

# Risk - An Overview

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Risk Management's Importance

and

Role of the Board- A perspective.

What is Risk?

Risk Dimensions and Products

Some Illustrations

Risk Management

Role and Responsibilities

Conclusions?

**Risk is about  
potential negative  
Outcomes.**

# Risk and Uncertainty

- Risk is priced by financial markets assuming it depends on known distribution of events to which investors assign probabilities and price things accordingly.
- Uncertainty on the other hand relates to events, conditions, and possibilities that can't be predicted, measured or modeled.
- Is pricing is right?

“.....bankers are in the business of managing risks. Pure and simple, that is the business of banking”

1982

# Types of Risk

Business Model Risk

Credit Risk

Liquidity Risk

Market Risk

Operational Risk

# Some Features

**Credit Risk** - Default, Migration , Recovery

**Liquidity Risk**- Funding, Asset marketability

**Market Risk** –Interest rate, Forex, Commodity

**Interest** - Mismatch, Basis,

**Operational** - Procedural, Human, Technical

# *Risk Dimensions of Balance sheet components*

# Risk dimensions of Balance Sheet

Components	Risks R
• Foreign cy	Exchange R
• Different maturity	Liquidity R
• Different market segment	Liquidity R
• Different credit	Credit R
• Different country	Credit R
• Different pricing	Interest R
• Processes, Acctng, Tech, settlement etc.	Operational R
• Different regulations	Other R
• Different legal systems	Other R

# Common Instruments to manage...

Exchange Risk	Interest Rate Risk
1. Forward Cover	FRA
2. Futures	Swaps
3. Currency Option	Option
4. Variance of this	Variance

*“Business is all about taking and managing risk.*

*But*

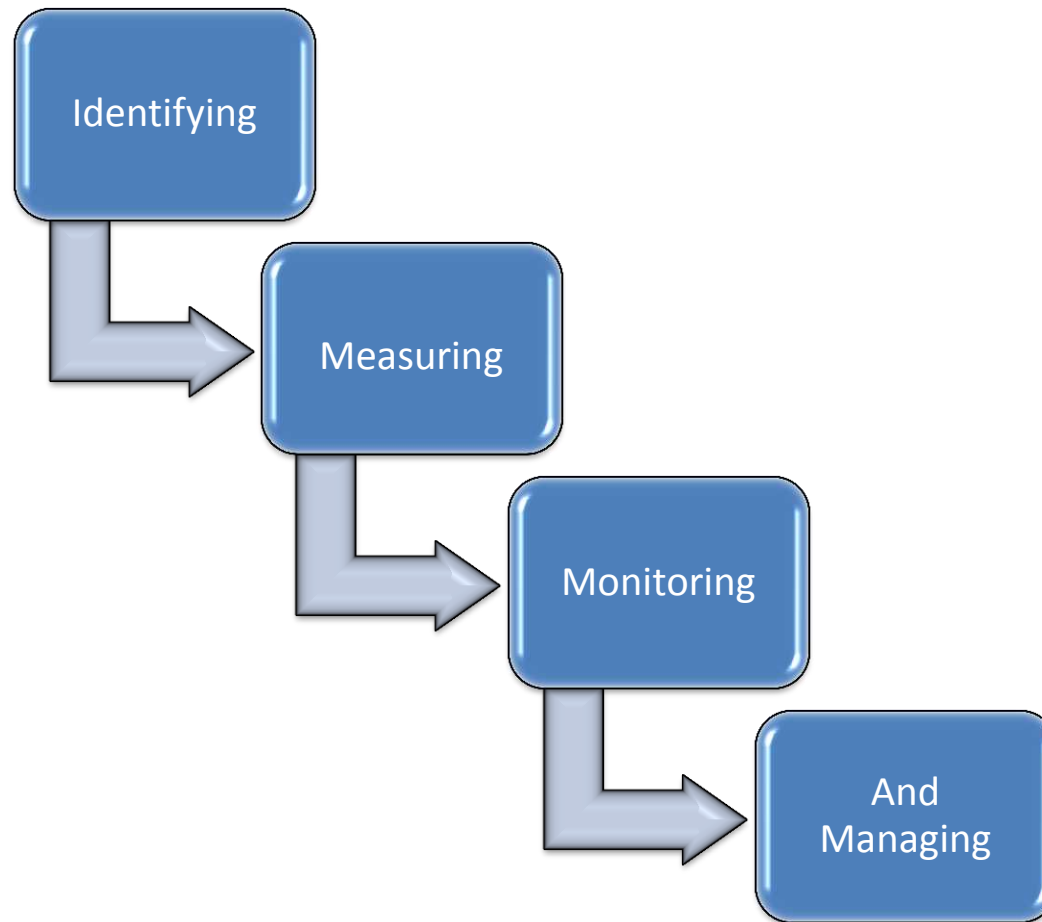
*What is bad is: risk that is mismanaged, misunderstood, mispriced and unintended.”*

Therefore Risk needs to be  
managed.

.

...”Risk Management is a discipline at the core of every financial institution and encompasses all the activities that affect its risk profile..”

# Risk Management involves



# Basic Aspects 1

- RISK BY CHOICE AND NOT BY CHANCE
- INTEGRATED, NOT FRAGMENTED APPROACH (ASSET, LIABILITY, OFF-BALANCE SHEET ITEMS)
- INTEGRATED APPROACH TO MARKET AND CREDIT RISKS

## Basic Aspects 2.

Risk management does not  
envisage compromising  
profitability with long term  
sustainability

# An Approach.

Risk management does not  
envisage compromising  
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# An Approach **contd.**

- Understanding risks  
and
- Management of risks

# An Approach Contd.

- What is the product?
- Hedging or trading/proprietary?
- Risk assessment?
- Loss limitations.
- Monitoring.
- Triggers to adhere to risk mitigation rules in place.  
(LCs,, BGs, Fwds ,Back to Back, Inv in NCDs etc)

# Simple lessons of the crisis

- Those with traditional banking little affected
- Exotic products turn chaotic
- Data integrity is critical
- Mathematical models lead us only to a point beyond which intuitive approach pays
- Models can't capture irrational human behavior
- Gold plated credit ratings are no substitute for bank's own due diligence

# Risk Template

## **Business Risks**

Credit, Market, Liquidity, Operational, Group, Management, Compliance, Capital and Earnings at risk.

**Level , Direction and Trends.**

# **Conclusion**

**Director's Role is One of  
Enormous Responsibility.  
Wishing you all the best.**