

INTERNATIONAL JOURNAL FOR LEGAL RESEARCH AND ANALYSIS



Open Access, Refereed Journal Multi-Disciplinary
Peer Reviewed

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Avinash Kumar



Avinash Kumar has completed his Ph.D. in International Investment Law from the Dept. of Law & Governance, Central University of South Bihar. His research work is on "International Investment Agreement and State's right to regulate Foreign Investment." He qualified UGC-NET and has been selected for the prestigious ICSSR Doctoral Fellowship. He is an alumnus of the Faculty of Law, University of Delhi. Formerly he has been elected as Students Union President of Law Centre-1, University of Delhi. Moreover, he completed his LL.M. from the University of Delhi (2014-16), dissertation on "Cross-border Merger & Acquisition"; LL.B. from the University of Delhi (2011-14), and B.A. (Hons.) from Maharaja Agrasen College, University of Delhi. He has also obtained P.G. Diploma in IPR from the Indian Society of International Law, New Delhi. He has qualified UGC – NET examination and has been awarded ICSSR – Doctoral Fellowship. He has published six-plus articles and presented 9 plus papers in national and international seminars/conferences. He participated in several workshops on research methodology and teaching and learning.

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INTERNATIONAL JOURNAL FOR LEGAL RESEARCH & ANALYSIS
ISSN

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ANALYSIS OF RISK MANAGEMENT STRATEGIES IN COMMERCIAL BANKS

AUTHORED BY - ADV. LIDIA MERIN P JOSE

Practicing Advocate at Cherthala Munsiff & Magistrate Court, Kerala, India

CO-AUTHOR - NAFIA FARZANA T A

CO-AUTHOR 2 - RESHMA RAMESH

Institution: 4th Semester LL.M (Criminal Law) Student at Bharata Mata School of Legal Studies, Choondi, Aluva, Kerala, India

ABSTRACT

Understanding risk management, risk assessment & analysis, risk identification, risk monitoring, and credit risk analysis in commercial banks are some of the elements that this study looks at that may have an impact on risk management procedures. The dependability criteria were met by the acquired data, leading to the adoption of regression and correlation analysis. According to the findings, risk management practices (RMP) are positively and significantly impacted by an understanding of risk and risk management (URM), risk assessment and analysis (RAA), risk identification (RI), risk monitoring (RM), and credit risk analysis (CRA). This implies that URM, RAA, RI, RM, and RA are important considerations for commercial banks. Commercial banks should concentrate on RM and RAA since they are significant factors that affect RMP.

INTRODUCTION

Risk can create issues that prevent some goals from being successfully accomplished. Any internal or external component, depending on the type of risk involved in a given situation, might have an impact on risk. Risk exposure can have detrimental effects. In situations like this, the best method to manage risk is to take proactive steps to identify any potential risks that could have unintended consequences. Managing risks is undoubtedly simpler than dealing with unintended outcomes. The banking industry is frequently associated with risk because of its significant reliance on chance. Because of their commercial orientation and significant exposure to substantial quantities of capital, banks have a strong correlation with risk. One of

the most important practices that is adopted, especially in banks, is risk management (RM). Banks have used risk management as a way to control risks. All banks are subject to many types of risk in the current dynamic environment, including market, interest rate, liquidity, credit, and foreign exchange risks.

BANK EXPOSURE TO RISK

Three broad areas can be used to classify banking risks: financial, operational, and environmental. Two categories of risk are included in financial risks. If traditional banking risks are not adequately handled, they can cause a bank to lose money. These risks include credit, solvency, and the structure of the balance sheet and income statement. Financial arbitrage-based treasury risks can yield profits in the event that the arbitrage is accurate or losses in the event that it is not. Treasury risk can be divided into four basic categories: currency, interest rate, market (including counterparty) risk, and liquidity. Complex interdependencies pertaining to financial hazards can also greatly raise a bank's total risk profile. A bank that deals in foreign exchange, for instance, is typically exposed to currency risk. However, if the bank has open positions or imbalances in its forward book, it will also be exposed to additional liquidity and interest rate risk. Operational risks are associated with the general business processes of a bank and the possible effects of information security, internal systems and technology, measures against fraud and mismanagement, and business continuity issues on compliance with bank policies and procedures. Operational risk also includes the bank's internal resources and personnel career management, governance and organisational structure, product and knowledge development, and customer acquisition strategy. Credit risk management significantly affected the profitable of the commercial banks in Nigeria¹. The business environment of a bank includes legal and regulatory issues, macroeconomic and policy worries, the infrastructure of the financial industry as a whole, and the payment systems of the countries in which it conducts business. All of these elements are linked to environmental risks. All exogenous hazards that could endanger a bank's operations or make it more difficult for it to remain in business are considered environmental risks.

¹ Abiola, I., & Olausi, A. S. (2014). The impact of credit risk management on the commercial banks performance in Nigeria. *International Journal of Management and Sustainability*, 3(5), 295-306.

CORPORATE GOVERNANCE

As was previously mentioned, banks are exposed to new risks and challenges as a result of financial market instability, greater competition, and diversification. As a result, in order for banks to be competitive, they must constantly innovate new ways to manage business risks. The growing market orientation of banks has also made adjustments to the ways that regulation and supervision are implemented necessary. One nation at a time, the role of maintaining the banking system and markets is being recast as a collaboration between several important stakeholders who oversee diverse aspects of operational and financial risk. This strategy reaffirms that the primary issues in guaranteeing the security and stability of individual banks as well as the banking system at large are the calibre of bank management, particularly the risk management procedure. The following is a summary of how the risk management partnership operates:

Supervisors and regulators of banks are powerless to stop bank failures. Their main responsibilities are to improve and keep an eye on the legal framework that governs risk management and to facilitate the process of risk management. In order to influence the other important stakeholders, regulators and supervisors must provide a sound enabling environment. The individuals in charge of corporate governance should be chosen by shareholders, who are able to do so. Regulators should make sure that shareholders have no intention of using the bank exclusively to finance their own or their associates' businesses. Ultimately, the board of directors (sometimes known as the supervisory board) is in charge of how a bank conducts its operations. The board is in charge of establishing operational rules, selecting management, setting the strategic direction, and above all assuring a bank's health. A bank's executive management must be "fit and proper," which means that in addition to upholding moral principles, managers must possess the skills and knowledge required to operate the bank. The management must have a thorough understanding of the financial risks that are being managed since it is in charge of carrying out the board's policies through the daily operations of the bank. The board's responsibility for risk management policy should be seen as extending to the audit committee and internal auditors. Traditionally, internal auditors conducted an unbiased assessment of a bank's adherence to its information systems, accounting procedures, and internal control systems. On the other hand, the majority of contemporary internal auditors would characterise their work as supplying assurance concerning the bank's risk management procedures, control framework, and corporate governance. Only by comprehending and analysing the primary danger indicators that propel each business line's distinct activities can assurance be attained. Audit committees can be very helpful to management in identifying and

managing risk areas, but they should not be given sole responsibility for risk management; instead, it should be integrated into management at all levels. In the process of gathering risk-based financial information, external auditors now perform a significant evaluation function. Proper methods for contact between bank supervisors and external auditors are essential, especially on a trilateral basis with bank management, as supervisors cannot and should not duplicate the work done by the latter. Instead of being based on a conventional audit of the income statement and balance sheet, the audit strategy should be risk-oriented. The partnership would suffer from an over-reliance on outside auditors, particularly if it resulted in a diminution of the management and supervisory responsibilities. As participants in the market, the general public and consumers must take ownership of their financial decisions. They need to achieve this through providing clear financial information disclosure and well-informed financial evaluations. If the concept of "public" is expanded to include financial media, financial experts like stockbrokers, and rating agencies, the public can be helped in its duty as risk manager. Generally speaking, a tiny or unsophisticated depositor would want more protection than just clear disclosure.

RISK-BASED ANALYSIS OF BANKS

Stability and confidence in the financial system are largely dependent on banking supervision, which is based on a constant analytical evaluation of banks. With the exception of a somewhat different end goal, the approach employed in an analytical evaluation of banks throughout the off-site surveillance and on-site supervision process is comparable to that of analysts in the private sector (such as external auditors or a bank's risk managers). For this reason, the analytical methodology for risk-based bank analysis recommended in this article is globally relevant. In a market that is competitive and unstable, bank evaluation is a difficult process. Apart from proficient management and oversight, other essential elements required to guarantee the security of banking establishments and the steadiness of financial systems and marketplaces encompass robust and enduring macroeconomic strategies and coherent and well-crafted legislative structures. Enough safety nets for the banking industry, efficient market discipline, and adequate infrastructure for the financial sector are also essential. Capital management risk has significant association with return on equity of commercial and operating risk has significant relation with the financial performance of commercial banks in Sri Lanka².

² Wijewardana, W. P., & Wimalasiri, P. D. (2017). Impact of risk management on the performance of commercial banks. in Sri Lanka. International Journal of Advanced Research., 5(11), 1441-1449. <https://doi.org/10.21474/IJAR01/5919>

A bank analyst needs to be well-versed in the specific regulatory, market, and economic environment that a bank operates in in order to formulate effective and practical courses of action, diagnose major issues, estimate future potential, and make meaningful assessments and interpretations of specific findings. In other words, even while focussing on a particular bank, an analyst needs to have a comprehensive understanding of the financial system in order to perform their work effectively. Both bank supervisory procedures and financial analysts' methods of appraisal are always changing. The evolution of international supervisory standards and practices is seen necessary in part to address the problems posed by innovation and new developments, and in part to facilitate the broader process of convergence. The Basel Committee on Banking Supervision is continuously deliberating on these matters. In order to evaluate a bank's state, traditional banking analysis has relied on a variety of quantitative supervisory methods, such as ratios. Ratios are typically associated with big exposures, open foreign exchange holdings, insider and related lending, loan portfolio quality, liquidity, and capital adequacy. Even if these metrics are very helpful, they do not provide a sufficient indicator of a bank's risk profile, stability in its financial situation, or future prospects. Additionally, the timeliness, precision, and completeness of the data utilised to compute financial ratios have a significant impact on the picture they depict. The comprehensive examination of a bank is the primary method for analysing financial risk. Financial ratios are positioned within a comprehensive framework of risk assessment, risk management, and changes or trends in such risks in risk-based bank analysis, which also include significant qualitative aspects. Bank analysis that is focused on risk also highlights the pertinent institutional factors. A bank's policies and procedures, their adequacy, completeness, and consistency, the efficacy and completeness of internal controls, the timeliness and accuracy of management information systems, and information support are a few examples of these aspects. It's been claimed that risk increases exponentially with the rate of change, but bankers take a long time to modify their risk appetite. Practically speaking, this means that the market's capacity for innovation is typically higher than its capacity to recognise and appropriately manage the risk that goes along with it. Banks have always viewed managing credit risk as their primary responsibility, but as the industry has evolved and the market has grown more unpredictable and complex, it has become clear that managing exposure to other operational and financial risks is just as vital.

ANALYTICAL TOOLS PROVIDED

Even though every study is different, there are a lot of commonalities in the overall analytical process when it comes to technical professionals' evaluation, on-site inspection, off-site surveillance, and bank risk management. In addition to financial and management data, the background and financial information required in the questionnaire should give a general picture of the bank to enable evaluation of the standard and thoroughness of bank policies, management, and control procedures. There are various categories for questions:

- Needs for institutional development
- Corporate governance, covering specific key players and accountabilities;
- Overview of the financial sector and regulations;
- Accounting systems, management information, internal controls, and information technology;
- Risk management, including balance sheet structure management, earnings and income statement structure, credit risk, and the other major types of financial and operational risk

UNDERSTANDING THE ENVIRONMENT IN WHICH BANKS OPERATE

One of the most important responsibilities of financial analysts and bank supervisors is gathering and evaluating risk management data from banks. A risk-based analytical evaluation of each bank's financial data highlights market patterns and relationships while providing information on the banking industry as a whole for bank management, financial analysts, bank supervisors, and monetary authorities. Sectoral analysis is crucial because it makes it possible to set standards for both a peer group within the sector and the sector as a whole. These standards can then be used to assess the performance of specific banking organisations. Disturbances from anticipated patterns and correlations should need additional examination, as they could reveal not only the risk encountered by specific institutions, but also shifts in the financial landscape of the banking industry overall. A sector analyst can learn about changes in the industry and how they affect different economic agents and sectors by looking at sector statistics. Banking statistics can provide light on the state of the economy since banks are an integral part of national economies and engage in both the domestic and global financial systems. Macroeconomists may find that their monetary models no longer accurately reflect reality as a result of the financial system's dynamism, which typically causes changes to

measurable economic variables. Policy makers are also concerned about how banking operations affect monetary statistics, including money supply data and credit extension to the domestic private sector. Evaluations of banks can function as a methodical approach to guarantee that monetary authorities identify and measure nonintermediate lending and financing, together with other procedures that hold significance for central bank policymakers. A structured approach to analysing banks has the benefit of taking a methodical and logical approach to the behaviour of the banking sector, which makes sector information easily accessible for macroeconomic and monetary analysis. As a result, bank supervisors are in a position to significantly support monetary authorities, whose policies are impacted by changes in the banking industry.

THE IMPORTANCE OF QUALITY DATA

Increasing openness and providing information that is helpful in making economic decisions are the goals of financial statements prepared in accordance with Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS). However, because financial statements primarily depict the effects of past events and may not always provide nonfinancial information, even those prepared in accordance with strict international standards may not contain all the information a person may need to perform all types of risk analysis. However, information regarding an entity's historical performance (income and cash flows) and present financial situation (assets and liabilities) may be found in IFRS accounts, and this information can be helpful in evaluating the entity's prospects and risks for the future. To make sound investment decisions, the financial analyst needs to be able to use the financial statements in conjunction with other data. A study of the financial situation as well as particular concerns about risk exposure and risk management are typically included in financial statement analysis, or analytical reviews. These assessments can be conducted off-site, but an on-site study would cover a far wider range of subjects and focus more on qualitative elements, such as the physical infrastructure, the standard of corporate governance, and the management's application of sound management information. Because many bank assets are illiquid and lack an objectively defined market value, a trustworthy assessment of the financial health of banks requires skilled analysts and supervisors. Timely evaluation of the net worth of banks and other financial institutions is made even more difficult by new financial products. The amount of information needed to attain financial stability has significantly increased due to the liberalisation of banking and capital markets, and it is now crucial to provide adequate and relevant information about market participants and their transactions in

order to keep the systems efficient and in order. In theory, information is needed by market players, depositors, and the general public just as much as it is by supervisory bodies. Theoretically, influential players in the market can exert gradual peer pressure to promote information sharing. Under normal circumstances, this kind of pressure could demonstrate to banks that transparency helps them raise capital, e.g., by encouraging depositors and potential investors to contribute capital. Even in economies with sophisticated financial systems, there is a regrettable tendency to transform the need to conceal information especially that which indicates unfavourable outcomes into a lack of transparency. Furthermore, the material that has the greatest potential to cause abrupt and severe market reactions is typically revealed at the last possible minute, usually unwillingly, due to the sensitivity of bank liquidity to a poor public view.

CONCLUSION

Understanding risk management, risk assessment & analysis, risk identification, risk monitoring, and credit risk analysis in commercial banks are some of the elements that this study looks at that might affect risk management procedures. Risk Management Practices (RMP) are positively and significantly impacted by an understanding of risk and risk management (URM), risk assessment and analysis (RAA), risk identification (RI), risk monitoring (RM), and credit risk analysis (CRA). This implies that URM, RAA, RI, RM, and RA should receive increased attention from commercial banks. Furthermore, as RM and RAA are significant factors that affect RMP, Pakistani commercial banks must pay attention to them. The findings will be valuable to individuals who are interested in learning more about the commercial banking system and may serve as a useful guide for improving RMP in commercial banks.