Credit Risk Management Policy (CRMP)

1- Preamble

The Uttar Pradesh Cooperative Bank Ltd. (UP Cooperative Bank) serves a vital role in the state's financial ecosystem, providing credit to short term credit cooperative structure, entrepreneurs, Personal Loans and small businesses. As the primary lender in rural and semi-urban regions, the bank faces significant credit risks. Therefore, a robust and well-defined **Credit Risk Management Policy (CRMP)** is essential to mitigate potential risks and ensure sustainable growth.

This policy has been formulated in line with the regulatory guidelines issued by the Reserve Bank of India (RBI), the Cooperative Banking Regulations, and the **Basel III** standards, where applicable, adapted to meet the unique requirements of cooperative banking. The National Bank for Agriculture & Rural Development (NABARD) issued a guidance note on credit note on credit risk management vides their reference no NB. DoS. HO. POL./4586/j-1/2009-10, Circular no. 18/DoS-04/2010, dated 20.01.2010 & reference no NB.HO.DoS.POL./4263/j-1/2023-24, Circular no. 36/DoS-03/2023-24, dated 14.03.2024 to enhance and fine-tune their existing risk management systems.

UP Cooperative Bank has unique challenges due to their local focus, reliance on agricultural and small business loans, and stringent regulatory oversight from the Reserve Bank of India (RBI). This policy breakdown will cover everything from the organizational structure, credit appraisal techniques, risk identification, mitigation measures, and recovery mechanisms to the use of advanced risk analytics and regulatory compliance.

2. Objectives of the Credit Risk Management Policy:

The primary objective of the Credit Risk Management Policy is to mitigate the credit risks associated with lending operations. This includes identifying, assessing, controlling, and monitoring credit risks at both the individual borrower level and across the portfolio.

Key objectives include:

i. **Risk Minimization**: Avoid and minimize loan defaults and Non-Performing Assets (NPAs).
ii. **Sustainable Growth**: Enable balanced and sustainable loan portfolio growth while maintaining profitability.
iii. **Regulatory Compliance**: Ensure strict adherence to all applicable RBI regulations, including exposure norms, capital adequacy, and provisioning requirements.
iv. **Enhancing Credit Culture**: Promote a culture of prudent risk-taking and sound credit judgment among all employees involved in lending operations.
v. **Sectoral Diversification**: Prevent over-concentration in any specific sector, especially agriculture, by promoting diversification.
vi. **Deposit Protection**: Preserve depositor confidence by maintaining a high-quality asset base and managing credit risk exposure

Key Elements:

- Identifying, assessing, and controlling credit risk at both the individual borrower level and across the bank's loan portfolio.
- Introducing an **Early Warning System (EWS)** to detect potential defaults early.

- Designing an organizational structure for credit risk oversight, which includes a clear line of responsibility for risk management.
- **Stress Testing and Scenario Analysis**: Introduce stress testing mechanisms to assess how external shocks (like a market downturn or a sectoral collapse) can impact the loan portfolio.

3. Definition of Credit Risk:

3.1-Credit Risk Defined: Credit risk arises from the possibility that a borrower or counterparty fails to meet its obligations, leading to financial loss for the bank. This includes risks such as:

3.2-Components of Credit Risk:

i. **Default Risk**: The likelihood that a borrower will default on a loan.

ii. **Concentration Risk**: Risk due to over-exposure to a single sector, borrower, or geographic region, which can lead to substantial losses.

iii. **Collateral Risk**: Risk arising from the inadequacy or illiquidity of the collateral securing a loan.

iv. **Moral Hazard**: The risk that borrowers might act irresponsibly or unethically once credit is granted.

v. **Recovery Risk**: The potential difficulties the bank may face in recovering the loan after default, especially in regions with limited legal infrastructure.

4. Credit Risk Governance Structure:

The governance structure for credit risk management at UP Cooperative Bank ensures that credit risks are identified, assessed, mitigated, and monitored effectively at various levels.

4.1-Board of Directors:

Role:The Board provides oversight on credit risk policy, ensures its proper implementation, and reviews the policy annually. The Board is responsible for approving high-value loans, setting risk appetite, and reviewing risk reports periodically.

Responsibilities:

- Establish the overall credit risk policy and ensure periodic review to keep it in line with the bank’s strategy and regulatory changes.
- Define the bank's **Risk Appetite Framework** (RAF), which determines the acceptable levels of credit risk for different asset classes and sectors.
- Review and approve limits on large exposures, sectoral caps, and single-borrower limits as per RBI norms.

4.2-Sub-committees:

a. **Risk Management Committee (RMC)**:

Role: The RMC is a sub-committee of the Board and oversees the bank's credit risk management strategy, policy implementation, and risk exposure levels.

Responsibilities:

i. Evaluate and approve lending policies and risk limits.

ii. Monitor credit risk concentrations and approve corrective actions.

iii. Review large loan exposures and approve loans exceeding branch-level authority.

b. **Credit Risk Management Committee (CRMC)**: Reviews risk on a more granular level, including individual loan exposures and specific borrower accounts that exceed predefined thresholds.The Credit Risk Managem ent Committee (CRMC) shall comprise the following-

I.	Managing Director	- Chairman
II.	G.M.(IT-Banking)	-Member
III.	G.M.(Audit & Inspection/Vigilance)	-Member
IV.	G.M. (ACD/MONT/IDD)	-Member
IV.	D.G.M.(Finance)	-Member
VI.	D.G.M.(Mont.)	-Member
VII.	AGM (Banking-Deposit)	-Member Coordinator

Role:

- Implementation of the credit risk policies and coordination with other departments like Credit, Audit, and Compliance.
- Monitoring sectoral exposure, setting credit limits, and adjusting policies based on market conditions and borrower performance.
- Handling of **Non-Performing Assets (NPAs)** through a specialized team focused on recovery and restructuring.

Responsibilities:

- At the operational level, designated officers are tasked with monitoring loan performance, conducting borrower evaluations, and flagging high-risk accounts.

c. **Sector Specialists**: For cooperative banks with significant exposure to agriculture or MSMEs, sectoral risk officers are employed to monitor risks specific to these industries (e.g., crop failures, market price volatility).

d. **Branch-Level Credit Committees**

- **Role**: Branch committees are responsible for appraising and approving smaller loan proposals in accordance with delegated authority.
- **Responsibilities**:
- Assess borrower creditworthiness based on financial statements, collateral, and KYC documentation.
- Monitor loan accounts and flag early signs of distress.

5. <u>Credit Risk Identification and Assessment</u>:

UP Cooperative Bank's due diligence process is designed to assess the creditworthiness of each borrower. The key steps include:

Borrower Due Diligence

5.1-KYC and Documentation:

- Rigorous adherence to the RBI's **KYC (Know Your Customer)** norms, including background checks, identity verification, and financial profiling.
- Thorough analysis of borrower financials, including income statements, cash flow projections, and external debt obligations.

5.2-Credit Bureau Checks:

- Mandatory retrieval of the borrower's **CIBIL score** or other credit rating reports to evaluate past credit behavior.
- Use of multiple credit bureaus (CIBIL, CRIF, Equifax, etc.) to cross-check borrower information and improve accuracy.

5.3-Financial Analysis:

- Detailed scrutiny of financial statements (for corporate borrowers) or income proofs (for individuals). This includes:
- **Profit & Loss Analysis**: Review of earnings stability, margins, and profitability trends.
- **Debt-to-Income (DTI) Ratio**: Assessment of borrower's ability to service debt based on existing obligations and income sources.
- **Cash Flow Assessment**: For businesses, a review of cash flow cycles and working capital management to determine repayment capacity.

5.4-Site Visits and Inspections:

- Physical verification of the borrower's business premises, agricultural land, or other collateral provided as security.
- For larger corporate loans, the bank may employ third-party auditors to conduct asset verifications.

5.5-Sectoral & Geographic Risk Analysis:

- The bank conducts an analysis of the sectors or regions where it lends heavily (e.g., agriculture, small-scale industries). Special attention is given to:
- Agricultural borrowers affected by weather, market prices, and government policies.
- MSME borrowers who may be impacted by fluctuations in demand, raw material costs, and competition.
- **Geographic Risk**: Rural areas may have specific risks such as natural calamities, lack of infrastructure, or socio-political instability.

5.6-Credit Risk Rating Systems:

a) **Internal Credit Rating System**: Cooperative banks develop or adopt internal credit rating systems where borrowers are assigned a risk grade based on factors such as financial health, credit history, and business prospects. These models consider:

i. **Quantitative Factors**: Income, assets, liabilities, net worth, and liquidity ratios.

ii. **Qualitative Factors**: Management quality, industry outlook, competitive positioning, and business model resilience.

b) **Rating Thresholds**:

- ➢ Borrowers with lower credit ratings are flagged for increased monitoring, higher interest rates, and potentially stricter collateral requirements.
- ➢ Loans above a certain risk threshold may require Board approval or additional documentation.

5.7-Risk Categorization

Borrowers are categorized into different risk buckets based on their business profile, repayment capability, and collateral adequacy:

- **Low Risk**: Borrowers with stable income, high credit scores, and strong financial profiles.
- **Medium Risk**: Borrowers with moderate credit risk, including small-scale farmers and MSMEs with variable income.
- **High Risk**: Borrowers with fluctuating income, poor credit history, or exposure to volatile sectors.

6. Credit Approval and Loan Processing:

6.1 Loan Appraisal Process:

The loan appraisal process at UP Cooperative Bank consists of the following steps:

- **Application Scrutiny**: The bank performs a thorough review of the loan application, including the borrower's credit score, income details, and business prospects, borrower's due deligence, Govt. licences and approval.
- **Field Investigation**: Branch Managers/Officers of Concered Credit department, should conduct physical verification/Inspection of assets (land, building, crops, livestock and other assets) and assess the viability of the borrower's income sources.
- **Collateral Assessment**: The bank appraises the collateral offered and determines the loan-to-value (LTV) ratio based on the risk profile of the asset.
- **Loan Decision**: Based on the credit risk rating and branch-level authority, the loan application is either approved, rejected, or forwarded to higher authorities for further evaluation.

6.2 Credit Approval Limits

- **Branch-Level Authority**: Small loans (agricultural, personal) up to a specified limit can be approved at the branch level.
- **Head Office Approval**: Loans above the branch-level limit are forwarded to the head office for approval.
- **Board-Level Approval**: Larger loans, for Sugar Mills and DCB's , require approval from the Board of Directors.

7. Credit Risk Mitigation:

*7.1-*Collateral Management: UP Cooperative Bank demands adequate collateral for all loans, except in cases of small or priority-sector lending where collateral may be waived (subject to RBI norms).

i. **Collateral Valuation and Acceptable Securities**:

- Collaterals may include property (both residential and commercial), gold, agricultural land, vehicles, and stocks.
- **Third-Party Valuation**: External valuers are used to determine the market value of the collateral.
- Regular revaluation is performed, especially for long-term loans or in cases where market conditions have changed significantly.

ii. **Loan-to-Value (LTV) Ratios**:

- **LTV Guidelines**: The bank sets LTV ratios based on collateral type, with stricter LTVs for riskier asset classes (e.g., real estate loans may have a maximum LTV of 70-75%).Gold loans maintain an LTV ratio as per RBI guidelines, typically not exceeding 75%.
- **Collateral Monitoring**: In cases of fluctuating collateral values (e.g., stocks, real estate), the bank performs periodic revaluations and may ask for additional collateral if the LTV ratio exceeds internal limits

7.2-Guarantees and Co-Borrowers:

- ✓ **Personal Guarantees**: In cases where the borrower's financials are weak or insufficient, personal guarantees from financially sound individuals (directors, family members) may be obtained.
- ✓ **Co-operative Borrowing**: For loans to Self-Help Groups (SHGs) or Joint Liability Groups (JLGs), the entire group guarantees the repayment, mitigating individual default risks.

7.3-Insurance Coverage:

- Certain loans (especially agriculture and MSMEs) are secured with insurance coverage for natural calamities, death, or loss of key assets.
- Responsibilty to insure all goods, stocks, plant and machinery etc. shall be of the borrower. If the borrower face to insure then the bank after debting the account of the borrower for premium can get the goods etc. insured.

  It should further be provided that-

  -The bank is not obliged to ensure the assets.

  -The bank is not responsible for the claim if it is rejected or not admitted and

  -The borrower agrees that the Bank debiting the premium for one year does not obligate the bank to ensure the assets in subsequent years.

- **Pradhan Mantri Fasal Bima Yojana (PMFBY)**: Agricultural loans are often insured under this scheme, protecting farmers and banks from crop failures.

7.4- Loan Pricing and Risk-Based Pricing:

Risk-Based Loan Pricing Framework:

- Borrowers with high credit risk are assigned higher interest rates to compensate for the potential default risk.
- Loans are priced using a **Base Rate** + **Credit Risk Premium**, which factors in the borrower's risk rating, collateral, and sector risk.

Differential Pricing Models:

- Different rates for retail loans (housing, personal) versus business loans (working capital, term loans).
- Sector-specific pricing strategies, especially for volatile sectors like agriculture and MSMEs, where interest rates reflect higher risks.

8. Concentration Risk Management:

8.1-Sectoral and Geographic Exposure Limits:

- **Sectoral Caps**: As per Nabard Circular Ref. No. NB.DOS.CMA/768/ A.75/2008-09 dated 12 May 2008, Bank will decided exposure limit and time to time in the reference any direction issued by Nabard/RBI. and The bank imposes limits on exposure to specific sectors like agriculture, MSMEs, and housing to avoid over-concentration.
- **Geographic Diversification**: Ensuring exposure is diversified across regions to avoid risk due to localized downturns (e.g., floods, droughts).

9. Monitoring & Control of Credit Risk:

9.1-Ongoing Loan Monitoring:

a) **Regular Account Monitoring**:

✓ **Loan Performance Tracking**: Regularly monitor borrower repayment behavior and loan performance through monthly reviews.

✓ **Red Flags**: Delayed payments, reduced income, and falling asset values trigger enhanced monitoring and preemptive action to prevent loans from becoming non-performing assets (NPAs).

b) **Covenant Monitoring**:

- Regular monitoring of loan covenants (e.g., maintaining a certain debt-to-equity ratio) to ensure borrowers adhere to agreed-upon terms.
- Immediate corrective action is taken if any covenants are breached, including restructuring or recalling the loan.

9.2-Early Warning Systems (EWS):

Triggers and Alerts:

- Automated systems detect potential default triggers such as overdue payments, significant changes in the borrower's financial profile, or sector-wide stress indicators.
- **EWS Dashboards**: Risk officers are provided with dashboards highlighting high-risk accounts, with alerts that prompt immediate review.

9.3-Remedial Actions:

- For flagged accounts, immediate steps include restructuring the loan, seeking additional collateral, or invoking personal guarantees.
- **Enhanced Monitoring**: High-risk accounts are placed on a watchlist for daily or weekly reviews.

10. Loan Classification & Provisioning:

10.1-Asset Classification:

Non-Performing Assets (NPA) Classification:

Loans that are overdue for more than 90 days are classified as NPAs. The classification is further broken down into:

Sub-Standard Assets: NPAs for 91 days upto 3 years.
Doubtful Assets: Doubtful assets Classified as –

- D1- NPAs for more than 3 years upto 4 years.
- D2- NPAs for more than 4 years upto 6 years.
- D3- NPAs over 6 years.

Loss Assets: Loans deemed irrecoverable by the bank and are recommended for write off.

10.2-Provisioning for NPAs:

The bank maintains provisions based on asset classification:
Standard Assets: Agriculture and MSME - 0.25% provision, Rest – 0.40%
Sub-Standard Assets: 10.00% provision.
Doubtful Assets: 20-100% provision based on the length of time the loan has been classified as doubtful. Provisioning to be as following –

Doubtful Assets Sub-Category	D1		D2		D3	
Type of Loans	**Secured Loans**	**Unsecured Loans**	**Secured Loans**	**Unsecured Loans**	**Secured Loans**	**Unsecured Loans**
Provisioning Required	20%	100%	30%	100%	100%	100%

Loss Assets: 100% provisioning.

11. <u>Recovery Mechanisms</u>:

11.1-Recovery Process:

a) **Loan Recovery Cell**:
A specialized loan recovery cell is organised to manage distressed assets. This team undertakes negotiation, legal recovery, and restructuring efforts.

For Npa management bank will take action as per board approved npa management policy.

b) **Legal Recourse**:

- Use of the **SARFAESI Act** for the recovery of secured loans, including the right to auction pledged assets.
- Recovery Process under U.P. Cooperative Society Act-1965.
- Filing cases with the **Debt Recovery Tribunal (DRT)** for larger NPAs.
- Filing cases with the National Company Law Tribunal (NCLT)
- Any court

11.2- **One-Time Settlement (OTS)** :

- Loans may be settled for less than the total outstanding amount under OTS schemes, particularly for distressed sectors (e.g., agriculture during a drought year).
- Strict eligibility criteria are laid down to prevent misuse, and OTS proposals are reviewed by the Board.

- Results of stress tests are reported to the **Board of Directors** and used to adjust the **Capital Adequacy Ratio (CAR)**.
- Bank will also consider the "Compromise & Settlement Policy" of the Bank to recover any dues.

12. **Reporting & Disclosures**:

- **Internal Reporting**: Regular reports on credit risk, including NPA levels, provisioning, stress test results, and recovery efforts, are submi3tted to the Board for review and decision-making.
- **External Reporting**: Compliance with RBI's reporting requirements, including disclosures on large exposures, sectoral NPAs, and provisioning in the annual report.

13. **Regulatory Compliance**:

a. **RBI Guidelines**:
Strict adherento the RBI's prudential norms for cooperative banks, including limits on sectoral exposure, single borrower limits, and capital adequacy requirements.

b. **Statutory Audits**:
Bank undergo frequent audits, including internal audits, statutory audits, and RBI inspections, to ensure compliance with regulatory guidelines.

14. **Training & Capacity Building**

- Ongoing training programs for staff involved in credit risk management, focusing on emerging risks, regulatory changes, and best practices in lending and credit monitoring.

15. **Technology & Automation**

- The bank leverages technology for risk management through the automation of loan appraisal processes, credit scoring models, and centralized risk management systems.

16. **Conclusion**

The Credit Risk Management Policy is vital for maintaining the financial health of U.P. Cooperative Bank, given their unique challenges. Effective credit risk management ensures that the bank remains sustainable, protects depositors, complies with regulatory mandates, and supports the community by providing responsible and sustainable lending.

Note:-

1- The borrower would indemnify the Bank for any loss or damage caused by any omission or commission should be added.

2- In case of any dispute, the matter shall be referred to the Registrar, Cooperative Societies and his decision shall be final.

3- All disputes shall be subject to Jurisdiction of Courts at Lucknow only.