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CREDIT MANAGEMENT: RBI GUIDE LINES & ITS IMPORTANCE

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ABSTRACT

For almost a decade, non-performing assets (NPAs) have posed a serious threat to the U.S. banking system, raising serious concerns about the long-term health of the affected institutions. The positive results of the series of initiatives taken by the Government of India and the RBI as part of banking reforms in accordance with the two Narasimha Committee Reports have been neutralized by the negative effects of this growing threat. Even though we've tried a number of different solutions to this problem, we still haven't been able to put an end to it. It's a global pandemic that has infected every major financial institution on the planet. A credit portfolio tracking system is an effective credit risk management strategy. Credit risk management includes the processes of identifying, measuring, monitoring, and controlling exposures to credit risk. Financial institutions cannot succeed over the long run without properly managing their credit risk.

Keywords: - Management, Credit, Bank, Payment, Risk.

I. INTRODUCTION

CONCEPT OF CREDIT MANAGEMENT

- **Credit Risk**

The bank faces the greatest threat from credit risk associated with its business model. In terms of potential harm, it is often the greatest sort of risk. The default and non-payment of debts by a borrower is known as "credit risk." This might occur if the counterparty is unable to charge or make timely payments. There are several potential causes of a departure. When a reliable borrower purchases debt, the overall risk profile rises and the loan value falls. In the event of liquidation, if the debt is hit on the sector, the cost is less than what the bank paid for it. In most cases, the bank will not incur significant costs due to the default. Large exposures from high-risk partners may be avoided with careful risk management. Equity and guarantee are two of the foundations upon which the rehabilitation rests.

Pre-settlement Uncertainty: Potential losses to the partner's partner throughout the term of the contract are what make up the pre-settlement threat. Pre-settlement may also occur during extended agreement and payment periods, which might last for years. Additionally, the client runs the danger of being unable to recoup damages in the case of a failure in his home country that blocks all international wire transfers. The term "sovereign transfer risk" describes this kind of danger.

Taking a chance on a settlement: Since the partner does not handle the payment or cash flow transfer directly, but rather it goes via another company that may also depend on the return at the moment, there is a chance of settlement risk.

- **Risks of Default**

The probability of a default occurrence is the default risk. The default probability describes this possibility. The term "typical" might mean different things to different people. The average deposit delay for default incidents is about three months. Additional words might be added to describe unique instances. The probability of a default depends on a number of factors. More likely to default are those who are economically weak, have high levels of debt, and have low, inconsistent income. Differentiating between peers with high and low risks requires both quantitative and qualitative data, such as data industry and leadership performance.

II. CREDIT RISK MANAGEMENT

One issue facing the banking industry is credit risk management. Banks make money by extending various forms of credit to individuals and corporations for various reasons. Lending money is an important source of revenue for banks, therefore when a consumer is unable to repay a loan, the bank takes on the lion's share of the risk. Financial institutions utilize the interest they earn to invest or fund their future operations. Banks and other financial institutions now prioritize the CRM process.

A financial institution's credit risk strategy should inform the creation and execution of an all-encompassing credit risk management plan aimed at achieving and maintaining effective credit risk management. The institution's risk appetite and the expected return on investment from taking different credit risks should inform its credit risk strategy. All members of the financial institution's board, management, and personnel should be familiar with the credit risk management plan and its requirements. In order to better identify and quantify the risk associated with a financial institution's lending and investment operations, a solid credit risk management program would employ a well-defined credit policy and set of procedures. Limits and guidelines for managing credit risk should be spelled out in detail in the credit policy.

III. SIGNIFICANCE OF CREDIT RISK MEASUREMENT AND MANAGEMENT

The following have contributed to the recent increase in credit risk:

- **Increase in Bankruptcies:**There have been more bankruptcies recently than in the past. Because of this, it's more crucial than ever before to use long-term, precise methods of credit risk assessments.
- **Deregulation:**New service providers have entered the market as a result of the deregulation that has encouraged innovation. For the market to operate normally, it is crucial to evaluate the credit risk of new entrants.
- **Disintermediation:**As high-quality major organizations reduce their reliance on bank funding, banks are left to support others with lower creditworthiness. Subramanian and Uma Krishnan (2004) conducted a study of 876 corporations in India and found that the ratio of bank debt to total debt was 73% for very small firms (annual sales of Rs. 10 crores or less) but only 41% for very large corporations (annual sales of Rs. As the company grew in terms of revenue, the ratio also decreased. As a result of this disintermediation, the overall credit quality of the loan book has declined, making accurate assessment and management of credit risk all the more crucial.
- **Shrinking Margins on Loans:**The gap between interest revenue and interest costs, known as the interest margin or spread, has been narrowing in recent years, as seen by trends in worldwide markets. The rising level of competition in the market is often identified as one of the main causes of this.
- **Growth of off-Balance Sheet Risks:**Numerous institutions are now more exposed to OTC derivative products due to their meteoric rise in popularity. Unlike exchange-traded derivatives, OTC derivatives are subject to counterparty risk.
- **Volatility in the Value of Collateral:**It has been noted that it is exceedingly difficult to forecast the market value of collateral held against a loan. The collateral's value might drop below the loan amount if this keeps happening. In advanced nations like Switzerland and Japan, financial crises were caused by a decline in collateral value.
- **Advances in Finance Theory and Computer Technology:**These developments have allowed financial institutions to put to the test very complex credit risk models that were

previously impossible without the aid of modern finance theory and computing technologies.

- **Risk-based Capital Regulations:**One of the other major forces behind credit risk efforts is the Basle Committee's pronouncement of risk-based capital requirements. This is especially true in light of the Basle agreement -II, which, unlike the prior agreement that has been in effect until now, acknowledges disparities in credit quality in the form of ratings and availability of collateral.

IV. RBI GUIDELINES FOR CREDIT RISK MANAGEMENT

The Reserve Bank of India (RBI) would want Indian banks to adopt certain actions, mostly at the commercial level, to implement suitable credit risk management schemes (Sharma, et al., 2015). The policy must include

- Portfolio leadership
- Credit threat model leadership and risk limit management
- Credit rating law framework
- Interbank loan risk provisioning is one example.
- Avoid discussing the financials or doing a risk assessment.

Basel Accords

Late in 1974, lawmakers from 10 countries' central banks formed a group to oversee the global financial system. Since its meetings have traditionally been held in the Bank for International Settlement (BIS) in Basel, Switzerland, this group has been known as the Basel Committee. This Committee has representatives from the United States, Canada, the United Kingdom, the Netherlands, Belgium, France, Germany, Italy, Japan, Luxembourg, Spain, Sweden, Switzerland, and the United States. The national bank, or its equivalent in the absence of a central bank, represents the country in question. The Basel Committee does not have the authority to impose its conclusions on other countries, and it was never intended to. In order to prepare for the eventual adoption of steps to enforce them by internal governments, it formulates broad standards and guidelines for monitoring and recommends declarations of good exercise via comprehensive legal or otherwise provisions better tailored to their domestic schemes. Without attempting to standardize the monitoring procedures of Member States in minute detail, this encourages alignment towards popular approaches and widespread norms.

The Governors of the Central Bank of the Unit of Ten Nations must approve any major initiatives that he proposes. There are numerous domestic authorities outside of the core banking brothers who have been engaged since the Panel comprises officials from groups that do not compose core banks. There is a wide range of economic issues embedded in these options. The committee was tasked with ensuring that no gaps in worldwide regulatory exposure existed, with a primary focus on ensuring that there was no foreign lending facility that might avoid detection and regulation. The BASEL Committee created a value estimating system in 1988 sometimes referred to as the Basel Capital Agreement. This framework has been steadily built since 1988, not just in the Member States but in practically every other nation with globally involved finances. The plan calls for a standard 8 percent minimum investment loan risk assessment framework to be in place by the start of 1992.

V. CONCLUSION

There has been a surge in nonperforming assets (NPA), notably during recessionary periods, despite the implementation of many prudential measures for NPA management. Since the banking sector is mostly unable to affect the economy and is instead subject to its effects, it is crucial to devise prudential measures to lessen the impact of recessionary pressures. The banks' loan losses vary widely from one another. Further investigation showed that certain banking conglomerates fared better than others throughout the downturn. Credit risk management has to be strengthened by placing a greater focus on preventative steps such better loan evaluation, portfolio diversification, improved follow-up, project review after execution with risk ratings applied, etc. This is corroborated by the study's findings on the need of preventative measures for controlling banks' nonperforming assets.

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