

RISK MANAGEMENT

The Group's risk management approach is supported by a sound and robust Enterprise Risk Management Framework (Framework), which is continuously enhanced to remain relevant and resilient against the background of a versatile risk landscape and evolving industry practices. The Framework involves an on-going process of identifying, evaluating, monitoring, managing and reporting significant risks affecting the achievement of the Group's business objectives. It provides the Board and the management with a tool to anticipate and manage both the existing and potential risks, taking into consideration the changing risk profiles as dictated by changes in business and the regulatory environment, the Group's strategies and functional activities throughout the year.

The Framework forms part of the Group's culture and is embedded into its business processes and practices. The Framework is targeted towards achieving the Group's objectives and is divided into four categories:



RISK MANAGEMENT (CONTINUED)

RISK MANAGEMENT GOVERNANCE

In line with the Framework, three lines of defence in managing risks are adopted within the Group. The following diagram summarises the responsibility and accountability of the various parties involved in the risk management governance of the Group.

Board of Directors (BOD or “the Board”)

- sets the overall strategic direction for the Group.
- provides oversight to ensure that the management has the appropriate risk management system and practices to manage risks associated with the Group’s operations and activities.
- sets risk appetite and tolerance levels that are consistent with the Group’s overall business objectives and desired risk profile.
- reviews and approves all significant risk management policies and risk exposures.

Board Risk Committee (BRC)

- assists the Board in the development of strategies, policies and infrastructure to manage the Group’s risks and ensure that there is effective oversight.

President/Chief Executive Officer (CEO)

supported by management committees which address the key risks identified

Management Executive Committee (MEC)

Asset Liability Committee (ALCO)

The Committees, comprising management are chaired by the CEO and undertake the following:

- oversight function for overall risk limits and capital allocation, aligning them to the risk appetite set by the Board.
- implementation of policies laid down by the Board and ensuring that there are adequate and effective operational procedures, internal controls and systems to support these policies.

First Line of Defence Business and Support Units

Second Line of Defence Risk Management & Compliance Division (RMD)

Third Line of Defence Internal Audit Department (IAD)

- primary responsibility of identifying, mitigating and managing risks within their lines of business.
- ensure day-to-day activities are carried out within the established risk and compliance policies, procedures and limits.
- independently assess risk exposures and the coordination of risk management on an enterprise-wide basis.
- ensure that risk management and compliance policies are implemented accordingly.
- ensure compliance with the applicable laws and regulations.
- the IAD being the third line of defence is responsible for independently reviewing the adequacy and effectiveness of risk management processes, system of internal controls and conformity with risk and compliance policies.

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Management has identified and managed the following key risks that could prevent the Group from achieving its objectives:

Type of Risk	Definition and Management
Strategic Risk	<p>Strategic risk is the risk of not achieving the Group's corporate strategy and goals. This may be caused by internal factors such as deficiency in performance planning, execution and monitoring as well as external factors such as changes in the market environment.</p> <p>Strategic risk management is addressed by the Board's involvement in the setting of the Group's strategic goals. The Board is regularly updated on matters affecting corporate strategy implementation and corporate direction.</p>
Credit Risk	<p>Credit risk is defined as the potential financial loss arising from the failure of a borrower or counterparty to fulfil its financial or contractual obligations. Credit risk within the Group arises from Purchase with Recourse (PWR) and Purchase without Recourse (PWOR) business, mortgage guarantee programmes, investments and treasury hedging activities.</p> <p>The primary objective of credit risk management is to proactively manage credit risk and limits to ensure that all exposures to credit risks are kept within parameters approved by the Board. Investment activities are guided by internal credit policies and guidelines that are approved by the Board. Specific procedures for managing credit risk are determined at the business level based on the risk environment and business goals.</p>
Market Risk	<p>Market risk is defined as the potential loss arising from movements of market prices and rates. Within the Group, market risk exposure is limited to interest rate risk and foreign exchange risk as the Group does not engage in any equity or commodity trading activities.</p> <p>The Group manages market risk by imposing threshold limits and entering into derivative hedge contracts. The limits are set based on the Group's risk appetite and risk-return considerations. These limits are regularly reviewed and monitored. The Group has an Asset Liability Management System which provides tools such as duration gap analysis, interest/profit sensitivity analysis and income simulations under different scenarios to assist in managing and monitoring the interest/profit rate risk.</p> <p>The Group also uses derivative instruments such as interest rate swaps, profit rate swaps, cross currency swaps and Islamic cross currency swaps to manage and hedge its market risk exposure against fluctuations in interest rates, profit rates and foreign currency exchange rates.</p>
Liquidity Risk	<p>Liquidity risk arises when the Group does not have sufficient funds to meet its financial obligations as and when they fall due.</p> <p>The Group manages liquidity risk by adhering to a strict match-funding policy whereby all asset purchases are funded by bonds of closely matched size and duration and are self-sufficient in terms of cash flow. A forward looking liquidity mechanism is in place to promote efficient and effective cash flow management while avoiding excessive concentrations of funding. The Group plans its cash flow and monitors closely every business transaction to ensure that available funds are sufficient to meet business requirements at all times. Reserve liquidity, which comprises marketable debt securities, is also set aside to meet any unexpected shortfall in cash flow or adverse economic conditions in the financial markets.</p>

RISK MANAGEMENT (CONTINUED)

Type of Risk	Definition and Management
Operational Risk	<p>Operational risk is the potential loss resulting from inadequate or failed internal processes, people and systems, or from external events. Each business or support unit undertakes self-assessment of its own risk and control environment to identify, assess and manage its operational risks. The Group has established comprehensive internal controls, systems and procedures which are subject to regular reviews by both internal and external auditors.</p> <p>Exposure to operational risk also entails the management of the following risk categories:</p> <ul style="list-style-type: none"> • Technology Risk: Technology Risk management involves structured and consistent risk assessment pertaining to technology and cyber security risks. The Group has embedded sound governance and effective management of technology risk which encompass strong information technology (IT) security, reliability, resiliency and recoverability to address technology risk elements such as availability, accuracy, accessibility and agility. • Business Disruption Risk: The Group has a robust Business Continuity Management (BCM) program to minimise the impact and likelihood of any unexpected disruptions to its business operations through implementation of its BCM framework and policy, business continuity plans and regular BCM exercises. The Group has also identified enterprise-wide recovery strategies to expedite business and technology recovery and resumption during catastrophic events.
Reputational Risk	<p>The Group's reputation and image as perceived by clients, investors, regulators and the general public is of utmost importance to the continued growth and success of the Group's businesses and operations. Invariably, reputational risk is dependent on the nature/model of business, selection of clients and counterparties and reliability and effectiveness of business processes.</p> <p>Stringent screening of potential clients and the design of business practices in accordance with high standards and regulatory compliance have been incorporated to safeguard the Group's business reputation and image.</p>
Shariah Non-Compliance Risk	<p>The risk of legal or regulatory sanctions, financial loss or non-financial implications including reputational damage, which the Group may suffer arising from the failure to comply with the rulings of the Shariah Advisory Council of regulatory bodies (SACs), standards on Shariah matters issued by Bank Negara Malaysia (BNM) or advice of the Shariah Advisors that are consistent with the rulings of the SACs.</p> <p>The Group consults and obtains endorsements/clearance from an independent Shariah Advisor for all its Islamic products and transactions to ensure compliance with relevant Shariah requirements. In addition, the Group obtains the approval of the Shariah Advisory Councils of BNM and Securities Commission of Malaysia (SC) for its Islamic products.</p> <p>Periodic Shariah Compliance Reviews and annual internal audits are performed to verify that Islamic operations conducted by the business units are in compliance with the decisions endorsed by the Shariah Advisor. Any incidences of Shariah non-compliance are reported to the Shariah Advisor, Group Board Audit Committee, BRC and Board.</p>

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KEY HIGHLIGHTS

In light of the changing business backdrop, RMD had put in place the following initiatives during the year 2019 to strengthen risk resilience and to support the Group's objectives:

1. Strengthening risk culture to reinforce risk framework.
 - The Group believes that a strong risk culture is an essential building block for effective risk governance. In order to inculcate the right risk culture of employees at all levels of business and activities within the Group, employees are encouraged to undertake continuous learning and communicate issues on a timely basis.
 - Several risk and BCM workshops as well as awareness sessions by external risk experts were conducted for management and staff in order to elevate the awareness and knowledge on risk matters and BCM.
 - RMD engaged relevant stakeholders to review BNM's and SC's framework/policies and conducted impact assessment on gaps, if any, relevant to the Group, hence ensuring alignment with industry best practices. The frameworks/policies reviewed include SC's Guiding Principles on Business Continuity, BNM's Risk Management in Technology, BNM's Shariah Governance and Companies Amendment Act 2019.
2. Ensuring the Group's portfolios are aligned with the risk appetite and strategies.
 - The risk appetite is a critical component that enables the Board and management to communicate, understand and assess risks that the Group is willing to accept in pursuit of its strategies. The Risk Appetite Statement is reviewed on an annual basis taking into consideration, all material risks and future business activities as part of the annual Internal Capital Adequacy Assessment Process.
 - RMD had provided advisory input in Cagamas' justification for preferential treatment in the Net Stable Funding Ratio (NSFR) liquidity guidelines. The final NSFR guidelines accorded an improved Available Stable Funding (ASF) factor of 60% for funding from non-financial entities with a residual maturity of less than one year where previously the ASF factor was 50%.
 - RMD has continuously ensured that business initiatives are aligned with the risk appetite by providing independent assessment and risk input for new and additional credit limits as well as new business proposals.
3. Enhancing risk management governance, controls and processes.
 - Risk management policies, methodologies and processes were continuously enhanced to be in line with industry best practices and regulatory requirements. RMD had undertaken independent review of policies and processes in line with requirements of BNM's Credit Policy with no major gaps identified.
 - A newly developed Business Continuity Management (BCM) Framework and Policy was established to provide an effective and structured methodology to enhance business resilience and recovery capability to withstand any adverse events encountered by the Group.
 - As part of the continuous improvement process, the stress test approach was enhanced to incorporate a higher level of granularity whilst the Credit Concentration Risk computation was revamped to include Herfindahl Hirschman Index (HHI) and Population Stability Index (PSI) methodologies.
 - The Compliance Department was restructured to report directly to the Senior Vice President of Risk Management and Compliance Division in line with best practices to preserve the independence of the compliance function.
 - The Group will continue to capitalize on the new Loan Administration System for timely monitoring and reporting. The immediate availability of data for analysis will facilitate timely detection, resulting in the prompt resolution of issues.
 - Technological evolution requires constant adoption of new technology and cyber risk management strategies to address emerging cyber threats. As the Group embraces the advancement of technology in the day-to-day operations, the exposure to IT risk has also increased rapidly. Hence, the organisation strives to fortify its cyber defence and resilience through enhancement of its IT risk management framework, policy and controls.