B.Com Honours

Semester VI

Calicut University

RISK MANAGEMENT IN BANKS AND INSURANCE

Course Code: COM6EJ304 • Module 2 Notes

Module II: Risk Management in Banking & Financial Institutions

Covers banking risk taxonomy (Credit, Market, Operational, Liquidity), Asset Liability Management (ALM), RBI's Prompt Corrective Action (PCA), Credit Rating Agencies (CRISIL, ICRA, CARE), Value at Risk (VaR), and Risk Maps.

Unit 5: Banking Risk Taxonomy (Credit, Market, Operational)

Risk Classification: Credit Risk (Borrower default), Market Risk (Interest rate & equity price risk), Operational Risk (Internal process failure, fraud, cyber risk), Liquidity Risk, & Country Risk.

Unit 6: Asset Liability Management (ALM) & RBI PCA Framework

ALM Function: Managing interest rate risk & liquidity mismatch via ALCO committee. **Prompt Corrective Action (PCA):** RBI supervisory framework triggered when bank CRAR, NPA, or ROA breaches thresholds.

Unit 7: Credit Rating Agencies (CRISIL, ICRA, CARE, FITCH)

Rating Agencies: Assess default probability of debt instruments. AAA (Highest safety), AA, A, BBB (Investment grade) vs BB, B, C, D (Default grade).

Unit 8: Value at Risk (VaR), Risk Maps, & Catastrophe Models

Value at Risk (VaR): Maximum expected loss over specified time horizon at given confidence level (e.g. 99% 1-day VaR of ₹10 Crores).

Unit 9: Financial Derivatives in Banking Hedging

Hedging Tools: Interest Rate Swaps (IRS) for ALM gap hedging, Currency Futures for exchange risk, & Credit Default Swaps (CDS) for credit risk transfer.

Practical Case Framework 1 (Banking Risks Taxonomy Reference Matrix): Compare banking risk type, primary risk driver, regulatory capital requirement, and mitigation tool.

Banking Risk Taxonomy Table:

Banking Risk Type	Primary Operational Risk Driver	Core Mitigation Instrument
Credit Risk	Borrower loan default / NPA surge	Collateral haircuts, Credit scoring, Credit Default Swaps
Market Risk	Interest rate shifts & bond yield movements	Duration matching, Value at Risk (VaR) limits
Operational Risk	System failures, cyber fraud, rogue trading	Internal controls, IT security audits, Business Continuity

Practical Case Framework 2 (Credit Rating Scale & Default Risk Matrix): Detail rating grade, rating symbol (CRISIL/ICRA), safety level, and investment grade status.

Credit Rating Agency Rating Scales Table:

Rating Grade Symbol	Credit Risk / Safety Level	Regulatory Investment Status
AAA	Highest Safety; Lowest credit risk	Investment Grade (Mandatory for institutional funds)
BBB	Moderate Safety; Moderate credit risk	Lowest Investment Grade tier
BB to D	High Default Risk; In default (D grade)	Speculative / Junk Grade (High yield)