Tiruvalla East Co-operative Bank Ltd No. 3260

Risk Management Policy 2023

(Resolution No. dated 21.10.2023 of the Board of Directors)

Introduction

As per Reserve Bank of India (RBI) guidelines, the Tiruvalla East Co-operative Bank (TECB) formulated this Risk Management Policy to implement effective Risk Management System in the area of credit, market and business operations and to provide adequate capital to meet them. This Policy is laid down to put in place a comprehensive framework for identification, assessment, monitoring and management of risk in a timely and efficient manner.

Risk Management must operate within the framework of the Bank's corporate vision and mission, risk appetite, prudential controls etc. and should be in line with the regulatory compliance needs. The policy also seeks to create systems and procedures which actively mitigate risks, optimize resources to protect the Bank against the downside and at the same time provide a reasonable return commensurate with the risk profile adopted. Bank in the process of financial intermediation may confront with various kinds of financial and non-financial risks viz., credit, interest rate, liquidity, legal, regulatory, reputational, operational etc. These risks are highly interdependent and events that affect one type of risk can have ramifications for a range of other type of risks. Thus the Bank should give considerable importance to improve the ability to identify, measure, monitor and control the overall level of risks.

1. Risk Management Structure

The primary responsibility of understanding and managing the risks is vested with the Board of Directors (BoD) of the Bank. As per RBI guidelines, Bank shall constitute a Risk Management Committee (RMC) at the BoD level and an independent Compliance and Risk Management Committee (CRMC) at the Management level. The BoD should set risk limits by assessing the Bank's risk bearing capacity. The RMC shall develop policies and procedures, review the risk models and also identify new risks. The RMC shall also assign risk limits in terms of Credit at Risk (credit risk) and Earnings at Risk and Value at Risk (market risk). At organizational level, overall risk management should be assigned to CRMC consisting of the top executives of the Bank.

2.1 Risk Management Committee (RMC) at BoD level

The Structure of RMC will be as follows:
Chairman: One of the Professional Directors nominated by BoD
Convener: One Director nominated by the BoD shall be the Convener and minutes of RMC meetings shall be recorded by the Convener.
Members: Two BoD members other than the Chairman and Convener, Two Members of the Board of Management other than the BoD members, Managing Director (MD)/Chief Executive Officer (CEO)
Quorum: Four members out of which Chairman of the RMC, one member of the BoD and one member of the BoM will be mandatory.
RMC will meet on a quarterly basis. However, meeting may be convened on a more frequent basis as and when the need arises.

The key roles & responsibilities of the RMC shall be as follows:

1. Recommendation and periodical updating of policies, strategies and frameworks for the management of risk to the BoD for review/approval.
2. Monitor and review of non-compliance, limit breaches, audit/regulatory findings and policy exceptions with respect to risk management.
3. Ensure the procedures for identifying, measuring, monitoring and controlling risks are in place.
4. Review of minutes of the CRMC.

2.2 Compliance and Risk Management Committee (CRMC) at Management level

The structure of CRMC will be as follows:
Chairman: Deputy General Manager (in charge)
Members: Manager (credit) (will also act as Convener), Information Technology Head, Accounts Manager, Establishment Manager and one Officer from Credit section nominated by the BoD.
Quorum: 3 (Three) members out of which Deputy General Manager (in charge) will be compulsory.

The CRMC will meet on a quarterly basis. However, meeting may be convened on a more frequent basis as and when the need arises. Convener will arrange for meetings whenever warranted and shall record minutes of the meetings.

The key responsibilities of the CRMC shall include:

1. Approve the risk appetite and any revisions to it with proper reasoning.
2. Ensure appropriate risk organization structure with authority and responsibility.
3. Provide appropriate and prompt reporting to the RMC and BoD.
4. To ensure that principles, policies, strategies, process and controls are being communicated throughout the Bank.
5. Analyse review reports from various departments concerning changes in the factors relevant to the Banks' projected strategy, business performance or capital adequacy, implications of new and emerging risks, legislative or regulatory initiatives and changes, organizational change and major initiatives in order to monitor them.
6. Ensure adherence to the extant internal policy guidelines and also regulatory guidelines, if any, published time to time.
7. Monitor statutory/regulatory reporting requirements related to risk management.
8. Monitor and review capital adequacy computation and capital to risk-weighted assets ratio (CRAR)
9. Approve the stress testing results/analysis and monitor the action plans and corrective measures periodically.
10. Reviewing and confirming orders/decisions connected with wilful defaulters submitted by credit department.

A prerequisite for establishment of an effective risk management system is the existence of a robust Management Information System (MIS). The existing MIS, however, requires substantial up gradation and strengthening to ensure the integrity and reliability of data.

The risk management requires specialized skills and expertise. The Bank should have necessary expertise and skill in managing various types of risks in a scientific manner. It should, therefore, be the endeavour of the Bank to upgrade the skills of staff. A committee approach to risk management will be adopted. While the Asset - Liability Committee (ALCO) deal with different types of market risk, the Credit Committees oversees the credit risk. Thus, market and credit risks are managed in a parallel two-track approach. The volatility in the prices of collateral securities also significantly affects the quality of the loans. Thus, there is a need for integration of the activities of both the ALCO and the Credit Committees and consultation process should be established to evaluate the impact of market and credit risks on the financial strength of the Bank.

2. Risk Governance

The risk governance shall be based on the following key principles:

1. While the BoD will be responsible for overall governance and supervision of core risk management activities, the execution strategy will be delegated to the CRMC which will be monitored/approved by the RMC or BoD.
2. Risk strategy is approved by the BoD and reviewed on an annual basis and is defined based on the Bank's risk appetite in order to align risk and performance targets.

3. All major risk classes will be managed through focused and specific risk management processes; these risks include credit risk, market risk, operational risk and liquidity risk.
4. Policies, processes and systems shall be put in place to enable the risk management capability.

3. Credit Risk

The risk is caused mainly due to the failure of a customer to make the required payments on time or defaults to meet commitments in relation to financial transactions. The credit risk depends on both external and internal factors. The external factors involved are the state of the economy, wide swings in commodity prices, economic imbalances and the internal factors are deficiencies in loan policies and its administration, upper lending limits, deficiencies in appraisal of borrowers' financial position, excessive dependence on collaterals, absence of loan review and post sanction surveillance, etc. Hence the management of credit risk should receive the top management's attention.

4.1 Credit Approving Authority

Bank should have a carefully formulated scheme of delegation of powers. The Bank should also evolve multi-tier credit approving system where the loan proposals are approved by BoD on the recommendation of the General MD/CEO/ General Manager. Bank can constitute a credit approving committee, comprising at least five Directors and invariably the General Manager or Managing Director. All the loan files approved by the said committee shall be placed in the next BoD meeting for concurrence. There shall be a Special Committee consisting of three senior officers of the Bank including the Manager (credit) to recommend the sanction of credit facilities. For sanction of loans having higher limits better rated quality customers shall only be considered. The spirit of the credit approving system may be that no credit proposals should be approved, if all the members of the committee do not agree on the creditworthiness of the borrower. The BoD will, inter alia, formulate clear policies on standards for presentation of credit proposals, financial covenants, rating standards and benchmarks, prudential limits on large credit exposures, loan review mechanism, pricing of loans, provisioning, regulatory and legal compliance, etc.

The credit risk assessment exercise should be repeated annually (or even at shorter intervals for low quality customers). The updating of the credit ratings should be undertaken normally at quarterly intervals or at least half-yearly intervals, in order to gauge the quality of the portfolio at periodic intervals.

4.2 Loan Review Process and Monitoring

Review of Advances is an effective tool for constantly evaluating the quality of loan book and to bring about qualitative improvements in credit administration. Each and every sanction is reported for control to the next higher authority. Monthly and Quarterly review of high value advances by the designated authority is to be in place.

A proper Credit Grading System should support evaluating the portfolio quality and establishing loan loss provisions. The loan reviews should focus on:

- Approval process
- Accuracy and timeliness of credit ratings assigned by loan officers
- Adherence to internal policies and procedures and regulations
- Compliance with loan covenants
- Post-sanction follow-up
- Sufficiency of loan documentation
- Portfolio quality and recommendations for improving portfolio quality

The findings of reviews should be discussed at appropriate level and the corrective actions should be elicited for all deficiencies. Deficiencies that remain unresolved should be reported to the top management.

4.3 Credit Risk and Management of Investment

Significant magnitude of credit risk is inherent in the management of investments. The proposals for investments should also be subjected to the same degree of credit risk analysis, as any loan proposals.

4. Liquidity Risk

Liquidity risk arises when the Bank is unable to meet a financial commitment arising out of a variety of situations.

- The inability to obtain funds to meet cash flow obligations is termed as Funding Risk. This arises with the need to replace net outflows due to unanticipated withdrawal and non-renewal of deposits.
- Time risk arises from the non-receipt of expected inflow of funds due to performing assets turning into non-performing assets.

The first step towards liquidity management is to put in place an effective liquidity management system which spell out the funding strategies, liquidity planning under alternative scenarios, prudential limits, liquidity reporting, reviewing, etc. as a part of Investment policy. The difference between cash inflows and outflows in each time period, the excess or deficit of funds becomes a starting point for a measure of Bank's future liquidity surplus or deficit, at a series of points of time. The Bank should also consider putting in place certain prudential limits to avoid liquidity crisis.

5. Share Capital Risk

Major portion of the capital of the Bank is the paid up ordinary share capital held by individual members of the Bank. Share Capital Risk is the risk that a Bank doesn't have enough share capital to keep the bank's capital to risk-weighted assets ratio (CRAR) is not below the required percent as fixed by RBI from time to time. The share capital may be refunded on request only to the members or nominees of the deceased members on demand, provided the refund does not result in CRAR of the Bank falling below the regulatory minimum.

6. Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. The risk often happens on account of omissions in the work of employees and somewhat difficult to handle. The problem with the risk is the difficulty in identification. The Bank normally does not come to know the operational risk during the course of transactions as it is very subjective and circumstance dependent. Two of the most common operational risks are transaction risk and compliance risk.

7. Transaction Risk

Transaction risk is the risk arising from fraud, both internal and external, failed business process and the inability to maintain business continuity and manage information by way of alignment to business strategy making availability of systems, maintaining data integrity, network security etc.

8. Compliance Risk

Compliance risk is the risk of legal or regulatory sanction, financial loss or reputation loss that Bank may suffer as a result of failure to comply with any or all of the applicable laws, regulations, code of conduct and standards of good practice. It is also called integrity risk since a Bank's reputation is closely linked to its adherence to principles of integrity and fair dealing.

Internal controls and the internal audit are used as the primary means to mitigate operational risk. The contingent processing capabilities could be used as a means to limit the adverse impacts of operational risk. Insurance is also an important mitigating factor of some forms of operational risk.

Risk education for familiarizing the complex operations at all levels of staff can also reduce operational risk. Bank shall strive to educate the staff at all levels and increase awareness of systems and risks. Risk Based Internal Audit shall take care of all the aspects of operational risk.

9. 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. All loan files and loan documents including property documents shall be kept in joint custody, one custodian shall be the Manager (loans) and the other custodian shall be a person in the HO authorised by the General Manager.

The ideal method of identifying problem spots is the technique of self-assessment of internal control environment. The self-assessment could be used to evaluate operational risk along with internal/external audit reports or RBI inspection findings. Bank should endeavour for detection of operational problem spots rather than their being pointed out by supervisors, internal or external auditors. Along with activating internal audit systems, the Audit Committees should play greater role to ensure independent financial and internal control functions.

10. Management of Risks

There are three key elements to successfully managing risk:

- Performing regularly-scheduled, comprehensive risk assessments
- Taking a risk-based approach and focusing time and resources on high-risk areas
- Developing and implementing programs to manage and mitigate risk

Following is a comprehensive overview of each of these strategies, and steps the Bank can take to implement them.

11. Comprehensive Risk Assessments

To receive informative assessment, decision makers need to understand risk context and trends through evaluating a variety of factors, such as:

- Root cause of the risk
- Likelihood of a negative event
- Impact of a negative event
- Preparedness to respond to a negative event
- Trajectory of risk - increasing, decreasing, or flat
- Activities to manage or reduce risk
- Residual risk if mitigating activities are accomplished
- Description of the environment

A thorough risk assessment that analyses these elements allows an organization to pinpoint and address risk areas based on each area's specific circumstances. It can also inspire an organization to create new mitigation strategies that help prevent or manage future exposure. New mitigation strategies can take the form of policies and procedures, systems, processes, education, and personnel.

12. Risk-Focused Practices

Similar to risk assessments, there are traditional, narrow risk-focus practices that only analyse financial activities and controls. While it's critical to assess financial activities and controls, many other factors also put the organization at risk.

That's why it's important to take a broader, more comprehensive approach to risk-focus practices, addressing top risk areas throughout the financial institution.

13. Address High-Risk Areas

More comprehensive evaluations focus on higher-risk areas, include the following:
- Cyber security
- Reliance on third-party service providers
- Credit Risk and Current Expected Credit Losses (CECL) implementation
- Regulatory risk, the Bank Secrecy Act or Anti-Money Laundering law (BSA/AML),
- Fraud

14. Improve Performance

All functional areas of the financial institution are connected, and each area has associated risks and opportunities for improving performance. Taking a more comprehensive approach to addressing the organization's risk areas allows one to evaluate potential issues that might otherwise be overlooked. In addition to the above risk areas, financial institutions should analyse the following elements to improve performance after a complete risk-focus assessment:

- Governance and management. Such as leadership, development, and succession
- Structure and staffing. Including staffing levels, skills, training, recruiting, retention, and turnover
- Operational efficiency. Such as technology, internal controls, policies, and procedures
- Safety and security. Including fraud, waste, and abuse
- Processes. Such as procurement, compliance, financial reporting, and marketing

15. Program Development and Implementation

While risk assessment is important, continuing to analyse and mitigate risk following the assessment is key to the Banks' continued safety. The hardest part of this process may be finding the time to prioritize continued mitigation efforts.

This is where internal audits or risk management practices - depending on which functions exist within the organization - can take on an expanded role to help your company:
- Prioritize risk
- Develop annual internal audit programs that focus on reducing priority risks
- Validate management actions
- Track and report program implementation progress

16. Implement Key Benefits

Of course, management is ultimately responsible for implementing new ways to mitigate risk, but there are many ways internal audits or risk-management practices can help, such as:

- Providing policy, procedure, and process best practices
- Guiding efforts to update policies and procedures and streamline processes
- Supplying training opportunities
- Focusing testing on areas of identified weakness

This approach can help your financial institution stay on top of current and emerging industry risk as well as leverage your risk assessments to identify actionable opportunities for improvement.

17. Policy Review

The Audit and Inspection wing shall put up the policy for review to the BoD biannually. Risk mitigating factors and systems may be incorporated in the individual policies like NPA Management Policy, Investment Policy, IT Policy and Risk Management Policy.