the adverse impacts of operational risk. Insurance is also an important mitigator of some forms of operational risk. Risk education for familiarising the complex operations at all levels of staff can also reduce operational risk.

Internal Control

One of the major tools for managing operational risk is the well-established internal control system, which includes segregation of duties, clear management reporting lines and adequate operating procedures. Most of the operational risk events are associated with weak links in internal control systems or laxity in complying with the existing internal control procedures.

Risk Aggregation and Capital Allocation

Most of internally active banks have developed internal processes and techniques to assess and evaluate their own capital needs in the light of their risk profiles and business plans. Such banks take into account both qualitative and quantitative factors to assess economic capital. The Basle Committee now recognises that capital adequacy in relation to economic risk is a necessary condition for the long-term soundness of banks. Thus, in addition to complying with the established minimum regulatory capital requirements, banks should critically assess their internal capital adequacy and future capital needs on the basis of risks assumed by individual.

8. REFERENCES

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