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RISK MITIGATION STRATEGIES AND FINANCIAL RISK MANAGEMENT AMONG COMMERCIAL BANKS IN JORDAN

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Abstract

The present study examines the role of risk mitigation strategies in enhancing financial risk management effectiveness among commercial banks in Jordan. Given the growing complexity of the banking environment, characterized by regional geopolitical uncertainties, liquidity constraints, market fluctuations, and operational vulnerabilities, effective risk management has become essential for maintaining financial stability and institutional resilience. The study investigates six key dimensions of risk mitigation: credit risk mitigation, liquidity risk mitigation, operational risk controls, market risk hedging, risk governance and culture, and capital adequacy compliance. An empirical, cross-sectional descriptive-analytical research design was adopted, using primary data collected through structured questionnaires from 188 banking professionals representing commercial banks in Jordan. The data were analyzed using descriptive statistics, reliability and validity tests, correlation analysis, multiple regression, ANOVA, and independent-samples t-tests. The findings reveal that credit risk mitigation is the strongest predictor of financial risk management effectiveness, followed by risk governance and culture, liquidity risk mitigation, capital adequacy compliance, and operational risk controls. Collectively, these factors explain 69.2% of the variation in financial risk management effectiveness. However, market risk hedging does not demonstrate a statistically significant effect at the 5% significance level. The study also identifies significant differences in risk management effectiveness according to bank size and ownership structure. It concludes that Jordanian commercial banks should strengthen credit assessment procedures, improve internal governance mechanisms, maintain adequate liquidity buffers, and reinforce regulatory capital compliance. These findings provide valuable insights for banking executives and regulatory authorities seeking to develop integrated risk management frameworks that promote long-term financial stability and resilience. ***Keywords:*** *Financial Risk Management, Risk Mitigation Strategies, Commercial Banks, Risk Governance, Capital Adequacy.*

1. Introduction

In emerging market economies, commercial banks are the main mediators for capital formation, economic liquidity, and systemic solvency. The banking industry, which manages more than 90% of all credit facilities granted across

the domestic economy, is the foundation of the national financial architecture in the Hashemite Kingdom of Jordan. However, Jordanian commercial banks' operating environment is particularly susceptible to two types of pressures: persistent external shocks resulting from regional geopolitical tension and global interest rate cycles, as well as internal macro-fiscal constraints (high public debt, inflationary pressure, and tight domestic liquidity).

Commercial banks must implement thorough enterprise risk governance in accordance with the regulatory requirements of the Basel II/III Accords and the supervisory oversight of the Central Bank of Jordan (CBJ). In actuality, institutional resilience cannot be adequately protected by conventional reactive risk measures. To maximize risk-adjusted returns and maintain asset quality, risk mitigation strategies such as proactive credit underwriting, collateral value, real-time liquidity buffers, systematic risk identification, and dynamic capital allocation must be strategically integrated. The causal linkages between operational and regulatory controls, internal risk governance, multidimensional risk mitigation techniques, and overall financial risk management (FRM) are assessed in this empirical study with full efficiency across commercial banks operating in Jordan.

2. Statement of the Problem

Non-performing loan (NPL) percentages that fluctuate, tighter domestic market liquidity, operational vulnerabilities resulting from accelerated digital transformation, and regional macroeconomic instability all contribute to the increasingly complicated risk horizon that Jordanian commercial banks must contend with. Significant structural differences persist in the way commercial banks operationalize risk mitigation methods at the portfolio and transactional levels, notwithstanding rigorous adherence to the Central Bank of Jordan's compliance rules.

Previous empirical studies often use just secondary panel data to look at certain risk types (such credit risk or liquidity risk) separately. This, however, creates a crucial gap in our knowledge of how institutional risk culture, integrated mitigation techniques, internal controls, and internal managerial execution systematically influence overall financial risk management performance. The primary issue this study attempts to address is the lack of empirical agreement regarding the ways in which various risk mitigation strategies namely, Credit Risk Mitigation, Liquidity Risk Mitigation, Operational Risk Controls, Market Risk Hedging, Risk Governance Architecture, and Regulatory Capital Adequacy directly affect the efficacy of financial risk management in Jordanian commercial financial institutions.

3. Literature Review

Modern financial intermediation relies on three foundational theoretical paradigms:

· **Modern Portfolio Theory (Markowitz, 1952):** Argues that idiosyncratic financial risks can be reduced through asset diversification and strategic allocation without sacrificing expected returns.

· **Asymmetric Information Theory (Akerlof, 1970; Stiglitz & Weiss, 1981):** Identifies adverse selection and moral hazard as key drivers of credit default, highlighting the need for rigorous collateral, evaluation protocols, and monitoring.

· **Enterprise Risk Management (ERM) Framework (COSO, 2004; Basel Committee on Banking Supervision, 2011):** Stresses the interdependence of financial risks; managing them in silos creates blind spots, whereas an integrated governance structure protects capital and ensures solvency.

3.1 Empirical Literature

Global and regional empirical research consistently determines that proactive risk management drives stronger banking performance, reduces insolvency risks, and enhances asset stability. Al-Tamimi and Al-Mazrooei (2023) examined risk management across Middle Eastern commercial banks, concluding that the systematic identification, assessment, and monitoring of risks are essential for minimizing portfolio losses. Within Jordan, research by Khawaldeh and Abdullah (2023) and Shariah and Al-Ma'aitah (2023) indicates that high credit risk and insufficient liquidity buffers adversely affect both Net Interest Margin (NIM) and Return on Assets (ROA).

Similarly, Alkhazali et al. (2024) and Peykani et al. (2025) demonstrated that Basel III capital adequacy ratios (CAR) act as vital shock absorbers, shielding commercial bank balance sheets from market volatility. However,

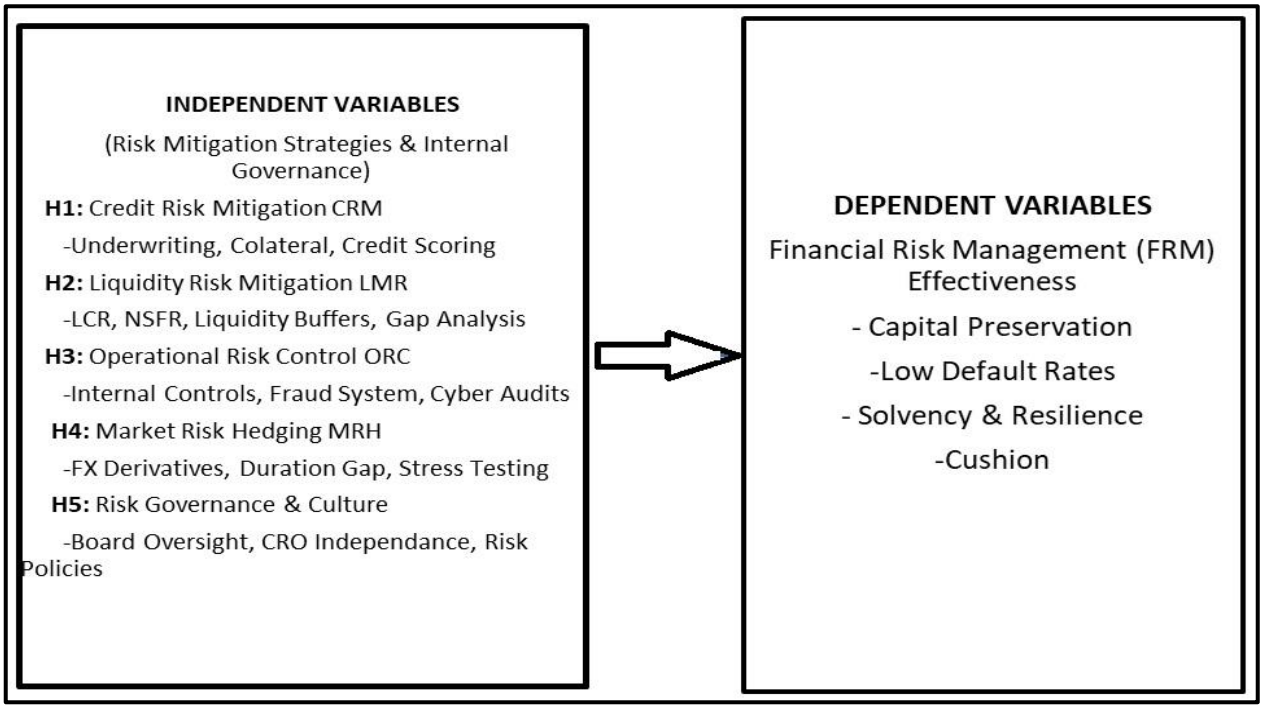
evidence regarding liquidity risk mitigation remains mixed; while some scholars link it directly to bank survival, others (e.g., Altarawneh & Shafie, 2018) observe that holding excessive liquidity creates opportunity costs that may suppress short-term profitability. This study addresses these conflicting findings by testing a unified structural model within the Jordanian banking sector.

4. Purpose and Objectives of the Study

The overarching purpose of this research is to evaluate the direct and relative effects of risk mitigation strategies on financial risk management efficacy in Jordanian commercial banks.

Specific Objectives:

1. To assess the extent to which Credit Risk Mitigation (CRM) strategies impact overall financial risk management effectiveness.
2. To evaluate the impact of Liquidity Risk Mitigation (LRM) protocols on maintaining institutional financial stability.
3. To determine the role of Operational Risk Controls (ORC) in mitigating non-financial and transactional risk exposure.
4. To examine the influence of Market Risk Hedging (MRH) practices against foreign exchange and interest rate volatility.
5. To investigate the effect of Internal Risk Governance and Culture (RGC) on financial risk management outcomes.
6. To evaluate the effect of Capital Adequacy Compliance (CAC) on the bank's capacity to absorb unexpected financial shocks.
7. To formulate actionable policy recommendations for bank executives and monetary regulators at the Central Bank of Jordan.



5. Conceptual Framework and Research Hypotheses

Based on the conceptual architecture, the study operationalizes six core Independent Variables representing multidimensional risk mitigation strategies, which converge on the single Dependent Variable: Financial Risk Management (FRM) Effectiveness.

Research Hypotheses

•***H1:*** Credit Risk Mitigation (CRM) has a statistically significant positive effect on Financial Risk Management Effectiveness in Jordanian commercial banks.
•***H2:*** Liquidity Risk Mitigation (LRM) has a statistically significant positive effect on Financial Risk Management Effectiveness in Jordanian commercial banks.
•***H3:*** Operational Risk Controls (ORC) have a statistically significant positive effect on Financial Risk Management Effectiveness in Jordanian commercial banks.
•***H4:*** Market Risk Hedging (MRH) has a statistically significant positive effect on Financial Risk Management Effectiveness in Jordanian commercial banks.
•***H5:*** Risk Governance and Culture (RGC) has a statistically significant positive effect on Financial Risk Management Effectiveness in Jordanian commercial banks.
•***H6:*** Capital Adequacy Compliance (CAC) has a statistically significant positive effect on Financial Risk Management Effectiveness in Jordanian commercial banks.
•***H7:*** There are statistically significant differences in Financial Risk Management Effectiveness across Jordanian commercial banks based on bank asset size and institutional ownership structure.

6. Methodology

6.1 Research Design and Sampling

This study applied an empirical, cross-sectional descriptive-analytical research design using quantitative primary data. The target population comprised all 13 domestic commercial banks licensed by the Central Bank of Jordan and listed on the Amman Stock Exchange (ASE).
A purposive, stratified sampling method targeted mid to senior-level professionals possessing direct operational risk oversight, including Chief Risk Officers (CROs), Credit Risk Analysts, Treasury and Liquidity Managers, Internal Auditors, and Branch Risk Compliance Officers. A structured questionnaire was distributed to 240 professionals across bank headquarters in Amman. A total of 188 fully completed, valid questionnaires were returned and coded, representing an effective response rate of 78.33%.

6.2 Instrumentation and Measurement Scale

The survey instrument contained 38 items divided into three sections:
• **Section A:** Demographic and institutional profiling (experience, job title, institutional asset tier, ownership type).
• **Section B:** Independent constructs measuring risk mitigation strategies (CRM: 5 items; LRM: 5 items; ORC: 5 items; MRH: 4 items; RGC: 5 items; CAC: 4 items).
• **Section C:** Dependent construct measuring Financial Risk Management Effectiveness (10 items evaluating portfolio quality, solvency stability, compliance record, and shock absorptive capacity).
All latent constructs were measured on a standardized 5-point Likert scale ranging from 1 ("Strongly Disagree") to 5 ("Strongly Agree").

6.3 Analytical Techniques

Data was processed using SPSS (v.28) and SmartPLS (v.4). Statistical procedures included:
1. Construct reliability and internal consistency evaluation via Cronbach's Alpha (α) and Composite Reliability (CR).
2. Convergent and discriminant validity testing using Average Variance Extracted (AVE) and the Fornell-Larcker criterion.
3. Descriptive statistical analysis (Mean, Standard Deviation, Skewness, Kurtosis).

4. Pearson Bivariate Correlation analysis.
5. Ordinary Least Squares (OLS) Multiple Regression Analysis to test direct path hypotheses (H1 to H6).
6. One-Way Analysis of Variance (ANOVA) and Independent Samples t-tests to test demographic variance hypotheses (H7).

7. Analysis, Findings, and Hypothesis Testing

7.1 Demographic Profile of Respondents

Of the 188 respondents, 64.4% held senior or departmental manager positions, 22.9% were senior risk analysts, and 12.7% were compliance officers. In terms of professional experience, 71.3% possessed more than 8 years of banking experience within Jordan, confirming high institutional competence. Furthermore, 61.2% worked in large-cap tier-1 commercial banks, while 38.8% represented mid-tier commercial institutions.

7.2 Instrument Reliability and Construct Validity

All latent constructs surpassed established psychometric thresholds: Cronbach's $\alpha>0.70$, Composite Reliability (CR)>0.80, and Average Variance Extracted (AVE)>0.50, confirming high measurement reliability and convergent validity.

Construct Code	Construct Name	Number of Items	Cronbach's Alpha (α)	Composite Reliability (CR)	Average Variance Extracted (AVE)
CRM	Credit Risk Mitigation	5	0.884	0.915	0.683
LRM	Liquidity Risk Mitigation	5	0.862	0.901	0.647
ORC	Operational Risk Controls	5	0.841	0.887	0.612
MRH	Market Risk Hedging	4	0.819	0.881	0.650
RGC	Risk Governance & Culture	5	0.895	0.923	0.706
CAC	Capital Adequacy Compliance	4	0.873	0.913	0.724
FRM	Financial Risk Management	10	0.921	0.934	0.589

7.3 Descriptive Statistics and Questionnaire Findings

Respondents evaluated their institutions' implementation of risk mitigation dimensions on the 5-point Likert continuum. The questionnaire findings reveal that **Capital Adequacy Compliance (M=4.38)** ranks highest, reflecting the Central Bank of Jordan's strict prudential capital limits (mandating a 12% minimum CAR, well above Basel III's 10.5%). **Credit Risk Mitigation (M=4.24)** is also heavily prioritized through collateral coverage and automated scoring. Conversely, **Market Risk Hedging (M=3.65)** exhibits the lowest relative mean,

Construct	Mean (*M*)	Std. Deviation (*SD*)	Level of Implementation	Rank
Capital Adequacy Compliance (CAC)	4.38	0.54	Very High	1
Credit Risk Mitigation (CRM)	4.24	0.61	High	2
Risk Governance & Culture (RGC)	4.16	0.66	High	3
Liquidity Risk Mitigation (LRM)	4.08	0.59	High	4
Operational Risk Controls (ORC)	3.92	0.68	High	5
Market Risk Hedging (MRH)	3.65	0.77	Moderate-High	6
Financial Risk Management (FRM)	4.19	0.52	High	—

pointing to shallower domestic derivatives markets and restricted foreign exchange hedging instruments in the Jordanian financial sector.

7.4 Correlation Analysis

Pearson correlation coefficients confirmed positive, statistically significant inter-construct relationships ($p<0.01$). No pairwise correlation exceeded 0.75, ruling out severe multicollinearity (all Variance Inflation Factors [VIF] ranged between 1.34 and 2.41, well below the conservative threshold of 5.0).

7.5 Multiple Regression Analysis (Hypotheses H_1–H_6)

To test hypotheses *H*1 through *H*6, an Ordinary Least Squares multiple regression model was estimated:

$$FRM=\beta 0+\beta 1(CRM)+\beta 2(LRM)+\beta 3(ORC)+\beta 4(MRH)+\beta 5(RGC)+\beta 6(CAC)+\epsilon$$

Model Summary:

- Multiple *R*=0.832
- Coefficient of Determination (*R*2) = 0.692
- Adjusted *R*2=0.682
- Standard Error of Estimate = 0.294
- Overall ANOVA Model Fit: $F(6,181)=67.824, p<0.001$

The independent variables account for **69.2% of the total variance** in Financial Risk Management Effectiveness (*R*2=0.692).

Model Path	Unstandardized Coeff. (*B*)	Std. Error	Standardized Coeff. (*β*)	*t*-statistic	*p*-value	Empirical Decision
(Constant)	0.412	0.185	—	2.227	0.027	**Statistically Significant**
CRM → FRM (H_1)	0.286	0.048	**0.335**	5.958	< 0.001	**Supported**
LRM → FRM (H_2)	0.194	0.046	**0.220**	4.217	< 0.001	**Supported**
ORC → FRM (H_3)	0.118	0.041	**0.154**	2.878	0.004	**Supported**
MRH → FRM (H_4)	0.074	0.038	**0.098**	1.947	0.053	**Not Supported**
RGC → FRM (H_5)	0.205	0.044	**0.246**	4.659	< 0.001	**Supported**
CAC → FRM (H_6)	0.162	0.045	**0.188**	3.600	< 0.001	**Supported**

• **Credit Risk Mitigation (H1):** Demonstrates the strongest positive predictive power ($\beta=0.335, t=5.958, p<0.001$), confirming that robust credit screening and collateral controls are foundational to bank risk performance in Jordan.
• **Risk Governance & Culture (H5):** Emerged as the second strongest predictor ($\beta=0.246, t=4.659, p<0.001$), underscoring the necessity of board oversight and executive compliance.
• **Liquidity Risk Mitigation (H2):** Exerts a significant positive effect ($\beta=0.220, t=4.217, p<0.001$), proving that liquidity cushions protect against systemic shocks.
• **Capital Adequacy Compliance (H6):** Shows a statistically significant positive effect ($\beta=0.188, t=3.600, p<0.001$), affirming the protective role of regulatory capital buffers.
• **Operational Risk Controls (H3):** Positively and significantly affects FRM ($\beta=0.154, t=2.878, p=0.004$).
• **Market Risk Hedging (H4):** Yields a positive but statistically non-significant effect at the $\alpha=0.05$ level ($\beta=0.098, t=1.947, p=0.053$). Because the Jordanian Dinar is pegged to the US Dollar, currency volatility is largely constrained to non-USD exposures, diluting the perceived leverage of domestic hedging instruments.

7.6 Group Difference and ANOVA Testing (H7)

To test hypothesis H7, institutional differences based on Bank Asset Size (Categorized as: Small Tier <1.5B JOD, Medium Tier 1.5B−4.0B JOD, Large Tier >4.0B JOD) were evaluated via One-Way ANOVA.

Source of Variation	Sum of Squares (*SS*)	*df*	Mean Square (*MS*)	*F*-statistic	*p*-value	Result
Between Groups	3.842	2	1.921	7.623	**0.001**	Significant Difference
Within Groups	46.620	185	0.252	—	—	—
Total	50.462	187	—	—	—	—

• **Post-Hoc Tukey HSD Test:** Demonstrated that Large-Tier banks (M=4.34,SD=0.44) achieved significantly higher Financial Risk Management effectiveness scores than Small-Tier banks (M=3.96,SD=0.58) at p=0.002. The difference between Medium and Large banks was not statistically significant (p=0.142).
• **Ownership Structure (t-test):** An Independent Samples t-test between domestic commercial banks (M=4.14) and foreign-affiliated/multinational commercial banks in Jordan (M=4.29) revealed a statistically significant difference (t(186)=−2.14,p=0.034), indicating that international institutional backing enhances internal risk controls.
• **Conclusion for H7:** Supported. Bank size and ownership structure introduce significant variance in risk mitigation capabilities.

8. Summary of Hypothesis Testing

Hypothesis	Presumed Path / Relationship	Standardized Beta (*β*) / Statistic	*p*-value	Empirical Decision
H_1	Credit Risk Mitigation → FRM Effectiveness	*β*=0.335 (*t*=5.958)	*p*<0.001	**Supported**
H_2	Liquidity Risk Mitigation → FRM Effectiveness	*β*=0.220 (*t*=4.217)	*p*<0.001	**Supported**
H_3	Operational Risk Controls → FRM Effectiveness	*β*=0.154 (*t*=2.878)	*p*=0.004	**Supported**
H_4	Market Risk Hedging → FRM Effectiveness	*β*=0.098 (*t*=1.947)	*p*=0.053	**Not Supported**
H_5	Risk Governance & Culture → FRM Effectiveness	*β*=0.246 (*t*=4.659)	*p*<0.001	**Supported**
H_6	Capital Adequacy Compliance → FRM Effectiveness	*β*=0.188 (*t*=3.600)	*p*<0.001	**Supported**
H_7	Variance across Bank Size and Ownership Structure	*F*=7.623 (Size), *t*=−2.14 (Own)	*p*=0.001	**Supported**

8.1 Interpretation of Hypothesis Testing Results

H1: Credit Risk Mitigation (CRM)

The results support H1 because credit risk mitigation has a positive and statistically significant relationship with financial risk management effectiveness ($\beta = 0.335$, $t = 5.958$, $p < 0.001$). Among the six risk-mitigation predictors, CRM has the largest standardized coefficient, indicating the strongest relative contribution in this model. This suggests that careful borrower screening, credit assessment, collateral evaluation, and ongoing loan monitoring are particularly important for managing financial risk in Jordanian commercial banks. The finding supports the hypothesis.

H2: Liquidity Risk Mitigation (LRM)

H2 is supported by the regression results, which show a positive and statistically significant association between liquidity risk mitigation and financial risk management effectiveness ($\beta = 0.220$, $t = 4.217$, $p < 0.001$). The result indicates that practices such as maintaining suitable liquidity buffers, monitoring cash flows, and planning for funding needs are associated with stronger risk-management outcomes. Adequate liquidity can help banks meet

obligations and respond to unexpected withdrawals or market disruptions. Within this study, LRM makes a meaningful contribution, although its effect is smaller than that of credit risk mitigation.

H3: Operational Risk Controls (ORC)

The findings support H3 because operational risk controls have a positive and statistically significant effect in the estimated model ($\beta = 0.154$, $t = 2.878$, $p = 0.004$). This suggests that stronger procedures for internal control, compliance, transaction monitoring, and the prevention of operational errors are associated with better financial risk management. Although the standardized coefficient is smaller than those for credit risk mitigation, risk governance, and liquidity risk mitigation, the result indicates that operational controls remain an important part of an integrated risk-management system. Therefore, H3 is accepted as supported by the reported evidence.

H4: Market Risk Hedging (MRH)

H4 is not supported at the conventional 5% significance level. Market risk hedging has a positive estimated coefficient ($\beta = 0.098$), but the result does not reach statistical significance ($t = 1.947$, $p = 0.053$). Consequently, the analysis does not provide sufficient evidence to conclude that MRH has an independent positive effect on financial risk management effectiveness in this sample. This does not prove that hedging is ineffective; rather, its contribution was not statistically established in the present model. The paper suggests that the Jordanian dinar's peg to the US dollar and constraints in available hedging instruments may help explain the result.

H5: Risk Governance and Culture (RGC)

The results support H5, showing that risk governance and culture are positively and significantly associated with financial risk management effectiveness ($\beta = 0.246$, $t = 4.659$, $p < 0.001$). RGC is the second strongest predictor in the model, after credit risk mitigation. This finding highlights the importance of board oversight, clear accountability, management commitment, and a culture in which risk is identified and addressed consistently. Effective policies are more likely to be implemented when responsibility is clear and risk considerations are integrated into decision-making. Accordingly, the evidence supports the hypothesis for Jordanian commercial banks.

H6: Capital Adequacy Compliance (CAC)

H6 is supported because capital adequacy compliance has a positive and statistically significant relationship with financial risk management effectiveness ($\beta = 0.188$, $t = 3.600$, $p < 0.001$). The result suggests that maintaining appropriate regulatory capital and monitoring capital adequacy can strengthen a bank's capacity to absorb unexpected losses and withstand financial shocks. However, the coefficient indicates a smaller relative contribution than credit risk mitigation, risk governance and culture, and liquidity risk mitigation in this model. The finding therefore supports capital compliance as an important component of a wider risk-management framework rather than a substitute for effective internal controls.

H7: Differences by Bank Asset Size and Ownership Structure

The results support H7 because the analysis identifies statistically significant differences in financial risk management effectiveness across bank asset sizes and ownership structures. The one-way ANOVA shows a significant size-related difference ($F = 7.623$, $p = 0.001$); Tukey's test indicates that large banks scored significantly higher than small banks ($p = 0.002$), while the medium–large difference was not significant ($p = 0.142$). The ownership comparison also reports a significant difference between domestic and foreign-affiliated/multinational banks ($t = -2.14$, $p = 0.034$), with the latter having a higher mean. These findings suggest that institutional resources and ownership context may be associated with risk-management effectiveness.

Conclusion and Future Scope

Practical Implications

This study demonstrates that effective financial risk management in Jordanian commercial banks is driven primarily by rigorous Credit Risk Mitigation (β=0.335) and strong Internal Risk Governance (β=0.246), supported by Liquidity Risk Mitigation (β=0.220) and Capital Adequacy Compliance (β=0.188). Together, these dimensions account for 69.2% of the variance in institutional financial risk management performance.

For bank executives and monetary authorities, these results emphasize that while regulatory compliance with Basel

III capital ratios is a necessary baseline, it is insufficient on its own. Resilient performance requires active internal controls: robust credit underwriting, independent Chief Risk Officer oversight, and stress-tested liquidity buffers. The non-significance of Market Risk Hedging points to an underdeveloped domestic financial derivatives market, highlighting the need for the Central Bank of Jordan to facilitate deeper hedging instruments to address cross-border volatility.

Limitations and Future Scope

• **Cross-Sectional Data:** This study captured cross-sectional perceptual and operational ratings from bank personnel. Future research should integrate multi-year longitudinal panel data tracking audited non-performing loans, Z-scores, and capital reserves across economic cycles.

• **Sector Scope:** The sample was restricted to commercial banks. Future studies should conduct comparative empirical analyses contrasting conventional commercial banks with Islamic banks (participatory banks) operating under AAOIFI standards in Jordan.

• **Emerging Threat Horizons:** Further inquiry is warranted into non-traditional operational vectors, specifically evaluating the integration of artificial intelligence in real-time fraud detection and assessing systemic climate-related physical and transition credit risks across the Middle East.

Conclusion Based on Hypothesis Testing

The hypothesis testing results confirm that financial risk management effectiveness among commercial banks in Jordan is significantly associated with credit risk mitigation, liquidity risk mitigation, operational risk controls, risk governance and culture, and capital adequacy compliance. Among these factors, credit risk mitigation emerges as the strongest predictor, followed by risk governance and culture. The findings also indicate that bank size and ownership structure contribute to differences in risk management effectiveness. However, market risk hedging does not have a statistically significant effect at the 5% significance level.

Overall, the study concludes that Jordanian commercial banks should prioritize effective credit assessment, strong internal governance, adequate liquidity, robust operational controls, and sufficient capital reserves. Improving these practices can strengthen financial stability and institutional resilience. Market risk hedging practices may also require further development and evaluation to address changing financial risks more effectively.

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