3.1 Background:

3.1.1 The libraries of Vaikunth Mehta National Institute of Co-op Management, Pune and College of Agriculture Banking (CAB), Reserve Bank of India, Pune both national level institutes were attended and the research papers dedicated web sites, namely google.com and social science research network (ssrn.com) were searched for the purpose of study of existing literature on the subject to understand the extent of work already done by earlier researchers and an analysis of expert opinions by eminent authors on Pricing of Products, Asset–Liability Management and Risk Management concepts.

3.1.2 It is observed that following are some of the publications that deal with the subject.

1. Monthly bulletins published by the Reserve Bank of India.


4. IIB VISION: monthly newsletter published by Indian Institute of Banking & Finance.


3.1.3 Almost 1000 research papers on subject of Asset-Liability Management and Risk Management are found on web sites. Various scholars have earlier put in lot of efforts in studying the different aspects of these techniques. It is observed that the researchers have earlier studied these techniques with specific references. These are Risk Management and Corporate Governance, Risk Management in an Asset Management Company, Risk Management of Foreign Exchange Exposure, Interest Rate Risk Management at U.S. Commercial Banks, Risk Management by Non Financial Firms, Building an IT Risk Management Competency etc. Some articles on pricing of products are also found.

3.1.4 The Asset-Liability Management and Risk Management are the two most important techniques in today’s competitive world. Every business organization maintains its books of accounts and prepares Balance Sheet. Thus, Asset-Liability Management has become must for every organization to survive in competitive business environment. This is applicable to all business organizations irrespective of its business activity. Similarly, every business organization is exposed to the various risks. The success of any organization therefore, would largely depend on how effectively the business risks are managed by them. Due to this the applicability of these techniques becomes very vast and is accepted globally. However, it would be worth mentioning that its applicability to the UCBs is made mandatory by the Regulator only since September 2008. As a result, lot of literature are available about the techniques but very few is available with specific reference to the UCBs.
3.1.5 It is observed that no researcher has attempted the research work with specific reference to UCBs in India. The reasons for this could be as under:

1. The co-operative banking structure in India is exclusive. It has evolved over 100 years and today it has become one of the important features of Indian economy. In spite of this, it is noticed that out of 31 states in India, the co-operative banking is more developed only in 5 states. This represents the geographical imbalance in the development of UCBs in India. Though, UCBs are in existence in some part of the world their contribution to the total economy of that particular country might not be as substantial as in India.

2. These techniques are relatively very new for the Tier- II small UCBs and are made mandatory only since September 2008. The Regulator has introduced these new techniques in India for the scheduled commercial banks in the year 1999 i.e. 10 years back. The scope of it was extended for the scheduled UCBs in the year 2002 i.e. 7 years back. The total number of scheduled co-operatives banks in India is just 55 as compared to the total number of co-operative banks of 2079. In terms of percentage it stands at 2.64 only. In September 2008 the scope of it was further extended to all UCBs. Thus, the applicability of these techniques has come to all the UCBs only in last year.

On this background, the study of existing literature is divided into three parts:

1. Review of literature at International level.
2. Review of directives issued by The Reserve Bank of India (RBI) and National Bank for Agriculture and Rural Development (NABARD).
3. Review of books and articles published in Magazines, Bulletins, newspapers, journals and newsletters etc.
3.2 Review of literature at International level:

3.2.1 A paper published by the University of Miami in the year 2003 states that the Enron Board's Finance Sub-Committee's approval of the first bankrupting Raptor transaction, Talon, has examined in as much detail as published documents. In doing so, the article examines a failure of corporate social responsibility. As not only members of the public were harmed, but also Enron's residual owners, the shareholders, the article examines a failure of corporate governance. The examination reveals that the decision was governed by analyses of the transaction's risks. The examination also reveals that the sub-committee was presented with false risk management information. The article highlights the importance of the risk management function, especially in corporations redesigned, or re-engineered, by strategies of outsourcing and project team management. 67

3.2.2 Enron Ltd. was multi location international company. The company had its operation in India also. Sudden failure of Enron Ltd. shocked the corporates all over the world. The author in his paper has studied this important case and has derived the conclusion that it was classic case of failure of corporate governance. The company ran into trouble because of transactional risk. Although, the risk management technique was in place in the company and sub committee was formed for the purpose, the false information was placed before it. The management of Enron Ltd. cheated the sub committee and intentionally tried to hide the important information about the deal with Raptor Ltd. The author has highlighted the need of risk management function, especially in corporations redesigned, or re-engineered, by strategies of outsourcing and project team management to over come these types of malpractices.

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3.2.3 This is a very valid point. In many UCBs the software on which the UCBs function is largely depending on private vendors. It is therefore, very important to ensure that whatever computer generated output is placed before Asset-Liability Committee or the Board of Directors is authenticated and correct. The terms and conditions on which the vendor is to be appointed and the expected performance of the outsourced function i.e. software should be clearly defined in the ‘Integrated Risk Management Policy’ of UCB. In this case manipulation in the Management Information System itself shows the deficiencies in the designing of the system. Highlighting more specifically these deficiencies in detail would have helped the readers in a better manner.

3.2.4 A working paper on the study of the conflict of interest in the year 2003 by Danielle Blanchard and Georges Dionne deals with the question of potential conflicts between the objectives of risk management policies and those connected with maximization of the firm's value. This question is a timely one, since many firms have a special committee devoted to risk management - banks and insurance companies in particular. In the wake of the Enron affair, various proposals have been formulated regarding the composition of the different committees set up by Boards of Directors. In the financial literature, it is now a widely accepted fact that risk management issues can give rise to conflicts of interest between heads of firms and shareholders, notably when executives are remunerated in stock options. The authors also expressed their opinion that, the board's risk management committee must be composed of competent and independent directors who hold no options to purchase the firm's shares.68

3.2.5 The objective of Board of Directors is to maximize the firm’s value. In other words maximizing the value of shares thereby benefiting the holders of it. The authors have raised this very important question on the background of failure of

Enron Ltd. multi location international company. This question also becomes important in India on the background of recent failure of Satyam Computers Ltd. (i.e. January 2009), a listed public limited company. For retaining talent in the organization many of the companies reward employees by issuing stock options. This is also done in India. It is likely that some of these employees might get representation on the Risk Management Committee. The approach of Risk Management is expected to be impartial. Though, the question under debate is delicate one, the authors have assumed that the interest in dual capacity i.e. as an employee and as a shareholder might bring in some speculative element in the functioning of Risk Management. This might result into injustice with other shareholders who are not employee of the organization. Basically, stock option facilitates the employees to share the market capitalization of the organization. Further, the Risk Management function overall adds to the safety of the organization and increases the value of shareholders. Thus, theoretically the opinion expressed could be correct but practically not acceptable.

3.2.6 On the other hand an opposite view has been taken by the Regulator in India. The Regulator in its directive has specifically mentioned that the Chairperson of the ALCO should be the Managing Director of the concerned UCB and other members should be the various head of the departments. In short, entire ALCO is represented by the employees of the UCB.69

3.2.7 Team of three authors namely Dario Bradolini, Massimiliano Pallotta, and Raffaele Zenti have studied a practical case of an Asset Management Company in the year 2004. The authors have expressed concerns over the differences between the meaning of risk management in a bank and in an asset management company, and then have illustrated the solution found to the challenge of building up a risk management system in an Italian medium size company.

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3.2.8 The authors have described the specific needs of an asset management company, in terms of proper financial modeling, time and resources constraints, given that an investment company: These specific needs are as follows:

A. manages "third party funds" (eventual losses are not its liabilities);

B. has a relatively long investment horizon, if compared to other market participants

C. often monitors relative risk, rather than absolute risk.

3.2.9 Mr. Steve Allen in his book has quoted that risk is a multi-faceted hydra of infinite complexity. Management of risk represents the consolidation of the entire financial risk management field such as framing of policies, methodologies, data and technical infrastructure. The author has elaborated on the problems of market pricing and risk techniques affecting managerial approaches to decision making.

3.2.10 This is absolutely a valid and important point. After the deregulation of interest rates the UCBs are suddenly exposed to lot of complexity. Though it was a demand of the UCBs for very long time they were not prepared for the same. In today’s inter connected world with the advanced technologies the impact of the decision taken by one country affects the other country. As the world economies have now more integrated in true sense, it has become important for the UCBs to understand the things very clearly and immediately assess the impact of the same on their bank. Unfortunately, the UCBs at present neither have the required

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technologies in place to get updated information about the happenings nor they have expertise to analyze the same and calculate impact of it on the bank. However, the UCBs would have to change this mindset as early as possible.

3.2.11 Understanding this practical difficulty the regulator has issued a detailed guideline on the subject of Risk Management and has now made it mandatory for all the UCBs. The second point raised by Mr. Steve Allen is about the framing of policies, methodologies, data and technical infrastructure. It is observed that the directive on the Risk Management has addressed all these issues. The regulator has asked the Board of Directors of the UCBs to frame Integrated Risk Management policy and to ensure that the policy guidelines are circulated among all the branches and departments. The tool of gap analysis for managing the liquidity risk and interest rate risk is also prescribed by the regulator. The maximum possible tolerance level of mismatch is mentioned in the directive and in case it exceeds the matter has to be reported to the regulator along with plan of corrective measure. Thus, the methodologies are clearly mentioned by the regulator in the directive. As regards the data and technical infrastructure, the regulator has understood the ground realities i.e. slow pace of computerization, non availability of adequate capital, non availability of qualified staff members etc. and has given some time for the implementation. The idea behind issuing this directive in the year 2008 could be allowing sufficient time i.e. up to 2010 when the regulator has planned to open the banking sector in India in a big way. Thus, the UCBs would get time of 2 years to overcome all these problems related to collection of data and technical infrastructure.

3.2.12 The author has elaborated on the problems of market pricing and risk techniques affecting managerial approaches to decision making. It also contains a detailed introduction to various aspects of financial risk management including an in depth look at market, credit and operational risk management performed at large
investment and commercial banks, with a focus on the practices followed by the experts.\textsuperscript{72}

3.2.13 Pricing of products has been definitely an important area that needs attention on priority. An attempt has been made in this study to find out the alternative solutions on the scientific way that would give proper results as well as overcome the present difficulties faced by the UCBs. Though, the author has made good efforts in describing the risk techniques that affect the managerial decision making, which is applicable to the UCBs partially. As the efforts in this direction are recently initiated and the built in problems of the UCBs are not yet fully solved the advanced risk techniques cannot be implemented. The regulator has also cleared this point that the use of Gap Analysis technique is just a beginning and once the UCBs are used to it the regulator plans to introduce advance techniques.

3.2.14 Mr. Steve Allen has described Financial Disasters in the book. He has expressed that the aim of financial risk management is to protect the firm from any type of disaster that might twist the stability of a firm. To prevent an organization from such catastrophes, an in – depth study of the historical events needs to be developed. The author has also identified companies that have been through or have gone belly – up due to financial disasters. For a clear understanding, the author classifies financial disasters into those that have occurred due to lack of transparency in operations, adverse market conditions and loss in reputational risks.\textsuperscript{73}


3.2.15 The urban co-operative banking sector in India has experienced lot of financial disasters. The recent one is that of collapse of Madhopura Bank in the state of Gujarat which has twisted more than 25 small UCBs in the state along with it. The regulator in its directive, while highlighting the need of long term viability of the UCBs, has referred to the adverse impact on profit, profitability and the net worth of the bank. Lack of transparency in the lending transactions of the Madhopra Bank and blind faith of other small UCBs who have invested their substantial amount in the said bank has jittered the co-operative banking not only in the state of Gujrat but though out the country. This has even raised question mark on the working of UCBs in the country and caused reputational risk to other sound UCBs in other states also. Since January 2007, world over the recession started and India also could not keep itself aside from it. Fortunately, In India the intensity of the recession was not that high as it is experienced by the developed countries like USA or European countries. During this period the UCBs especially in the states which were advance in industrial developments faced adverse market conditions and risks arising out of that. Thus, the financial risk management is definitely to protect the UCBs from disaster that might twist the stability of the bank. Though this is very basic principle that has been highlighted by the authors, UCBs in India are still far away from the same concept.

3.2.16 As models for estimating portfolio risk on medium-long horizons are crucial, and the related theoretical problems are absolutely not trivial, the authors have briefly described the model they use. It is based on bootstrapping, that allows us to calculate several risk measures for a large number of portfolios. It allows us to simulate medium-term to long-term financial scenarios, without imposing any particular probability function, taking into account heteroscedasticity, serial correlation, and any existing market views. The authors have also shortly described the implementation, with some details on the database and the calculation engine (both available in the market). This kind of system is more straightforward and cheaper to implement than traditional, bank-oriented risk systems: it took less than one year to implement the whole tool, with limited costs (basically some cheap
licenses and the work of two quant). The authors hope that their experience could be of help to other asset management companies.

3.2.17 Ras Asset Management is an Italian mid size Asset Management Company. The functioning of Asset Management Company is very similar to that of banking company. Third party funds, long term horizon and monitoring of the risk are the three parameters that are common in both the activities. In this article the authors expressed concerns over the meaning of Risk Management in Banks and Asset Management Company. This is acceptable to some extent. The point of difference between these two organizations is short term sources and its utilizations. Banks do accept short term deposits. In India, the definition of ‘short term’ is used for the period of 7 days to 15 months and the definition of ‘Long Term’ is used for the period above 5 years. Asset Management Company does not deal in short term business. The other point of difference between these two is long term. In case of Asset Management Company the sources and deployment of funds is on long term basis for the majority of business activity. In case of banks, Capital, Reserves and Surplus, Refinance etc. are some of the long term sources and Investment in dated securities of Governments or trustee securities, housing loans etc. are some of the deployments on the long term basis. However, volume wise it is not big portfolio in case of banks as compared to that of Asset Management Company. This does not mean that there is major difference as regards to the Risks faced by these two activities.

3.2.18 Italy is a developed country as compared to India. Naturally, the modules available for the Risk Management are much advance in Italy. Modules with alternate scenarios and probabilities are available there. The authors namely Dario Bradolini, Massimiliano Pallotta, and Raffaele Zenti have further compared the orthodox Risk Management systems with these new ones on the parameter of related costs and finally came to the conclusion that the new modules are more suitable to the Asset Management Companies. In India, these techniques are
introduced just 10 years back (i.e. in the year 1999). In case of UCBs it is introduced just in the year 2008. Hence, initially simple technique of ‘Gap Analysis’ is recommended by the Regulator.

3.2.19 The authors have put in lot of efforts in studying the two finance related activities i.e. Banks and Asset Management Company on the parameters of third party funds, time horizon and management of risk. The activity of these two different types of institutions is same and the process of matching of inflows and outflows of funds is same. Hence, the concerns expressed over the meaning of risk associated with the activities could not be different.

3.2.20 In the year 2007, an attempt was made to establish the relationship between Innovation and Risk Management. The author Mr. Eduardo G. Manuel has stated that always, anytime, we speak about innovation, that occurs in our live, firms, countries and regions. The innovation is very important for the survival of any firm, any entrepreneur, any country and any region in world market due to their speed of evolution. The author is on the view that the relationship between innovation and risk management will exist always whereas we are continuing to live in global world that it originated a global market in all economic sectors. For any firm, any entrepreneur, any country or any region that wants to survive in this world or market needs to do a risk management that consists to innovate, and so can reduce the uncertainty relatively their contextual environment that affect a determined activity and consequently that is affecting their performance.74 The objective of the author is to study the relationship between Innovation and Risk Management. The conclusion is that for the survival in the market Risk Management has to be innovative. This would further reduce the uncertainty by affecting the performance of the organization. In fact the findings of the paper are

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absolutely true. Risk Management is an important function that has to be carried out on an ongoing basis. In the directive issued by the Regulator it is clarified that the Role of the Asset-Liability Committee has to be proactive. In the objectives of the ALCO it has been clarified that the entire process of the Risk Management in UCBs has to be reviewed every year. Any deficiencies noticed or reported by the Risk Management Group in the implementation are to be removed on priority basis. The financial world has become very integrated and dynamic. Thus, the Integrated Risk Management Policy document in UCBs has to be innovative and needs updating on an ongoing basis.

3.2.21 However, the author has not highlighted in specific the innovations to be implemented through the Integrated Risk Management Policy that acts as a tool between the management and the operating staff. Integrated Risk Management Policy is the main pillar of the Risk Management function.

3.2.22 A very interesting paper was presented by Yuval Millo and Donald MacKenziel on 1st March 2008 at the forum of Centre for Analysis of Risk and Regulation (CARR) in Discussion Papers Series. The authors have stated that the growth of modern financial risk management is a result of the accuracy and reliability of risk models. The authors further argues that the remarkable success of today's financial risk management methods should be attributed primarily to their communicative and organizational usefulness and less to the accuracy of the results they produce. This paper traces the intertwined historical paths of financial risk management and financial derivatives markets. Spanning from the late 1960s to the early 1990s, the paper analyses the social, political and organizational factors that underpinned the exponential success of one of today's leading risk management methodologies, the applications based on the Black-Scholes-Merton options pricing model. Using primary documents and interviews, the paper shows how financial risk management became part of central market practices and gained reputation among the different organizational market participants (trading firms,
the options clearinghouse and the securities regulator). Ultimately, the events in the aftermath of the market crash of October 1987 showed that the practical usefulness of financial risk management methods overshadowed the fact that when financial risk management was critically needed the risk model was inaccurate.\textsuperscript{75}

3.2.23 It is interesting that the authors have come to the conclusion that today’s success of Risk Management be attributed to the communicative and organizational usefulness of the system. The Regulator in India has highlighted the importance of information in its directive. Undoubtedly, if the organization wants a system to deliver accurate results, in that case it has to ensure that the information or data input is correct and authenticated. While designing Integrated Risk Management Policy for UCBs, due consideration has to be given to this aspect very seriously. In developed countries lot of modules are available in market for measuring and managing the risks. Since these techniques have come to India in 1999, we are in the very initial stage. This ‘Integrated Risk Management Policy’ has to be monitored on an ongoing basis. The purpose of this is to evolve the newer modules as the deficiencies of earlier modules are found. Finally, the authors have referred the market crash of October 1987 and found that at the critical times risk modules are inaccurate.

3.2.24 The authors were lucky to submit the paper on 1\textsuperscript{st} March 2008. Had it been in December 2008 the findings could have dramatically changed except the last one! The impact of present recession started pinching worldwide since April 2008.

3.2.25 Stock Market indices that are supposed to be considered as one of indicator of the economy started declining in 2008-09. In India, the BSE index touched the

high of 21,500 in January 2008 and is presently around 8,900 levels. Failure of
reputed financial organizations in United States of America and European
countries indicate that the risk management system of these failed organizations
was not accurate and adequate. Failed organizations include names of very old and
world wide operating firms such as Lehman Brothers (financial firm), Fenny and
Fredie (Both leading mortgage finance agencies), the present crises of AIG
(insurance company) and Citi Bank (commercial bank) etc.

3.2.26 The authors have studied various aspects with lot of intensity and have done
lot of good work but the sudden change in the economic conditions world wide has
raised certain question marks. The authors’ basic argument of attributing the
success of risk management system becomes secondary. The priority key question
that arises in the minds of customers of these organizations is, whether the risk
management system was in place in these reputed organizations? The final finding
of the authors is absolutely correct like the crash of 1987, in current year also these
risk modules are found inaccurate.

3.3 Review of directives issued by The Reserve Bank of India and NABARD:

3.3.1 In the year 2002 the Regulator (R.B.I.) has issued directive to the Scheduled
UCBs reveals that the first time band for the purpose of preparing ‘Structural
Liquidity Statement’ is set as 1 to 14 days.76 This means the inflows and outflows
of 14 days would be clubbed together. This is not very logical. If the UCBs need to
manage the ‘Liquidity Risk’ effectively, then they should know the exact inflows
and outflows for the very next day. The ‘overnight’ liquidity position is very
important from any UCB’s point of view. This time band of 1 to 14 days fails to
provide this vital information to the management of UCBs. Assume that the out
flow of fund on the day 1 is Rs. 1.00 crore and inflow of fund on the day 13 is Rs.

76 R.B.I. directive circular no. POT.SUCB.CIR.9/09.120.00/2001-02 Dated 2nd April 2002, p. 1 to 22.
1.00 crore. Thus, the ‘Structural Liquidity Statement’ prepared as per the directive of the Regulator would show mismatch at ZERO level. This ZERO level mismatch would indicate no concerns about the liquidity position of UCBs. However, UCBs would fail very next day as it would not be in a position to honor its commitment on very next day.

3.3.2 This important deficiency in the directive has been pointed in the book namely ‘Jindagi-Deyata Vyavasthapan Aani Jokhim Vyavasthapan’ on the subject of Asset Liability Management and Risk Management written in regional language i.e. Marathi. The Author’s view on the deficiency has been upheld by Mr. Vishwas Nitsure, Deputy General Manager (retired) Reserve Bank of India, Urban Banking Department, Mumbai, while writing forward to this book. The Regulator announced to remove this deficiency in the year 2007 by splitting the first time band of 1 to 14 days into three time bands i.e. 1 day, 2 to 7 days and 8 to 14 days. However, it is interesting to note that the Directive issued to Tier II UCBs on subsequent date does not incorporate these amendments.

3.3.3 Further, the directive issued by the Regulator also reveals that within each time band there could be mismatches depending on cash inflows and outflows. While mismatches up to one year would be relevant since these provide early warning signals of impending liquidity problems, the main focus should be on the short term mismatches viz. 1 to 14 days and 15 to 28 days time bands. UCBs however, are expected to monitor their cumulative mismatches (running total) across all time bands by establishing internal prudential limits with the approval of the Board. The mismatches (negative gap between cash inflows and outflows) during 1 to 14 days and 15 to 28 days time bands in normal course should not exceed 20% of the cash outflows in each time band. If any UCB in view of its

77 Umesh Inamdar, Jindagi-Deyata Vyavasthapan Aani Jokhim Vyavasthapan p. 36.
current asset liability profile and the consequential structural mismatches needs higher tolerance level, it could operate with higher limit sanctioned by the Reserve Bank of India for a limited period. The tolerance level fixed at 20% itself appears on very higher side. Further, the logic behind this 20% mark is not justified by the Regulator anywhere in the directive. The UCBs may ask why the tolerance level is not at 25% or why not at 15%. However, there is no clarification to aspect.

3.3.4 It is further observed that the said directive talks about three main risks i.e. Liquidity Risk, Interest Rate Risk and Currency Risk. Presently UCBs are exposed to number of risks because of globalization. On this background, the directives issued by the Regulator appear to be very inadequate.

3.3.5 In addition, it is observed from the said directive that the size (number of members) of ALCO would depend on the size of each UCB, level of business and organizational structure. To ensure commitment of Top Management and timely response to the market dynamics, the CEO or the Secretary should head the committee. The Chief of Investments / Treasury including Forex, Credit, Planning etc. can be members of the committee. In addition, Head of the Information Technology Division if a separate division exists should also be invitees for building up of Management Information System (MIS) and related IT network. UCBs may at their discretion even have sub committees and support groups. The technical problem in the directive is that the CEO or the Secretary of the bank to become Head of the ALCO. As per the bye-laws the CEO cannot take policy decisions unless and until specific powers are delegated to him. In case of delegation of powers to CEO, all decisions taken by him are required to be ratified by the Board of Directors of the UCB. Therefore, in practice it is observed that in some UCBs, a member of the Board is heading the ALCO and in some UCBs,

81 R.B.I. directive circular no. POT.SUCB.CIR.9/09.120.00/2001-02 Dated 2nd April 2002, p.1 to 22.
where ALCO is headed by the CEO has got recommendatory powers only and the ultimate decision is taken by the Board of Directors of the UCB. It would be also interesting to note that the Regulator has not made any change between the first directives on the subject that was issued to the scheduled UCBs \(^8^2\) in 2002 and to the Tier II UCBs in 2008.\(^8^3\)

3.3.6 The National Bank for Agriculture and Rural Development (NABARD) has issued directive on the subject of Asset-Liability Management and Risk Management to State Co-operative Banks. It is observed that the deficiency found with the R.B.I. directive about the Head of ALCO and provisions of bye-laws is attended by the directive of NABARD to some extent. It is noticed from said directive that the NABARD has added column of Committee of Directors.\(^8^4\) It has directed that the Managing Committee of the Board or any other specific committee constituted by the Board should oversee the implementation of the system and review its functioning periodically.

3.3.7 The Reserve Bank of India in its directive dtd. 17\(^{th}\) September 2008 addressed to all Primary Urban Co-operative Banks, has mentioned that UCBs are now operating in a fairly deregulated environment and are required to determine their own interest rates on deposits and on advances\(^8^5\). The interest rate on bank’s investment in government and other permissible securities are also market related. Intense competition for business, involving both the assets and liabilities, together with increasing volatility in the domestic interest rates as well as foreign exchange rate, has brought pressure on the management of UCBs to maintain an optimal balance between spread, profitability and long term viability.

\(^{8^2}\) R.B.I. directive circular no. POT.SUCB.CIR.9/09.120.00/2001-02 Dated 2\(^{nd}\) April 2002, p.1 to 22.

\(^{8^3}\) R.B.I. directive circular no. RBI/2008-09/175, UBD.PCB.Cir. No. 13/12.05.001/2008-09, Dated 17\(^{th}\) September 2008, p. 1 to 11.


\(^{8^5}\) R.B.I. directive circular no. RBI/2008-09/175, UBD.PCB.Cir. No. 13/12.05.001/2008-09, Dated 17\(^{th}\) September 2008, p1 to 11.
The unscientific and ad-hoc pricing of deposits in the context of competition, and alternative avenues for the borrowers, results in inefficient deployment of resources. At the same time, lack of prudent liquidity management can put banks’ earnings and reputation at great risk. The management of UCBs have to base their business decisions on sound Risk Management system with ultimate objective of protecting the interest of depositors and stakeholders. It is therefore, important that UCBs should introduce effective Asset-Liability Management system to address the issues related to liquidity, interest rate and currency risk. It is also observed that the Regulator has taken lot of efforts in educating the small UCBs in India. The regulator has time and again insisted on development of proper systems that most of the UCBs are lacking. This can further be substantiated that out of total UCBs of 1853, 1798 banks are with small business operations. This indicates that 97% of the total UCBs are small. Thus, the Reserve Bank of India has tried its best to educate these banks by issuing this directive. It has also cautioned these banks about the unscientific and ad-hoc approach towards pricing of products. The importance of spread, profitability and long term viability are also explained with deep concerns. All these efforts of the Regulator has shown its intention that the regulator is not against the co-operative banking in India as some bankers claims it.

3.3.8 Considering the large number of (1798) small UCBs spread across the country the Regulator’s move to educate them and that too in very short time frame of just 3 months appears very ambitious. These banks are required to prepare and submit their first ‘Structural Liquidity Statement’ based on the financial position as on 31.12.2008. It appears that the Regulator has not considered the geographical problems and level of existing computerization in these banks. Maharashtra State is considered as one of the co-operatively developed States in India. However, it is the fact that these developments have taken place only in some districts. The level of development is not equal. Mumbai, Thane, Pune, Nashik, Aurangabad and Nagpur are few developed districts, but other districts are far behind. There are 688 multi unit small UCBs. These small UCBs would find it very difficult to collect the required data from its branches due to low level of computerization and
connectivity problems. Therefore, the Regulator should have given these banks some more time to build the necessary infrastructure. However, the NABARD has done this. Considering various problems faced by the States, the NABARD has excluded some of the State Co-operatives Banks from the current program of implementation.

3.4 Review of books and articles published in Magazines, Periodicals, Bulletins, Newspapers, Journals and Newsletters etc:

3.4.1 The techniques of the Asset-Liability Management and Risk Management were made mandatory for the Scheduled Commercial Banks in India in the year 1999. It is argued by the author in one the article in ‘Sakal’ newspaper that the basic business carried by the Commercial Banks and UCBs is the same and hence the risks associated with the banking business remains the same for Commercial Banks and UCBs. The aspect of interest rate sensitivity (Positive or Negative) of the Balance Sheet of UCBs is discussed in detail in this article along with brief reference to the techniques of Gap Analysis, Duration Gap Analysis, Value at Risk etc. Though the article was appreciated by various UCBs, the author of this article could have written it in more matured way. Comparative position of Commercial Banks and UCBs is missing in the article. Further, inclusion of illustration would have made the article more meaningful. The entire article has been focused from the Regulators point of view and its need for the safety of UCBs. However, the difficulties faced by UCBs such as collection of data, expertise available to analyze the data, low level of computerization, specific problems of rural UCBs etc. are totally overlooked. It would be interesting to mention here that within period of next 6 months (i.e. April 2002) the Reserve Bank of India made these techniques mandatory for the Scheduled UCBs in India.

3.4.2 The Book published in 2005 by The Indian Institute of Banking and Finance reveals that the business with large variation in net cash flow would be a business with higher risk. The profit potential and loss possibilities would be higher in such business due to higher variability of net cash flows. Capital requirements would be higher because of possibilities of higher losses. Similarly, business with lower variation in net cash flow would be a business with low risk. The profit potential as well as loss possibilities would be lower in such business due to low variability of net cash flow. Capital requirement would be also lower because of possibilities of less loss. This is the basic linkage between risk and capital. The authors have done extremely good work by providing the study material on this important topic. However, the views as explained appear to be inadequate. There is no doubt that the net flow of funds is important in managing the Asset side and Liability side of the Balance Sheet. The relationship between the risk and reward is well established long back. Higher the risks, higher the profit and similarly, lower the risks lower the profit. Further, the capital back up as provided by the management for taking these risks depends on the attitude of the management and financial position of the bank. The authors should have given importance to the mandatory provisions that increases the requirement of capital during the transition period. For example, it is observed during this research study that one of the selected banks from grade ‘IV’ went in troubles because of various mandatory provisions. Wrong decision in distributing credit forced the UCB to make incremental provision for the Non Performing Assets and at the same time declining market value of the investment portfolio also forced the UCB to make incremental ‘Marked to Market’ provisions for the depreciation in the value of invested securities. Business volume of this UCB is very small and there were no high variations in the net cash inflows. Because of the directives for the mandatory provisions, the UCB went reporting higher losses over the period of five years. The net cash inflows were very low as compared the required level of provisioning. As a result, the accumulated losses mounted up and the Regulator went on degrading

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87 Risk Management, Indian Institute of Banking and Finance, Study Material, Macmillan, 2005, p. 87
the UCB and imposed incremental supervisory restrictions. As the UCB is in ‘IV’ grade it has become impossible to get share capital. As per the directives it took five years for the UCB to make 100% provision for N.P.A. a/c. This period is referred as transition period. Therefore, if the bank is making cash losses this additional burden of provision further adds to the difficulties of UCB. Finally, the amount of provision is netted out while calculating the figure of risk adjusted assets. During this transition period the banks reported operating profits but after provisioning finally reported losses. Because of accumulated losses the UCBs loose the capacity to garner new capital. As the required capital was not generated during this transitional phase, the Regulator further downgraded UCBs. Thus, the UCBs are trapped in vicious circle. The authors should have highlighted this fact also in the book while establishing the relationship between the risk and capital.

3.4.3 In February 2006 the Executive Director of NABARD said that the essence of banking in rural areas should be ‘trust’. Banks need to practice ‘faith banking’ in the rural areas by not asking for collateral security.\textsuperscript{88} He also has expressed that this would help increasing rural penetration. NABARD plays a very important role in development of agriculture and rural area. Collateral security means additional security over and above the prime security. The views expressed by the senior level management official were upheld by the some of the UCBs working in the rural area for their own benefit. It would be important to understand the basic difference between NABARD and UCBs. NABARD is a specially designed institution for the development of agriculture and rural area. The inflow of funds of NABARD is by way of budgetary allocation and to provide refinance to banks whereas the UCBs are commercial organizations. The working capital of these UCBs come from the depositors and shareholders. These are not ‘Government Aided’ organizations. Hence, it is very important for the Board of Directors of the UCBs to ensure that the funds so mobilized are utilized in more prudent way. Commercial Banks would always like to have additional security that provides

\textsuperscript{88} ‘IIBF VISION’, Monthly Newsletter of Indian Institute of Banking & Finance, February 2006, p.6
cousins to the bank. These two organizations are basically not comparable. There is no valid point in upholding the views expressed by the senior management level official of NABARD. From the point of view of risk management to get as much possible, security should be encouraged. In case of urban areas the borrowers are providing collateral security. The UCBs should not have differential policy for the customers in urban area and rural areas. The view expressed by the NABARD official appears to be self motivated.

3.4.4 The Working Group set up for the study of ‘Asset-Liability Management framework’ by the Reserve Bank of India in the year 2006 proposed full migration from Traditional Gap Analysis (TGA) to Duration Gap Analysis (DGA). The group also recommended that Banks should adopt the DGA for the ‘Interest Rate Risk’ management in addition to the TGA as followed presently. The proposed framework, both DGA and TGA, should be applied to all assets, liabilities and off Balance Sheet items of the Bank. Banks should adopt the modified duration gap approach while applying the DGA to measure interest rate risk from the economic value perspective\(^{89}\). The guidelines proposed by the Reserve Bank of India will serve only as a benchmark for the banks. The banks will not be expected to adopt uniform ALM system, given the difference in the level of computerization and Management Information System amongst various banks. Though the working group made its recommendation in the year 2006, the Regulator has not yet acted on it. Duration Gap Analysis is an advance mechanism. The UCBs are not yet well conversant with the Traditional Gap Analysis. Under the circumstances it would not be proper to push these UCBs for using advance techniques. The study group has taken lot of pains to conduct the study. The intension of the group is to use advance techniques for better Asset-Liability Management needs appreciation, practical ground scenario do not permit UCBs to accept those recommendations at this stage. It would be pre mature. The study group has also shown courage by mentioning that the proposed guidelines would serve only as benchmark and banks would not be expected to adopt a uniform ALM system.

3.4.5 The Managing Director of The Saraswat Co-operative Bank Ltd., (Asia’s Largest UCB) Mr. S.K.Banergi has said in March 2006 that he is aiming to increase Saraswat Bank’s Profit though the proposed wholly owned micro finance subsidiary and IT subsidiary. 90 He has further added that “The entry of big banks in the retail segment has put considerable pressure on the net interest margins and pushed up the cost of lending”. The Saraswat Co-operative Bank Ltd. is Asia’s number one UCB and has been implementing Asset-Liability Management and Risk Management since 1999. It started implementing these new techniques much earlier to the year in which it was made mandatory for the scheduled UCBs i.e. 2002. The Saraswat Bank is much concern about the Net Interest Margin. It has also floated fully own subsidiaries. The views expressed by the Managing Director would definitely help in educating other UCBs as regards to the area of concerns. The objective of the Asset-Liability Management is to maintain the required spread on an ongoing basis. Floating of fully own subsidiaries would also provide opportunity for other UCBs for launching of new business on the lines of the leader.

3.4.6 The article of Bureau Reporter of The Economic Times on 6th September 2007 reveals that the Regulator in a bid to impose more discipline among banks in managing their liquidity, has asked banks not to have negative gap in their fund outflows for the next day. 91 Negative gap refers to a mismatch in which interest sensitive liabilities exceed interest sensitive assets. As mentioned earlier the banks were having comforts in terms of informing the Regulator about a negative outflow in the first time band of 1 to 14 days. This comfort has now been brought down to a single day. As per these draft guidelines the time band of 1 to 14 days has been divided in to three parts i.e. day – 1, 2 to 7 days and 8 to 14 days. Net cumulative mismatch in these new bands should not exceed 5%, 10% and 15% respectively. In case of next time band i.e. 15 to 28 days it should not exceed 20% The Regulator

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also made change in this draft guideline that the reporting of data would be on 
fortnightly basis, not on monthly basis as per the earlier directive. The Regulator 
also allowed time of 6 months i.e. up to January 2008 to the banks to fine tune their 
existing Management Information System. These new norms are stringent but they 
are needed for the improvement in liquidity management of the banks.

3.4.7 However, it is observed that these changes are not incorporated in the 
subsequent directives neither by the Reserve Bank of India or by the NABARD. 
The directive issued by the Reserve Bank of India to Tier – II UCBs in the year 
2008, the directive issued by the NABARD to the State Co-operative Banks in the 
year 2008 and to the District Central Co-operative Banks in the year 2008 are 
based on the original directive issued by the Reserve Bank of India in the year 
1999 and continued to have the same deficiency. The formats in which these banks 
are supposed to report still carries first time band of 1 to 14 days. The frequency for 
the submission of data is also one month. This indicates that the regulator has not 
converted these draft guidelines in to regular guidelines though they are very 
important for Liquidity Risk management.

3.4.8 In an article dated 29th June 2008 published in ‘Sakal’ a Marathi daily 
newspaper the author has suggested the logic behind the calculation of Prime 
Lending Rate. This article was written on the background of inflation rate @ 
11.42% highest during last 13 years. The author has rightly pointed out the 
contributing factors for determining Prime Lending rate of the bank such as cost of 
funds, required percentage of Cash Reserve Ratio, cost incurred for collecting 
funds, size of the Non Performing Assets etc. The earlier prevailing Prime Lending 
rates of the four major nationalized sector banks were as under:

92 ‘Determining the Prime Lending Rate’, . Arvind S. Paranjape, SAKAL newspaper, Dated 
29.06.2008, p. 6
The author has highlighted rightly that cost of fund is the main factor that includes interest paid on the various products used by the bank for garnering the deposits. Though in India, interest rate on Savings Bank deposit is still administered by the Regulator and banks do not pay interest on the Current deposits. If the product is of term nature that plays important role in determining the cost of fund of that particular bank. The required ratio of Cash Reserve also impacts the cost of fund as this amount is blocked with Regulator that pays interest on this amount at negligible rate. In today’s competitive world garnering deposits by launching various products has become very costly. Further, the customers need services at their door step. Investment cost of technology oriented products has also increased. All these things add to the cost for garnering deposits as well as distribution of credit. The strict norms introduced by the Regulator for recognizing category of Non Performing Assets hardly leaves any scope for the banks to alter their accounts as it was done prior to the introduction of these norms. All these facts should be considered by the bank while determining the Prime Lending Rate of the Bank. The author has put in lot of efforts in writing this article which is evident from the contents. Interestingly, due to various majors announced by the Finance Ministry and the Reserve Bank of India, the rate of inflation has come down to just 0.44% (as announced on 19th March 2009) and it is likely that in near future India may see deflation like many other countries. With this drastic fall in the rate of inflation the Prime Lending rates have not come down proportionately. This indicates that the bankers also consider some other factors while pricing their products. In recent past the Governor of the Reserve Bank of India and the Spokes person of the Ministry of Finance have time and again indicated the banks to reduce their Prime Lending rate. The purpose is to curb the recessionary trend. However, no banker has responded to it in a big way including the leader i.e. State Bank of India. The fact of today’s economic environment is the fear of further
deepening of growth among the bankers. Due to these uncertainties the bankers have lost the confidence and instead of lending money they prefer to park those funds in Government Dated Securities. The bankers have argued that they cannot bring down the Prime Lending rate because of high rate of interest offered on the deposits. They cannot bring down the rates on deposits as the Government itself is offering 8% to 8.50% on various postal deposit schemes and employees Provident Fund. Further, the Government is in need of funds of almost 10,000 crores of rupees every week to reduce its fiscal deposits. Thus, the view of the author is not complete. He should have considered the aspect of prediction of future status of economy and interest rate scenario also in his article.

3.4.9 In an another newspaper article dated 29.06.2008 which deals with the issue of pricing of product, the author has tried to explain how the pressure of increasing inflation fuels the hardening of interest rates in the economy.93 This article is written on the background of increase in the Repo and Reverse repo rates by the Reserve Bank of India. The author has taken overview of all the sources of funds such as Savings deposits, Term Deposits, Issue of shares, Float available from collection of various taxes on behalf of Government etc. in his article. Finally, the author has expressed his view that due to increase in the repo rate and reverse repo rate by the Regulator, results in reduction in working capital of the banks. He also has highlighted the increase in costs of administration of banks. This factor forces the banks to increase the rate of interest, increasing the price of product. In the month of July 2008, the inflation rate in India climbed to as high as almost 13%. Obviously, the Ministry of Finance and the Reserve Bank of India were very much concerned about it. The role of the Regulator is very important in giving directions to the economy. Though the Regulator is an independent authority it has to accommodate the views of the Government in power. In the mid of the year i.e. 2008 the growth rate was around 7% to 7.5% and the inflation rate was around 12.5% to 13%. This has indicated the poor health of the economy. The Regulator

93 ‘Why Interest Rates go up’, Chandrashekhar Patwardhan, SAKAL newspaper, Dated 29.06.2008, p. 6
has to balance between growth and inflation. Giving priority to bring down the inflation, the regulator has almost compromised on growth. To implement this, the Regulator has increased the repo and reverse repo rates. This is the tool, always used by the regulator to pull out the excessive credit from the economy. The author has tried to highlight the relation between the increase in repo and reverse repo rate and hardening of interest rates that is worldwide accepted fact. Similarly, when there is reduction in repo and reverse repo rate, the interest rates are soften. This is also worldwide accepted fact. However, it would be interesting to note that it would not work in similar way at all the times. This factor is totally missing from the article. In last 9 months time the Reserve Bank of India has reduced the repo and reverse repo rate twice. But there is no correlation between the rate at which the Regulator has reduced the repo / reverse repo rates and the rate at which interest rates have soften. This time the situation is different. Though the inflation has fallen to new low of 0.44% as on 19th of March 2009 and the Regulator has focused its attention on the growth aspect. They are highly concern about the fiscal deficit. If the report of CLSA published in March 2009 is to be believed then the growth in India would fall to 5% against the prediction of 7.5% by the Government. The fiscal deficit would increase to 14%. To reduce this deficit the Government would come to the market for borrowing money in big way. Further, it would not be able spend the money on various schemes as planned to give boost to the economy. The recession in the developed countries like United States of America and European countries would also bring impact on Indian economy. Due to this future scenario, though the Regulator has brought down the repo and reverse repo rate, the lending rates have not come down with same intensity. This is why the observation of the author does not hold well at all the times.

3.4.10 The article published in the Economic Times on 23rd March 2009 reveals that the Urban Co-operative Credit Societies may be used for money laundering. The bureau reporter in this article has discussed about the operational risk. He has expressed concerns that as the banks have closed most of the loopholes for money laundering, co-operative credit societies could turn out to be the weak link in the
system. Some of the co-operative credit societies have garnered substantial funds and they are bigger than many UCBs. Further, these co-operative credit societies do not fall under the supervision of The Reserve Bank of India. These societies are supervised by the concerned Co-operative Department of the State Government. These co-operative credit societies have now introduced core banking software. This has enabled them to issue multi city cheques for transfer of money\(^\text{94}\). The reporter wants to point out that this activity is similar to that of issuing demand draft by the banks. The banks are governed by the Reserve Bank of India and because of this they also attract the provisions of ‘The Prevention of Money Laundering Act,2002’ and provisions 2005. However, these credit societies are out of purview of this act. This enhances the chances of miss-utilization of the system. The reporter has raised excellent points by writing this article. In fact 10 years back the ‘Madhava Das’ committee constituted by the Reserve Bank of India had suggested that there is a need to stop the practice of primary credit societies undertaking banking business without first obtaining licence from the Regulator. The Aurangabad bench of the Mumbai High Court also sought to put an end to the practice of co-operative credit societies issuing such cheques. The bench directed the petitioner to move the matter separately in form of Public Interest Litigation (PIL). This observation of the high court is very serious. Basically, the ‘Know Your Customer’ (KYC) norms are made mandatory by the Reserve Bank of India to stop routing of benami transactions through the account, to stop funding to the terrorist activities through the account and to stop further circulation of unaccounted money in the economy through the account. The Reserve Bank of India, in its directive on the subject cautioned the banks about the systemic risks and operational risks to which banks are exposed. For better management of risks the Regulator has made it mandatory for all banks to have ‘Customer Acceptance Policy’ and ‘Customer Identification Policy’ in place. These two sub policies are part of bank’s ‘Integrated Risk Management Policy’. The Regulator has levied financial penalty of Rs. 5.00 lakhs on those banks who have not complied on this point. To support the KYC concept, the Central Government has passed act named

\(^{94}\) ‘Co-operative Credit Societies may be used for Money Laundering ’, Bureau Reporter, The Economic Times, Dated 23\(^{rd}\) March 2009, p. 12.
as ‘The Prevention of Money Laundering Act, 2002’ and has passed the rules in 2005. This act has provision of rigorous imprisonment and financial penalties. All these things indicate the seriousness of the matter. The reporter has only expressed the possibilities in his article. Had he included KYC norms and Provisions of the Money Laundering Act, 2002, the article would have become complete.

3.4.11 Editor C. Anita while editing book for ICFAI University expressed need for setting up Role of Credit Information Bureau. The author has stated that the credit information bureau is specialized body set up to function as a warehouse of information to the clients of financial institutions who lend their customers. The credit information bureau assists their member financial institutions by providing current and past data on the credit qualities of the prospective customers, thus providing leverages to the term lending institutions while extending credit. Such an availability of credit information of high quality helps the member institutions to attain the desire efficiency of credit protection.95

3.4.12 This has been the need of the urban co-operative baking sector for long time. In the recent past it is observed that many of the UCBs have failed due to Credit Risk. Though the credit risk is very broad concept and that cannot be separated from the banking business, the information about the prospective borrower plays important role in the total credit risk. Many of the Multi State Scheduled UCBs have in recent past started Credit Enquiry Department and the work allotted to the staff members working in the department have to go in the market and collect as much possible information about the borrower and his dealings by actually meeting suppliers, debtors, creditors and banker etc. The purpose behind this is very clear that these UCBs want to ensure that quality of the borrower client is tested in the initial stage of credit risk. As these banks are having very huge business volumes and they have established their credentials in the

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95 ‘Risk Management - Insight from Experts’, Edited by C. Anita and published by the ICFAI University, 2002, p82.
financial markets, these banks usually get the possible information through market participants. But for the small size UCB it is just impossible to get such information from the market. Further, there are restrictions on the area of operations that acts as limiting factor for the UCBs. Hence, for long time the need to have Credit Information Bureau is felt by the urban co-operative banking sector. In fact an attempt to this was also made by the UCBs in Pune district on voluntary basis. However, it has failed as some of the UCBs refused to share their data base of customers.

3.4.13 The subject raised by the editor undoubtedly becomes very important and the concept of the Credit Information Bureau has become essential for the UCBs as more and more banks have started failing because of the credit risk. The need to have such official bureau is felt by almost all UCBs but because of some hesitancy and fear the UCBs are not coming out openly and sharing information among them. Getting information about the prospective customers from the market as has been done presently by some of Multi State Scheduled Banks becomes individual efforts of that particular bank and it would be beneficial only to that particular bank. This does not add any contribution to the co-operative movement or co-operative banking sector as a whole. Further, there is always risk of getting incorrect information associated when the efforts are made on individual basis. The urban co-operative banking in India has good infrastructure in place. At grass root level the district associations are present and all the banks operating in that district are usually members of it. Similarly, at state levels, State Level Federations are present whose Board of Directors is elected by their member banks and district associations. Thus, by using this available infrastructure if the credit information bureau is established then the smaller UCBs might not object to it or hesitate to share the information.

3.4.14 Whatever problems are faced by the UCBs, they would have to come together and find out solution for this valid point raised by the editor which is in
the larger interest of the co-operative movement. The editor has just expressed the idea of having credit information bureau. However, she has not recommended any prescription to it and that is the deficiency in the article. It is understood that the prescription to this problem would not be easy but certainly would not be impossible also. Using the offices of District Associations and State Level Federations this problem would have been solved.

3.4.15 IIBF VISION Newsletter December 2009 issue has revealed that the regulator in India is also worried about the increased rate of failure of the UCBs. In this issue IIBF it has been stated that RBI proposes to establish a separate fund for the urban co-operative banks. The article is based on the recommendations of the working group headed by RBI Executive Director, Mr. V.S.Das. The purpose of setting up of this fund is to help urban co-operative banks to tide over liquidity problems and short fall of the prescribed capital adequacy norms. In addition, it is also proposed that a national level umbrella organization is to be set up to provide ATM, investment banking and cash management services to these entities. The fund is to be named as ‘Emergency Fund Facility Scheme’ and is to be set up through an agreement between UCBs and State Governments with banks contributing in with 0.05% of their assets. The amount would qualify for interest.96

3.4.16 Interestingly this study also highlights the similar problems of the UCBs as mentioned in the purpose of setting up of this fund. The UCBs are supposed to be local banks catering the banking needs in the local area. However, to survive in competitive environment, the management of the some of the UCBs are of the opinion that that they should not only grow by size but also expand geographically. There is a growing tendency observed especially in the UCBs in the urban area that they want to provide all type of technology oriented services as provided by the

private and foreign sector banks. Without understanding the limitations such as lack of capital, lack of expertise, lack of technological support and huge capital investments which are required to start these services. Many of the UCBs are proceeding in this direction. There is no doubt that in competitive banking environment the UCBs also need to gear up for providing these types of services but at what cost? Further, whether these UCBs are financially strong enough to bear such high costs?

3.4.17 The efforts of the regulator in setting up umbrella organization for providing these types of services to member banks needs to be appreciated because it would provide common platform for the UCBs. The umbrella organization would certainly be able to bring down the costs involved as it would have collective powers. It would be very difficult for the Individual UCB to deal with various vendors who would be part of providing these types of services. Similarly, the skills and expertise required to understand the technology and its implementation would differ from bank to bank. These types of problems would be sorted out more efficiently by the umbrella organization. Further, the agreement between the UCBs and State Governments would reduce the degree of fear among small and medium size UCBs in sharing the data. There are lot of incidences of cheating the small and medium size UCBs in past. Services related to ATMs, Investment banking and cash management support are need of the hour and umbrella organization would be appropriate solution for that.

3.4.18 Though the article has revealed the purpose and resource mobilization of the proposed emergency fund, it is silent about the actual management of it. The governing body, its selection and administrative structure needs further clarity.

3.4.19 With the integration of the global economies, the financial markets are becoming very dangerous day by day. Dominic Barton, Roberto Newell and
Gregory Wilson in their book have pointed out this fact. The authors have quoted that ‘Financial crises are imminent in the global economy. The key to survival and growth in business is – anticipate first and then manage. Managing a crucial situation to emerge as a winner is the first step on the ladder to success. This is not as difficult as it seems.\textsuperscript{97} All the three points raised by the authors are absolutely important and are applicable to the UCBs in present scenario. The first point that the financial crises are imminent in global economy is very valid. It has been observed that the due advance telecommunication technology and increased use of computerization has resulted in more integration of the financial markets in the world. During the time of 24 hours in a day some or other financial market in the world is open and operational. The financial crises in that country or any strict supervisory action taken by the regulator of that country in resolving the crises results in negative reaction all over the world. These negative reactions are so swift that in many countries institutions do not get adequate time to square off the transactions. Due to the integration or fast flow of information across the globe, the financial markets world over have become very volatile. In the month of November 2009, the Dubai faced severe financial crises due to reality sector investments. One of the largest organizations from this sector has failed to honor its financial commitment and the negative waive of this news adversely impacted all the markets in the world. Stock market index is considered as one of the parameter for economic growth. The day on which this news broke out from Dubai many financial markets in the world drifted down and many financial markets opened substantially lower on the next trading session. Fortunately, UCBs are not permitted to invest money in the stock markets. However, banks from other sector suffered on their investment portfolio. As the markets were opened on lower side, the banks could not get time to disinvest. Money markets were also volatile and

\textsuperscript{97}‘Risk Management - Insight from Experts’, published by the ICFAI University, 2002, with chapter from the book ‘Dangerous Markets: Managing in Financial Crises’ by Dominic Barton, Roberto Newell and Gregory Wilson, p45.
that affected many UCBs because of their open positions in the money market. Thus, it is clear that the UCBs cannot keep themselves away from the volatile financial markets and this volatility in the financial markets is becoming dangerous day by day. The point number two raised by the authors that the key to survival and growth in business is – anticipate first and then manage. It is observed in recent time that though conceptually UCBs are supposed to be local banks in practice all of them are hungry for growth. The belief is that the growth is the only solution for survival.

3.4.20 The managements of the UCBs need to understand that these two things are different. There is no doubt that the growth is required for any bank but that does not assure long term survival. Had it been true, no big bank in the world has collapsed? Collapse of world’s largest Berrings Bank is good example of this. The function of Risk Management becomes very important on this background. The regulator has now made it mandatory for all UCBs irrespective of its size which is very good for long term survival. The directive issued by the regulator indicates various steps to be followed by the UCBs in the process of Risk Management. These steps are Identification of Risk, Measurement of Risk, Management of Risk and finally Immunization of Risk. The authors in their book have referred to step number one and three. Anticipate first and then manage clearly means Identification of Risk and Management of Risk. If the UCBs succeed in managing various risks efficiently they would survive for longer time. The authors have also pointed out that managing crucial situation to emerge as a winner is the first step on the ladder to success and this is not as difficult as it seems. Therefore, the UCBs need to strengthen the function of Risk Management. Once the efficient systems and procedures are designed and put to use then the function of Risk Management would not be very difficult task.

3.4.21 This highlights the need to change the mindset of the Board of Directors of the UCB that growth and survival are two different aspects and between them
survival should be given the top priority. In integrated world markets UCBs cannot keep themselves away from developments taking place in those markets. Thus, UCBs need to first understand that financial markets are becoming increasingly volatile and the efficient Risk Management system would certainly help the UCBs in long term survival.