S A D R Ž A J

SUMMARY

Every business carries an element of risk. Therefore, managing risks is crucial process in many organizations. The function of risk management is to organize and carry out a plan to control or reduce the risks to which a bank is exposed. This planning involves a five-step process. The first step is to identify potential risks. Once risks have been identified, the next step is to assess the potential severity of loss and probability of occurrence. The third step is to find a potential treatment for the problem. This may involve the transfer, avoidance, reduction or retention of a potential risk. Next is to implement the plan by choosing the right method of treatment. Prior to implementation, a review and evaluation of the plan is necessary.

Financial risk management focuses on risks that can be managed by using traded financial instruments. Risk managers recognize and review their organizations loss exposures including property, liability, personnel and net income. This helps promote growth through profit, continuous operation and stable earnings.

Initial risk management plans are never perfect. Practice, experience and actual results, will necessitate changes in the plan. Therefore, the plan should make room for flexibility in decision making. Risk management is considered an art in management circles and experience and exposure to situations helps mastering this art.

Financial risk management is the practice of creating economic value in a bank by using financial instruments to manage exposure to risk, particularly credit and market risk. Financial risk management requires identifying the sources of risk, measuring risk, and plans to address them. As a specialization of risk management, financial risk management focuses on when and how to hedge using financial instruments to manage costly exposures to risk.

The most important risks for the bank are:

Credit risk - the risk of loss due to a debtor's non-payment of a loan or other line of credit (either the principal or interest (coupon) or both).

Liquidity risk - financial risk due to uncertain liquidity. A bank might lose liquidity if its credit rating falls, it experiences sudden unexpected cash outflows, or some other event causes counterparties to avoid trading with or lending to the bank.

Market risk - the risk that the value of an investment will decrease due to moves in market factors. The four standard market risk factors are:

1. Equity risk, or the risk that stock prices will change.
2. Interest rate risk, or the risk that interest rates will change.
3. Currency risk, or the risk that foreign exchange rates will change.
4. Commodity risk, or the risk that commodity prices (i.e. grains, metals, etc.) will change.
5. *Equity index risk*, or the risk that stock or other index prices will change

Operational risk- Basel Committee define’s operational risk as:
"The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events." Basel Committee recognizes that operational risk is a term that has a variety of meanings and therefore, for internal purposes, banks are permitted to adopt their own definitions of operational risk, provided the minimum elements in the Committee's definition are included.

In the banking sector worldwide, Basel Accord are generally adopted by internationally active banks to tracking, reporting and exposing operational, credit and market risks.