A

RESEARCH PROJECT REPORT

ON

RISK MANAGEMENT IN BANKING SECTOR

UNDER THE GUIDANCE OF

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SUBMITTED BY-

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BATCH-(2018-2020)

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<u>DECLARATION</u>

I, Aishwarya Verma, confirm that the work for the following term paper with the title: " **RISK MANAGEMENT IN BANKING SECTOR”** is undertaken by myself and that no help was provided from other sources as those allowed. All sections of the paper that use quotes or describe an argument or concept developed by another author have been referenced, including all secondary literature used, to show that this material has been adopted to support my thesis.

AISHWARYA VERMA

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ACKNOWLEDGEMENT

Research project report is one of the important part of MBA(FM) program, which has helped me to get a lot of experience, which will be beneficial in my succeeding carrier.

For this with an ineffable sense of gratitude I take this opportunity to express my deep sense of ineptness and gratitude to Prof. GIRISH GARG, for her encouragement, support and guidance in carrying out the project .It has been my great privilege to work under her inspiring guidance.

I am also thankful to my parents and my friends for their indelible co-operation for achieving the goal of this study.

AISHWARYA VERMA

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CHAPTER - I

INTRODUCTION

Risk: BIS has defined Risk as- "Risk is the threat that an event or action will adversely affect an organization's ability to achieve its objectives and successfully execute its strategies."

Risk Management: Risk management is how a bank or an organization manage its certain kind of risks which is credit, operational and market risk. These type of risk affect the organization internally as well as externally. Such as, operational risk affect the organization internally, while market risk affect the organization externally. So, organization should be ready to face such kind of risks. Risk management is basically managing three things, that is as follows:

- Understand what can happen in the future
- Understand which risk should be given priority
- Make strategies to reduce that risk

THEME OF THE STUDY

Risk management in organization means how much an organization is ready to make changes. Organization should not just wait for the risk that is going to incur in the future rather they should make strategies and plans to be prepared for facing such risks. Risk management doesn't mean that we should eliminate risk. It mean that we should take risk by having the deep knowledge of it, knowing every aspect, all pros and cons of taking that risk. So that we can measure that risk and diversify it while making portfolio. As in portfolio we take different securities with different risk measure and return aspect.

STUDY PROBLEM

Basel II came into existence because there were certain problem in Basel I. These problems are:

1. Basel I was not effective in handling all the risks.
2. Nothing is mentioned about Operational Risk in Basel I
3. Same guideline was given for all the risks in Basel I
4. For Example: according to Basel I, giving loan to a company which is just started and giving loan to a company which is well established is equal.

Study problem can be stated as follows:

"To what extent banks have implemented Basel II norms related to enhancing internal control in the banks?"

OBJECTIVES

- Covering different aspects of risk assessment
- Identifying keys for effective risk management
- To understand the challenges and impact of Implementing Basel II
- To analyze the current progress of Basel II in Delhi.

CHAPTER - II

LITRETURE REVIEW

Basel Accord: Basel Accord are the sets of banking regulation given by "BCBS (Basel Committee on Banking Supervision)" which give guidelines on how to regulate banks and how to manage various risks, i.e., capital risk, market risk and operational risk. BCBS maintains its secretariat at the "BIS (Bank for International Settlement)". The committee generally have its meet in Basel City which is situated in Switzerland. BIS has been made by G-10 countries which works on common problem of banks all over the world and developing standards and providing guidelines to banks all over the world towards making strong it's financial condition.

Basel I Accord: On 1988, BCBS passed a guideline on banking supervision which was named as Basel 1. This was the first guideline issued by the BCBS. There was a need to pass bring this guideline because banks were facing heavy losses due to higher number of NPAs. That is the borrower use to take loan from bank and then they don't payback. Banks don't use to estimate and manage its risk. So, there was need to frame a guideline on this. Basel 1 focused on the main issue faced by the bank, i.e, credit risk. According to Basel 1 guideline "all country's Banks should maintain a capital adequacy ratio of 8%".

Capital Adequacy Ratio

"Capital Adequacy Ratio is least capital requirement of the bank. It is also known as Ratio of Capital to Risky Assets."

Classification of Capital According to Basel I

- Tier 1 Capital: It is primary capital of bank. It is permanent and reliable in nature. In this equity capital and disclosed reserve are included.
- Tier 2 Capital: It is secondary capital of bank. In this general provision, undisclosed reserves, provision against NPAs etc. are included.

"The risk -weighted asset is the bank's assets weighted according to risks."

Basel II Accord: Since Basel 1, banking has been changed dramatically. Increase in complexity of financial activities and different type of risks were introduced other than just credit risk which prompted the need to update the old guideline and bring new guideline. The problem with the Basel 1 was that, it was not effective in handling all the risks and in it nothing was mentioned about Operational Risk. In the previous guideline,

Same rules were made for all the risks. For Example: according to Basel 1, giving loan to a company which is just started and giving loan to a company which is well established is equal. So, there was a need to update the old guideline as a result Basel 2 came into existence in 2004.

BASEL II FRAMEWORK

Basel 2 framework is the points on which this guideline mainly focused. Basel 2 guidelines is based 3 pillars. The 3 pillars are:

PILLAR 1 – MINIMUM CAPITAL REQUIREMENT

This pillar suggested that banks should maintain a least capital requirement. This minimum ratio is 8%. So, banks should keep this much capital of risky asset along with them. So that, they can be ready for the future and they don't have to face heavy losses due large amount of NPAs. Guidelines for estimating and managing Operational risk was introduced in Basel 2. Rules for estimating and managing Credit risk was upgraded and rules for Market risk didn't change.

According to Basel II, Capital is classified into 3 Tiers:

- "Tier 3 Capital: Short-term subordinated loans are included in this type of capital."

According to pillar 1 of Basel 2, it was mandatory for the banks to give the full knowledge of its capital and risk position to the central bank of their country.

PILLAR 2 - SUPERVISORY REVIEW PROCESS

In India, RBI acts as a supervisor for all the banks. So, under Basel 2, the work of RBI is to keep an eye on all the banks that whether they are maintaining the least capital needed to keep with themselves or not. Under this pillar, Supervisor also have to monitor whether banks are using better techniques for measuring and managing risk which is going to arise in the future or not.

- Under pillar 2, supervisor has to keep an eye on banks that whether they are maintaining capital adequacy ratio of 8% or more or not.

- According to pillar 2, Supervisors has to monitor whether the banks are disclosing their risk position to the RBI or not and whether they are prepared for facing the risk or not.

- According to pillar 2, supervisor should come in between before a bank's capital requirement go below minimum requirement.

- According to pillar 2, if some bank's capital level went below the minimum requirement then supervisor should help the bank to take recovery action.

PILLAR 3 – MARKET DISCIPLINE

According Pillar 3, Banks must disclose their risk exposure, Capital Adequacy Ratio, etc. to public. So that public can have full knowledge about the risks before making investment in a bank. According to this pillar, this disclosure risk exposure and capital adequacy should be done time to time. So that, public could have the updated and recent knowledge about the situation of a bank. Market Disciplines are set up so that banks can work in an effective manner and doesn't have to face heavy losses. These disciplines are set, so that banks can be safe and doesn't go in debt. According to pillar 3, risks are seen with different aspects. Like, if loans is given to a well establish company, then its risk exposure will be different. While if the loan is given to new company that is recently establish, its risk exposure will be different.

TYPES OF RISKS

CREDIT RISK

As per Basel II, the risk that is expected when the loan is given to the borrower and the borrower can became the defaulter. That means he/she may or may not be able to able to return full amount of loan. That's why it's called credit risk because it's the risk on the credit given to borrower.

For example: If a person takes loan from the bank and if he/she was unable to payback that loan because of his/her situation. Some people don't pay back the loan intentionally. So here credit risk arises and bank should be prepared to face such kind of risk.

MARKET RISK

"Market Risk is defined as the possibility of loss caused by changes in the market variables such as interest rate, foreign exchange rate, equity price and commodity price". Market risk that arise when the market go up and down. Banks face liquidity problem sometime as banks not always have cash or liquid asset with them. So, this risk is called liquidity risk which comes under market risk. The fluctuation in price of the foreign exchange or price of equity also comes under this risk. The guideline for market risk doesn't get updated in Basel 2.

OPERATIONAL RISK

Operational risk is the internal risk of an organization. Operational risk include action like risk caused by fraud or misrepresentation of data inside organization, risk in production and sell of goods, i.e., the company might get raw material for making good at high price and price of the product with company is producing might fall down due various reason like season, tread etc.

RISK MANAGEMENT:

KEYS FOR EFFECTIVE RISK MANAGEMENT:

- To coordinate hazard conduct and impact the state of a company's hazard profile, the board should utilize every single accessible alternative. Utilizing money related motivating forces and punishments to impact hazard taking conduct is viable administration instrument.
- Sharing of data by keeping privacy flawless is additionally useful to discover various ways for controlling the hazard as important sources of info might be gotten through this sharing. Indeed, even data on financial soundness of counterparties that are known to face significant challenge can likewise help.
- Enhancement is critical. As it brings down the change in financial specialist portfolios, improves corporate capacity to raise obligation, decreases business dangers, and increases working productivity.
- Administration ought to never be overlooked. Cautious organizing of the collusion ahead of time of the arrangement and ceaseless change from there on help to fabricate a useful relationship.
- Without emotionally supportive network inside the association itself, outside collusions are destined to fizzle.

MARKET RISK MANAGEMENT:

We may accept that there are restricted devices accessible to relieve this hazard, yet this isn't so. Future, choice, subordinates exchanging and its many sub types are a portion of the apparatuses which help to speculators to secure the venture or limit their presentation toward advertise chance. If there should arise an occurrence of subsidiaries as in more extensive sense subordinates are viewed as used to fence against showcase hazard, yet they can be utilized to moderate different sorts of dangers, similar to credit chance, operational risk.

CREDIT RISK MANAGEMENT:

Apparatuses of Credit Risk Management: The instruments and devices, through which credit chance is overseen are: Exposure Ceilings, Review/Renewal, Risk Rating Model, Risk based logical valuing, Portfolio Management, Loan Review Mechanism.

OPERATIONAL RISK MANAGEMENT:

This hazard can be decreased to incredible degree by viably controlling association all in all by making certain strides, such as guaranteeing that planned procedures is completed cautiously and with the assistance of specialists, and are followed in wanted way.

BENEFITS OF BASEL II

- Basel 2 has seen different risk from different aspect. For example the risk in giving loan to a new company that is just established and risk in giving to well established company is different.

- Basel 2 issued guidelines on operational risk to increase control inside the organization. So that organizations can run efficiently. It decreased the risk of fraud, risk of sale and purchase inside the organization.

- In Basel 2, Credit risk was updated. New techniques were brought to estimate and manage credit risk. Credit risk is the risk arises from giving loan to the borrowers. As there is risk that borrowers can default to pay back the loan.

- In Basel 2, guideline about the market risk did not change. As in Basel 1, there was guideline about the movement of prices in the market and it remained as it is in Basel 2. As there was no need to change that.

- In Basel 2, techniques and method of estimating and managing the risk has been changed. New technologies were brought into effect for estimation of risk that is going to arise in future.

LIMITATIONS OF BASEL II:

- One of the limitation of Basel 2 is that the public don’t have all the knowledge about the bank. So, they cannot take appropriate decision whether to make investment in a bank or not.

- Banks are unable to estimate the exact risk that is going to arise in the future. As a result, banks cannot be ready to face such risk.

- Banks are unable to use the most updated techniques and methods to estimate risk in the organization, to manage risk in the organization, to reduce risk in the organization.

- Banks are unable to manage operational risk due to the frauds and misrepresentation of data inside the organization. It happen due to the human resource problem also.

- It was difficult for the bank to differentiate between risks. Different type of risk need different kind of preparation. For example: different kind of preparation is needed for facing the risk which arise from if a well establish company takes loan and different kind of preparation is needed to face the rise which arise from if a newly establish company takes loan. So, risks should be seen from different aspects, so that the bank does not suffer loss in the future.

CHAPTER - III

RESEARCH METHODOLOGY

The reason why there is need for doing this research is to know how risk is managed in the banking sector right now. We are doing is survey also to know how these new regulations help banks in measuring risk and after that reducing those risk through the help of risk management.

This study is done to find out to what extend Basel 2 norms has been implemented by banks, that means how much a bank is following regulation mentioned in Basel 2 accord. Through this survey we also typed to find out whether banks are maintaining their capital adequacy ratio or not.

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STUDY PROBLEM

"To what extent banks have implemented Basel II norms related to enhancing internal control in the banks?"

OBJECTIVES

- Covering various parts of risk appraisal
- Distinguishing keys for powerful risk executions
- To comprehend the difficulties and effect of Implementing Basel 2 fully.
- To break down the present advancement of Basel 2 in Delhi

DATA COLLECTION

1. Primary source:
    a. Personal interview
    b. Questionnaire

2. Secondary information:
    a. Internet
    b. newspaper,
    c. Audit reports.

STUDY COVERAGE AND SAMPLE

Study inclusion comprises of all bank representatives inside inner control, chance administration, tasks division, and credit office. Survey was disseminated more than 10 banks in Delhi chose on arbitrary testing method. 10 questionnaires were given to the employees of different bank. The questionnaires were about the risk management system in the bank. They have to fill up these questionnaires.

Questionnaires are prepared with optional type questions and some questions which are answered in just yes or no. This survey is mainly done on the Credit Manager, Operation Manager in the bank as they deal with the certain risk estimation and management on daily basis in the bank.

For the study, banks are divided into two types and survey is done. Survey is done from following banks:

PUBLIC SECTOR BANK

- SBI
- PNB
- SYNDICATE
- CANARA
- UNION

PRIVATE SECTOR BANK

- ICICI
- HDFC
- YES
- AXIS
- KOTAK MAHINDRA

SCOPE OF THE SURVEY

The Banking Industry has been evaluated the preparation in seven zones.

- Awareness of regulations
- Organizational structure
- Reporting ability
- Compliance with Basel II
- Capital allocation
- Basel II action plan
- Technology

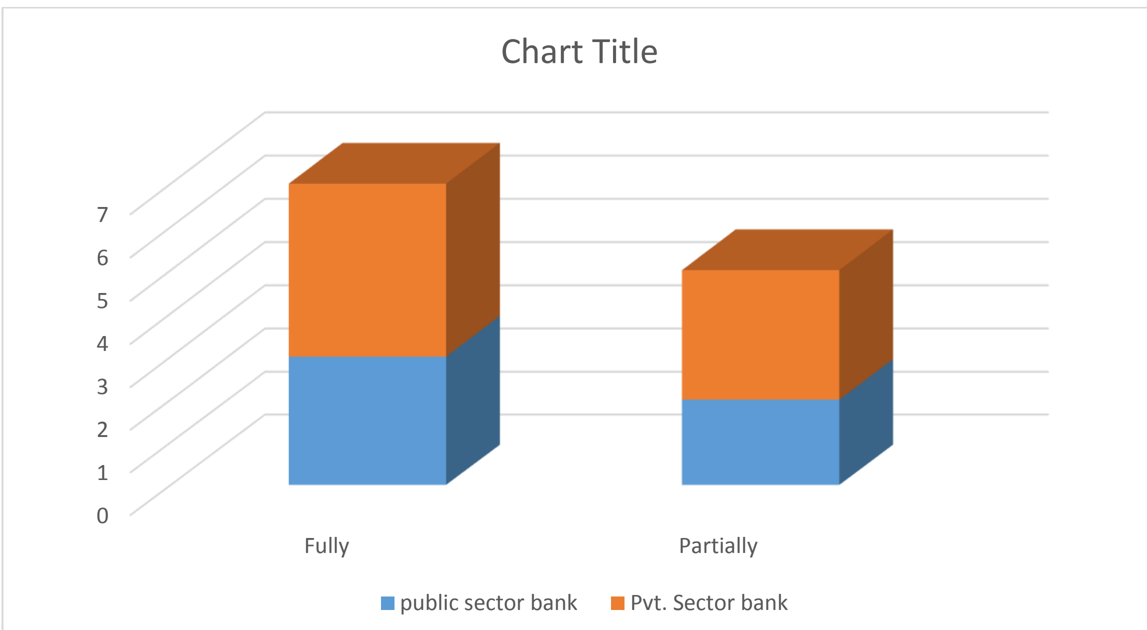
CHAPTER - IV

ANALYSIS & INTERPRETATION

All the underneath examination and understanding is done from the overview directed in Banks.

1. To what extend your bank is following Basel 2 guidelines?

	Public Sector Bank	Private Sector Bank
Fully	3	4
partial	2	1

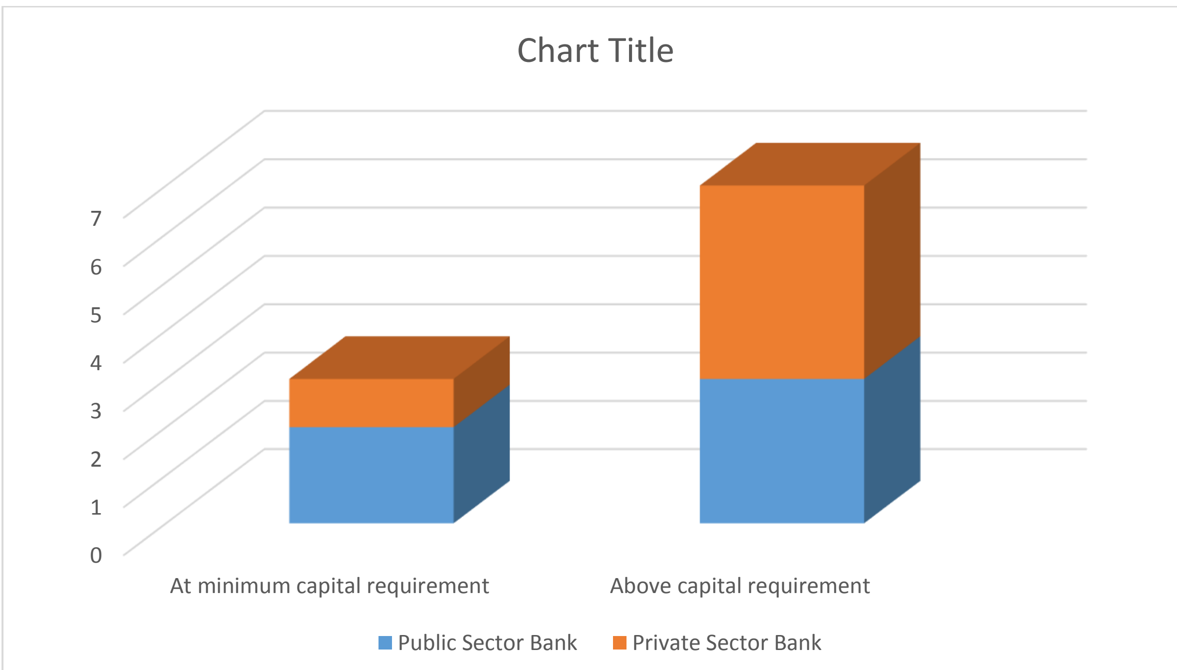


INTERPRETATION

From this graph, we can interpret that more than half of the banks are following the Basel 2 guidelines and rest of the bank is on the way to implement it fully.

2. Are your bank maintaining capital adequacy ratio just at the minimum level or above the minimum level?

	Public Sector Bank	Private Sector Bank
At minimum capital requirement	2	1
Above minimum capital requirement	3	4

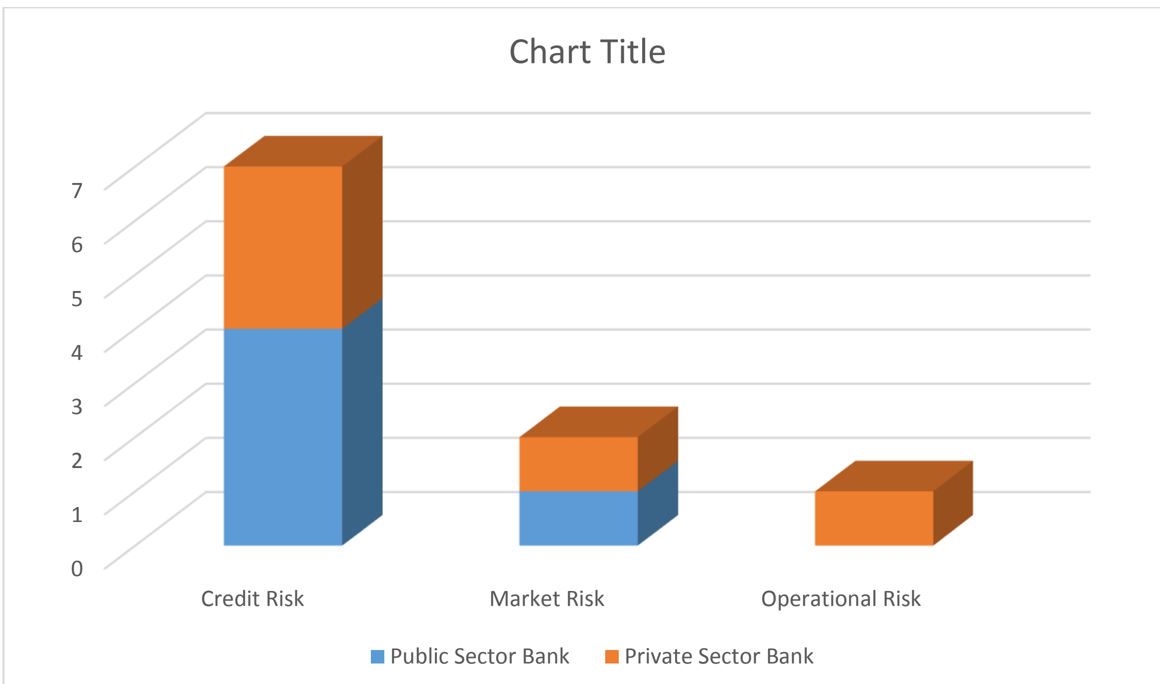


<u>INTERPRETATION</u>

From this graph, we also find out that most of the banks are maintaining more than the minimum capital adequacy requirement and very few banks are just maintaining the minimum capital required.

3. Which risk do your bank give priority?

	Public Sector Bank	Private Sector Bank
Credit Risk	4	2
Market Risk	1	1
Operational Risk	0	1

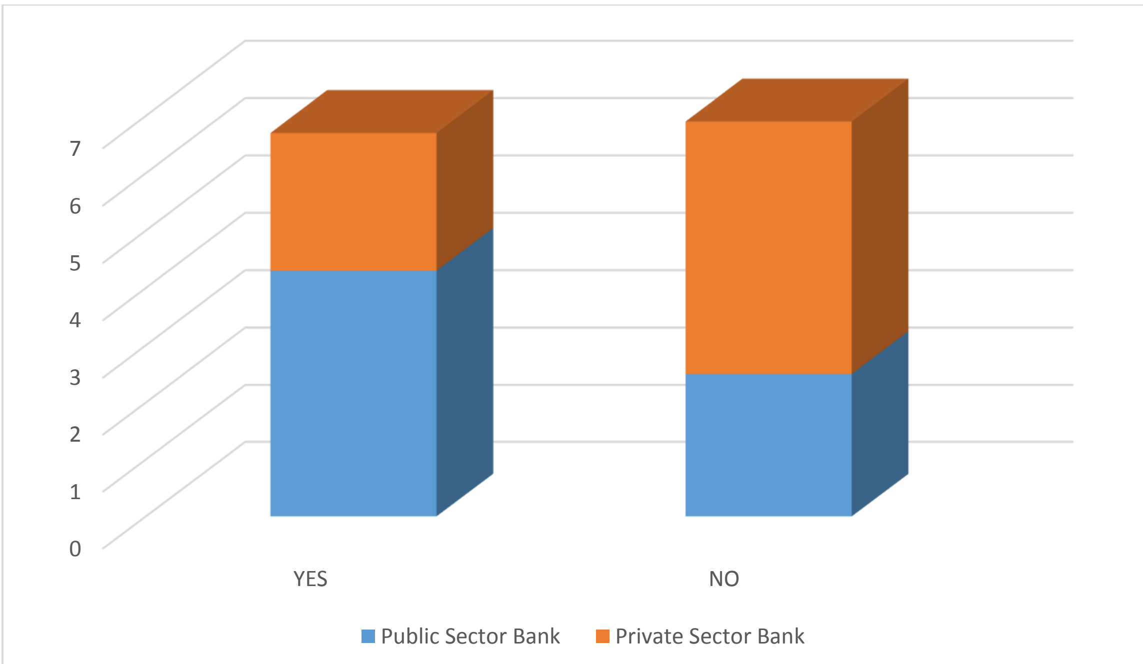


<u>INTERPRETATION</u>

From the graph, we can see that most of the banks focusing more on credit risk, after that they are focusing on market risk and least they are focusing on operational risk.

4. Are your bank adopting better techniques to estimate and manage risk?

	Public Sector Bank	Private Sector Bank
YES	3	4
NO	2	1

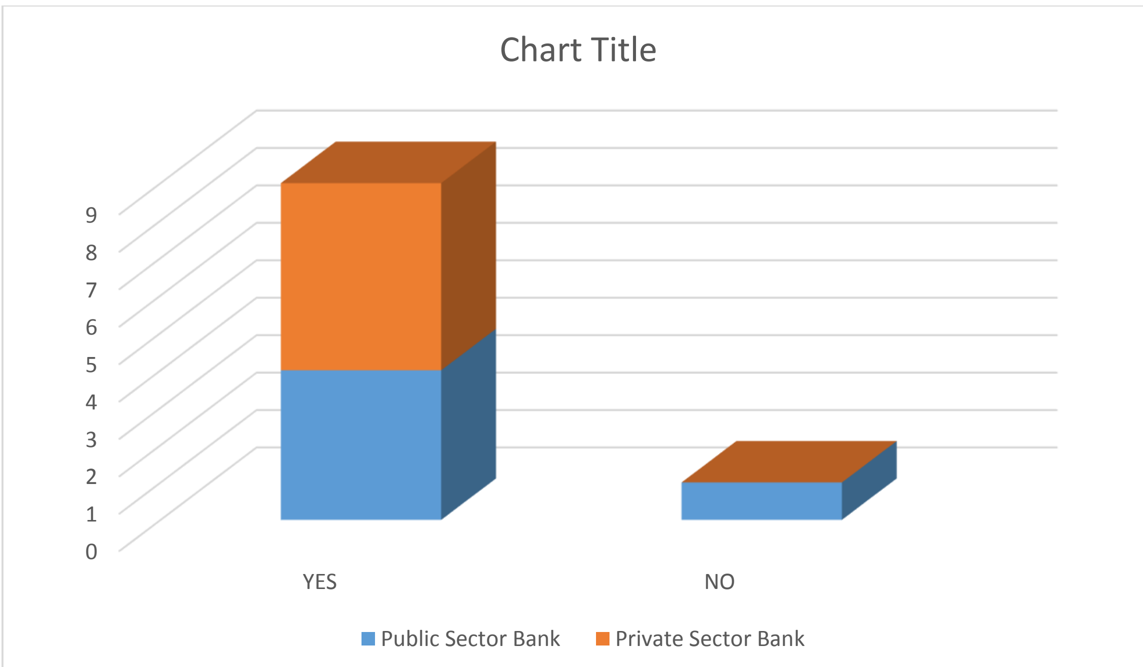


<u>INTERPRETATION</u>

This graph show that most of the banks have already adopted better techniques to estimate and manage the risk while some are still trying to adopt better techniques to improve their risk management system.

5. Are your bank taking measure for reducing operational risk?

	Public Sector Bank	Private Sector Bank
YES	4	5
NO	1	0

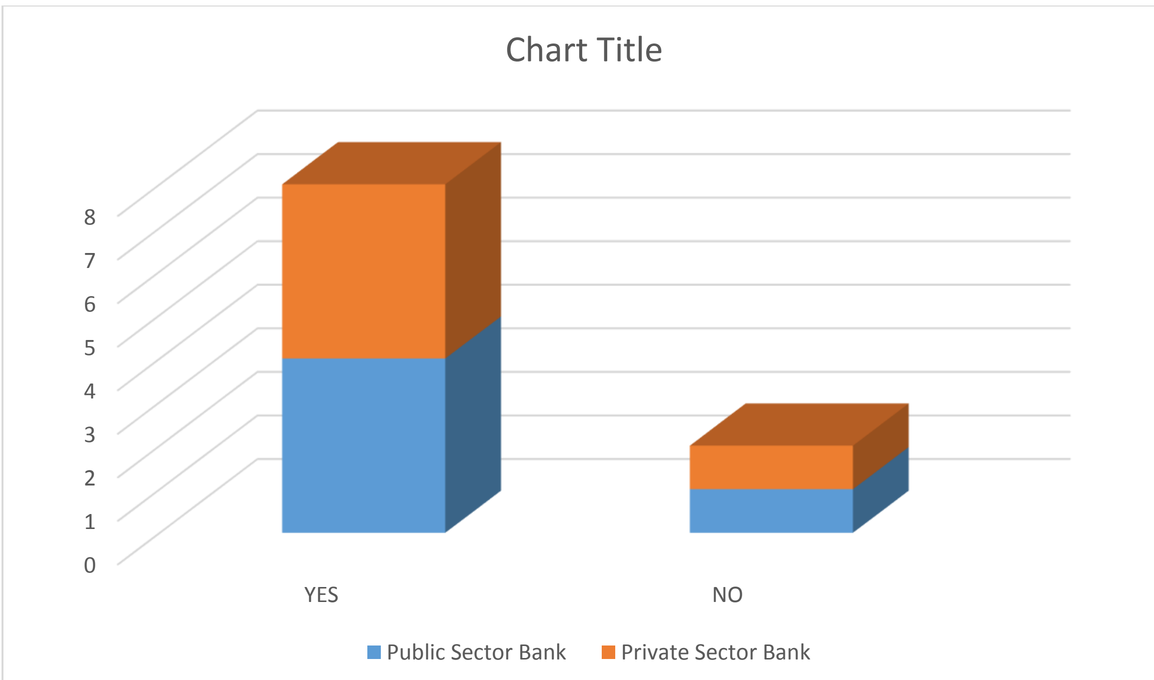


INTERPRETATION

From this graph, we find out that most of the banks are taking measure to reduce the operational risk and rest have not taken risk measures for reducing operational risk.

6. In your bank, is there separate risk department?

	Public Sector Bank	Private Sector Bank
YES	4	4
NO	1	1

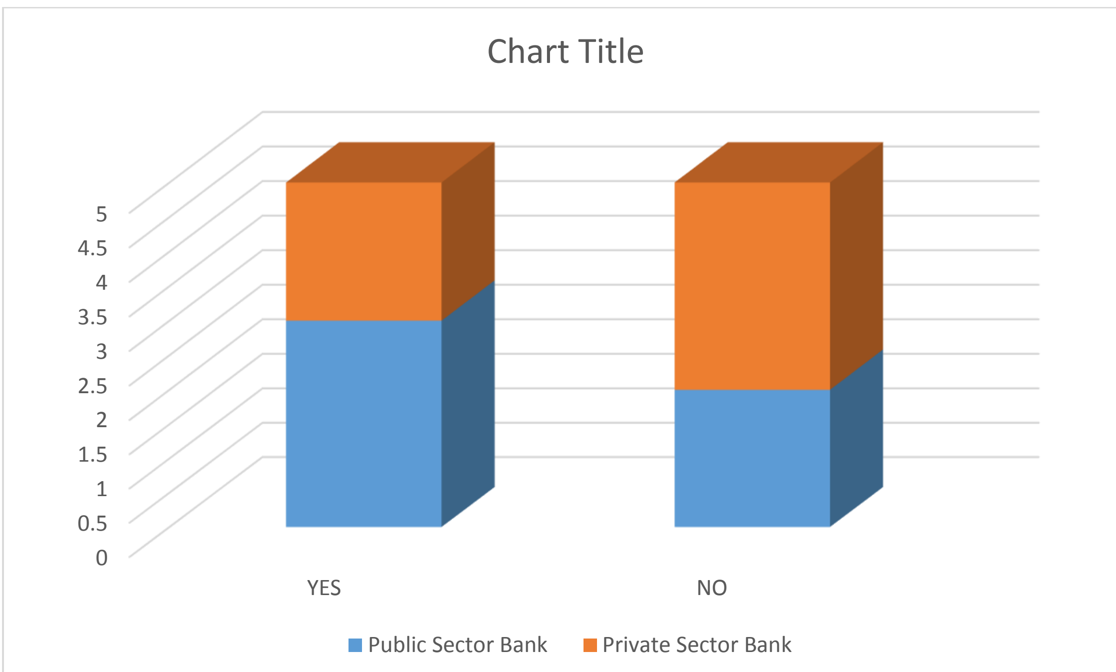


INTERPRETATION

We can see in this graph that all most all the banks have separate risk department working for controlling the risk.

7. In risk department in your bank, is separate employee assigned for different kind of risk?

	Public Sector Bank	Private Sector Bank
YES	3	2
NO	2	3

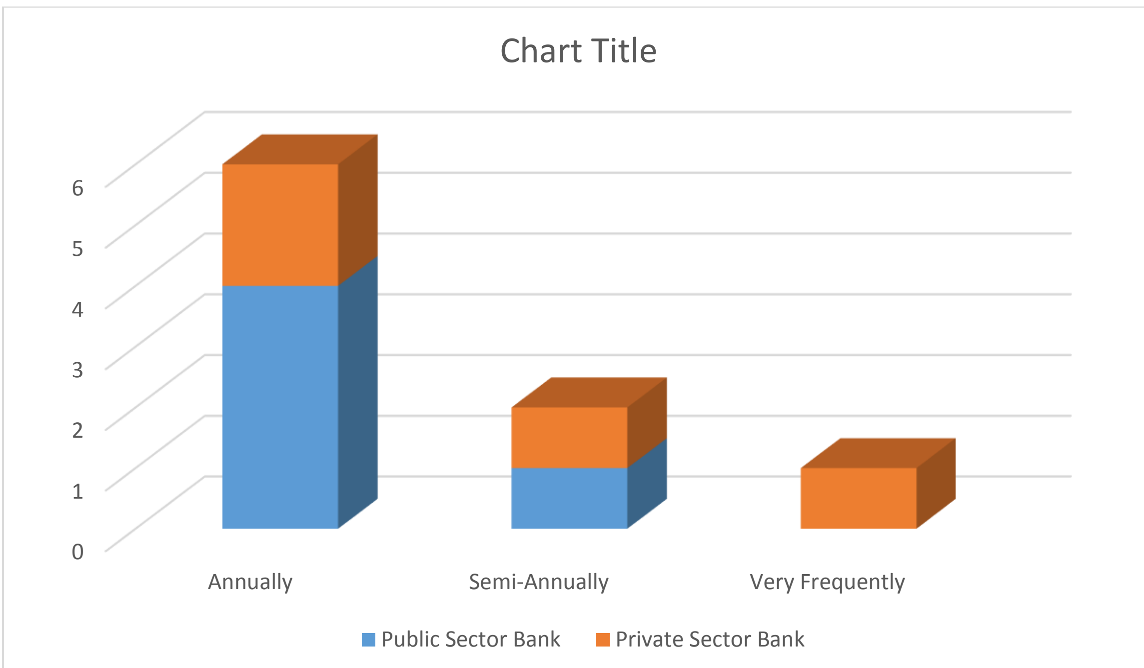


<u>INTERPRETATION</u>

We find out from this graph that in that risk department, only half of the banks have assigned separate employees for handling different kind of risk.

8. How often do your bank in a year make strategy for facing risk?

	Public Sector Bank	Private Sector Bank
Annually	4	2
Semi-Annually	1	1
Very Frequently	0	1

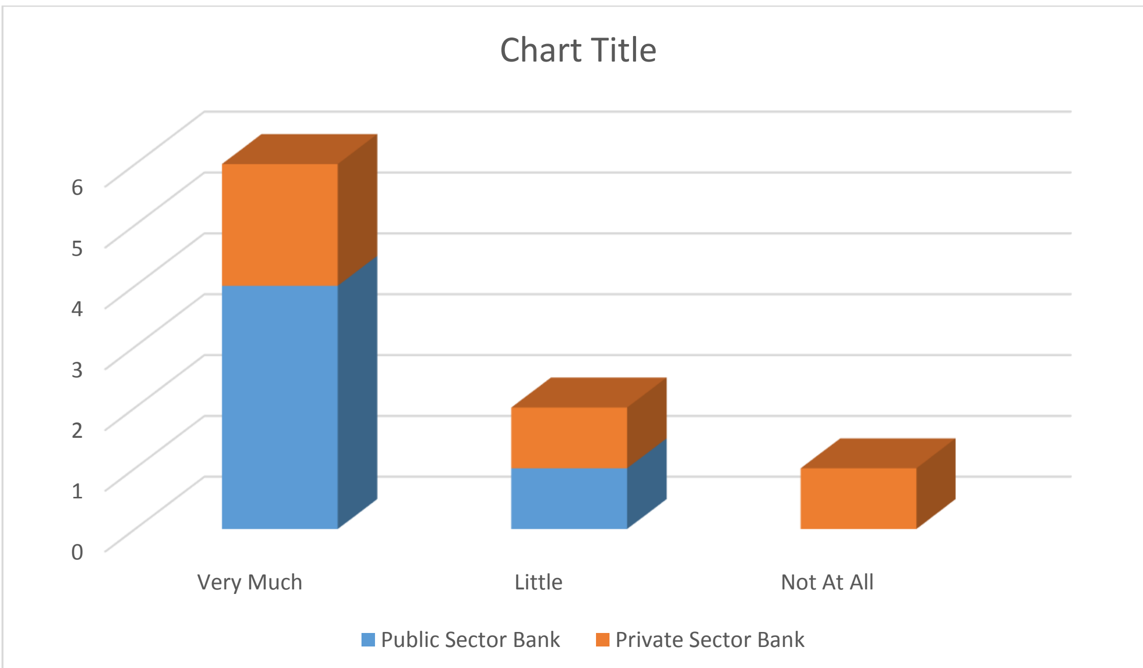


INTERPRETATION

We find out from the graph that most of the banks make strategy for facing risk annually, and few banks are only making strategy semi- annually for facing risk and only 1% banks are making strategy frequently for the risk that is going arising in future due to lending and borrowing activities.

9. Is Basel 2 guidelines improved the risk management in your bank?

	Public Sector Bank	Private Sector Bank
Very Much	4	2
Little	1	2
Not At All	0	1

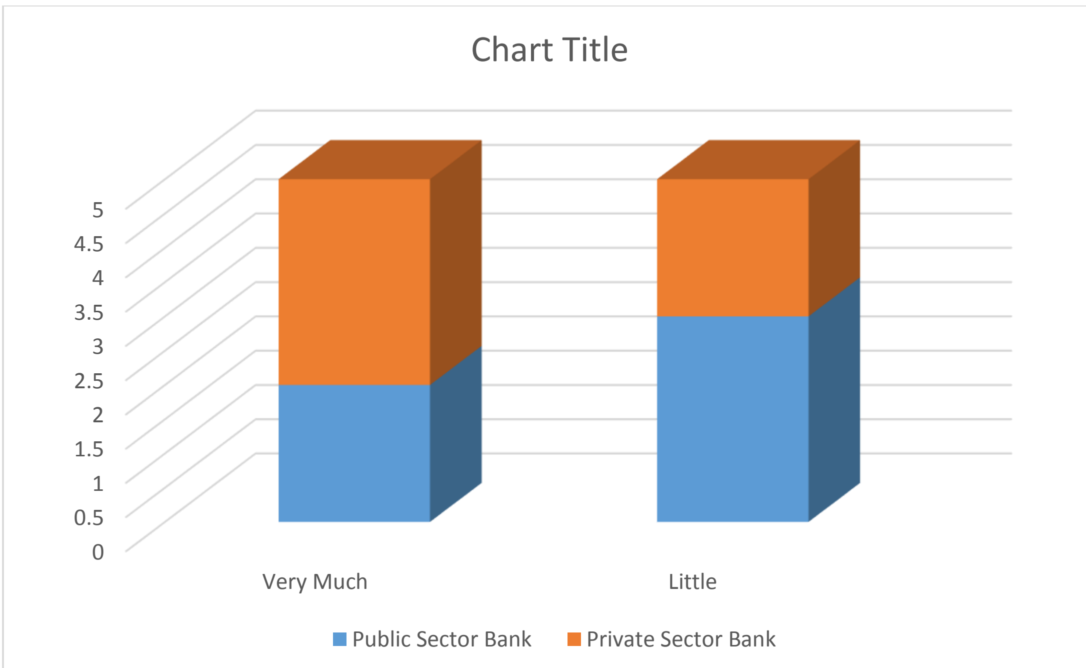


INTERPRETATION

From the graph, we find out that most of the public sector banks and private sector bank's risk management system has been improved after implementing Basel 2 guidelines.

10. How much your bank's risk estimation go right?

	Public Sector Bank	Private Sector Bank
Very Much	2	3
Little	3	2



INTERPRETATION

From the graph, we find out that estimation of risk that bank do for facing risk, half of the time goes right and half of the time goes wrong.

CHAPTER - V

FINDINGS AND SUGGESTIONS

FINDINGS

- After doing this survey we came to the conclusion that more than half of the banks are following the Basel 2 guidelines and rest of the bank is on the way to implement it fully.

- From this survey, we also find out that most of the banks are maintaining more than the minimum capital adequacy requirement and very few banks are just maintaining the minimum capital required.

- From the survey, we found out that most of the banks focusing more on credit risk, after that they are focusing on market risk and least they are focusing on operational risk.

- We find out from the survey that most of the banks have already adopted better techniques to estimate and manage the risk while some are still trying to adopt better techniques to improve their risk management system.

- From the survey, we find out that most of the banks are taking measure to reduce the operational risk and rest have not taken risk measures for reducing operational risk.

- We find out from the survey that all most all the banks have separate risk department working for controlling the risk.

- After doing the survey, we find out that in that risk department, only half of the banks have assigned separate employees for handling different kind of risk.

- We find out from the survey that most of the banks make strategy for facing risk annually, and few banks are only making strategy semi- annually for facing risk and only 1% banks are making strategy frequently for the risk that is going arising in future due to lending and borrowing activities.

SUGGESTIONS

- Based on the survey, my suggestion is that all banks should fully follow the guidelines of Basel 2 for better risk management system.

- According to me, banks should maintain the capital adequacy ratio above the minimum requirement. So, they don't have to face liquidity problem.

- Based on the survey, my suggestion will be banks should give equal priority to all the three risk that is credit risk, market risk and operational risk.

- As per my suggestion, banks should adopt better techniques for estimating the risk and managing the risk.

- As per the survey, we can say that bank should focus on the operational risk more than they are focusing right now.

- I think all the banks should have separate risk department which work on only estimating and managing risk because risk management is very necessary for any bank to be safe and run efficiently.

- And as per my suggestion, in the risk department, different manager should be assigned for handling different type of risks as a single manager cannot equally pay attention to all the risks. As different risks have different aspects and they need to be managed in different ways.

- I think banks should have different time frame for making strategies for facing different type of risk. Strategies for market risk should be made more frequently by the banks while they can make strategies for credit risk and operational risk annually or semi-annually.

CHAPTER - VI

CONCLUSION

Basel 2 guidelines has improved the risk management system of many banks like after implementing Basel 2 guidelines banks are more appropriately able to estimate and manage the risk. So, Basel 2 most be implemented and followed fully by every bank because these guidelines has been brought for their betterment only. So that they don't have to face loss. Banks should maintain the capital adequacy ratio above the minimum requirement. So, they don't have to face liquidity problem.

Banks are giving more priority to credit risk that should not happen. Banks should give equal priority to all the three risk that is credit risk, market risk and operational risk. Banks have already adopted better techniques to estimate and manage the risk while some are still trying to adopt better techniques to improve their risk management system.

Strategies for facing different type of risk. Strategies for market risk should be made more frequently by the banks while they can make strategies for credit risk and operational risk annually or semi-annually.

Banks should have separate risk department which work on only estimating and managing risk because risk management is very necessary for any bank to be safe and run efficiently and in the risk department, different manager should be assigned for handling different type of risks as a single manager cannot equally pay attention to all the risks. As different risks have different aspects and they need to be managed in different ways. As per the study, most of the banks have separate risk department working for controlling the risk but some banks don't have separate manager handling different risks.

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CHAPTER VII

ANNEXURE

I am AISHWARYA VERMA student of 4th semester, MBA (FINANCIAL MANAGEMENT). I am working on a report titled "**RISK MANAGEMENT IN BANKING SECTOR".** In this regard I request you to spend your valuable time in filling this questionnaire **(Tick the appropriate box).** This information will be used only for academic purpose and will be kept confidential.

PERSONAL INFORMATION

1. Name:
2. Name of the bank in which you are working:
3. Your position in the Bank: :
4. In which kind of bank are you working?

Public Sector Bank	
Private Sector Bank	

5. In which city your bank's head office is situated:

Tick the appropriate box

1. To what extend your bank is following Basel 2 guidelines?

	Public Sector Bank	Private Sector Bank
Fully		
partial		

2. Are your bank maintaining capital adequacy ratio just at the minimum level or above the minimum level?

	Public Sector Bank	Private Sector Bank
At minimum capital requirement		
Above minimum capital requirement		

3. Which risk do your bank give priority?

	Public Sector Bank	Private Sector Bank
Credit Risk		
Market Risk		
Operational Risk		

4. Are your bank adopting better techniques to estimate and manage risk?

	Public Sector Bank	Private Sector Bank
YES		
NO		

5. Are your bank taking measure for reducing operational risk?

	Public Sector Bank	Private Sector Bank
YES		
NO		

6. In your bank, is there separate risk department?

	Public Sector Bank	Private Sector Bank
YES		
NO		

7. In risk department in your bank, is separate employee assigned for different kind of risk?

	Public Sector Bank	Private Sector Bank
YES		
NO		

8. How often do your bank in a year make strategy for facing risk?

	Public Sector Bank	Private Sector Bank
Annually		
Semi-Annually		
Very Frequently		

9. Is Basel 2 guidelines improved the risk management in your bank?

	Public Sector Bank	Private Sector Bank
Very Much		
Little		
Not At All		

10. How much your bank's risk estimation go right?

	Public Sector Bank	Private Sector Bank
Very Much		
Little		

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