

# Risk Management

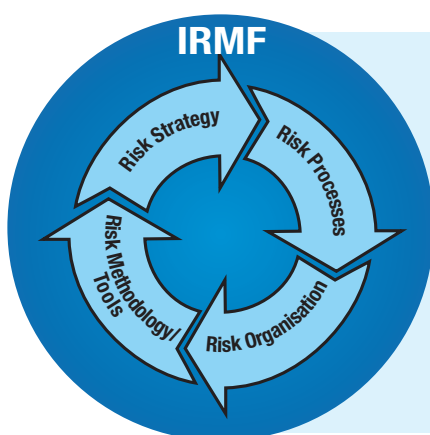
## Risk Management Philosophy

- Strong risk management culture to ensure returns that commensurate with our financing and risk taking activities.
- Proactive management of risk exposures within our risk appetite by constantly fine tuning our risk management approaches in line with the changing financial landscape.

## Integrated Risk Management Framework

The Group's Integrated Risk Management Framework (IRMF) sets the fundamental elements to manage business and financial risks on an integrated group-wide basis.

The IRMF supports a programme of action that is consistent with industry's best practices to better position the Group to deal with economic and business challenges. The main thrusts of the IRMF are:



- Consistent risk frameworks, policies and measurements for each type of risk, across all lines of business i.e. enterprise-wide risk management.
- Effective integration of risk policies and processes into business decision-making.
- Integration of risk strategy, risk organisation, risk processes and risk methodology/tools.

## Risk Governance Framework



## Risk Management (cont'd)

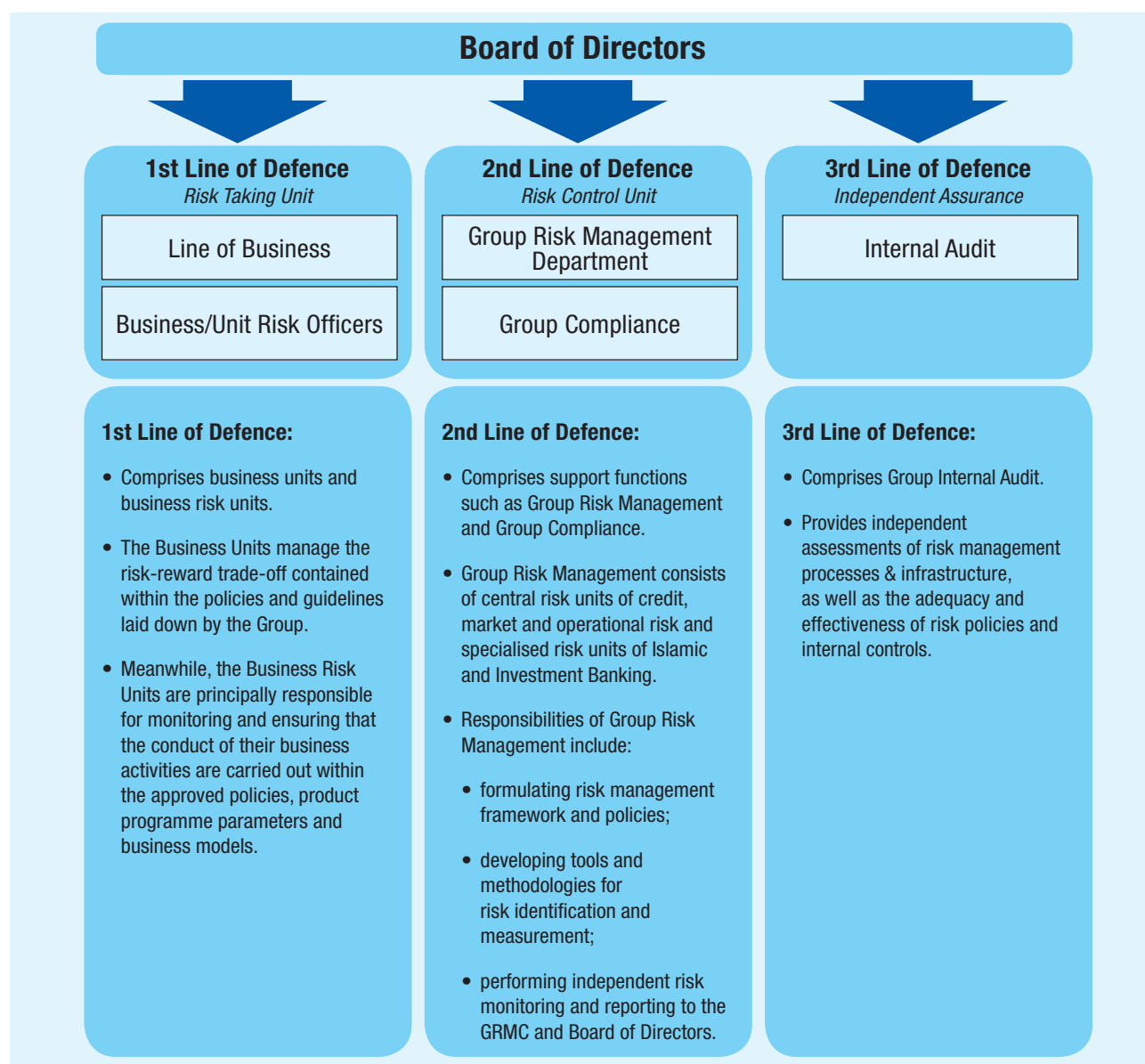
The Board of Directors, through the Group Risk Management Committee (GRMC), is responsible for the overall risk oversight. This includes reviewing and approving risk management policies, risk appetite, risk exposures and limits, whilst ensuring the necessary infrastructure and resources are in place.

GRMC is supported by specialised risk committees and risk working groups to manage credit, market, liquidity, operational risks and other key risks:

- Credit Risk Working Group
- Group Assets & Liabilities Management Committee
- Group Operational Risk Management Committee
- Product Working Group

Business units and risk management units are represented at the respective committees/working groups, to reflect the joint ownership of business and risk management responsibilities by both the risk takers and risk managers.

## Three Lines of Defence



## Capital Management

### Basel II, Pillar 1 – Capital Computation

The Group has adopted the following computational approval for capital requirements under Pillar 1 of Bank Negara Malaysia's (BNM) guidelines:

- Risk Weighted Capital Adequacy Framework for conventional banks;
- BNM Capital Adequacy Framework for Islamic Banks for Islamic banks.

Risk Category	Approach
Credit Risk	Standardised Approach
Market Risk	Standardised Approach
Operational Risk	Basic Indicator Approach

### Basel II, Pillar 2 – Internal Capital Adequacy Assessment Process (ICAAP)

In accordance with BNM's implementation of the Pillar 2 guidelines – Internal Capital Adequacy Assessment Process (ICAAP), the Group had initiated its capital management planning process. The Group had established its Capital Management Framework which covers three dimensions i.e. strategy, process and infrastructure. The objective is to ensure that the Group is adequately capitalised. The Group promotes efficient use of capital by aligning business strategy, risk appetite and expected returns with capital requirements.

In addition, the Group had formalised its Risk Appetite Statement which aims to promote balanced, sustainable growth whilst balancing the risk-reward trade-off. The Group's Risk Appetite Statement expresses the quantum of risks that the Group is willing to accept within its overall strategy. The focus areas are Strategic and Reputational Risks with core components on capital adequacy, liquidity, earnings volatility and asset quality.

### Basel II, Pillar 3 – Disclosure Requirements

Meanwhile, Pillar 3 of Basel II requires banks to provide consistent and comprehensive disclosures for risk management practices, to improve transparency in the financial markets and enhance market discipline. This is in place since March 2011. Please refer to the Basel II Pillar 3 Disclosure on page 207.

### Basel III

At the end of 2011, BNM had issued guidelines on the Implementation of Basel III. BNM's guidelines were broadly in line with Basel standards issued earlier in December 2010. Generally, the implementation of the Basel III guidelines aims to strengthen the capital components of the banking institution in order for them to be more resilient to financial stress. The primary recommendations of Basel III include:

- Higher minimum common equity and Tier-1 capital
- Capital conservation and counter-cyclical buffer
- Leverage ratio
- Phasing out of certain capital instruments

The regulators have given these additional requirements, in addition to Basel II, a phased-in transitional period of eight years from 2011 and full adoption in 2019. With regard to the proposed phased de-recognition of Hybrid Tier-1 capital instruments, the Group does not expect to be impacted as it does not have such instruments. The Group had put in place processes to monitor the additional capital requirements and Basel III liquidity ratios to ensure smooth transition when these ratios are subsequently implemented by BNM.

### Stress Testing

The Group carries out stress tests to estimate the potential impact of extreme events on the Group's earnings, balance sheet and capital. These stress tests also aim to gauge our sensitivity and vulnerability to a sector, customer segment or product segment.

The Group has a stress testing framework which is applied to identify:

- Potential vulnerable risk areas of the Group's portfolio to stress events. It examines an alternative future that could cause problems to the Group's portfolio, thus enabling the Group to assess the potential worst case scenarios and to be prepared to face such challenges; and
- Possible events or future changes in financial and economic conditions that could have unfavourable effects on the Group's ability to withstand such changes (particularly in relation to the Group's capital and earnings capacity to absorb potentially significant losses), thus enabling the Group to take steps to manage these risks and conserve capital.

The Stress Test Working Group comprises representatives from Group Risk, Business Risk, Group Finance and the Lines of Business. The stress test parameters are formulated internally, taking into account the economic scenario, plus current and forecasted key indicators over a rolling one year period. The scenario, parameters and eventual stress test results are presented to the Stress Test Working Group and to the GRMC and Board for concurrence and approval respectively.

## Risk Management (cont'd)

Stress tests are conducted on specific areas, line of business, entity and group level to identify potential vulnerabilities brought about by the events/scenarios identified. The results, including impact on earnings and capital of the respective entities and group are analysed and reported to the Stress Test Working Group, GRMC/Board and BNM. Where necessary, proactive action is taken to address weakness or vulnerability in the portfolio.

### Credit Risk Management

#### *Risk Definition:*

Credit risk arises from the risk of financial loss as a result of the failure of a customer or counter-party to discharge his contractual obligations. The Group's credit risk exposures arise primarily from its lending, investment and trading activities.

#### *Credit Risk Management:*

The Credit Risk Management Framework defines core policies to be adopted by the credit granting programmes, products and business models. The core policies, together with business level policies, require that the Group underwrites risks that are within our risk appetite. Regular credit reviews and business-specific early warning frameworks ensure early detection of an imminent problem, thereby improving the chances of remedial action or recovery.

In the Group's Credit Risk Management, internal credit rating scorecards/models or external credit rating are used as credit evaluation tools to underwrite loans and invest in debt securities as well as other credit processes. The scorecards and models are validated regularly to ensure robustness and relevancy.

Business Risk Units monitor and report credit portfolio quality to the Credit Risk Working Group and GRMC regularly. Such reporting enables the identification of adverse credit trends, allowing corrective measures, and re-alignment of risk strategies when necessary.

Functionally, Group Credit Risk Management is responsible for managing credit risk, involving the following roles:

- formulate group-wide credit risk policies;
- formulate risk control limits;
- portfolio risk monitoring;
- develop risk measurement methodology;
- monitor and report credit exposures.

The Group is a firm believer in building and enhancing the risk frameworks and measurement tools to improve the capability of managing credit risk. For example, the Group had rolled-out the enhanced credit risk rating model/system for Wholesale Banking. Besides that, the Group had established the Model Development Framework which governs the model development process for credit rating models. There is also close engagement between business units, business risk managers and credit underwriters for better alignment of credit policy changes and execution.

### Market Risk Management

#### *Risk Definition:*

Market Risk is the risk of loss of earnings arising from changes in interest rates, foreign exchange rates, equity prices, commodity prices and in their implied volatilities.

Liquidity Risk takes two forms: funding liquidity risk and market liquidity risk. Funding liquidity risk could arise if the Group is unable to meet financial commitments when due. Market liquidity risk arises if the Group is unable to unwind or offset its position in the market within a short span of time, at or near the previous market price, because of inadequate market depth or disruptions to the marketplace.

#### *Market Risk Management:*

The Market Risk Management Framework outlines the core policies and methodologies in managing market and liquidity risks. The framework integrates the Group's internal policies with best practices and relevant regulatory requirements. It is supplemented by product specific policies that define the risk limits and parameters for the product plus administrative procedures to handle and report exceptions, risk monitoring and reporting.

Market risk, in the Banking Book, is supervised primarily by the Group Assets & Liabilities Management Committee and executed through Financial Markets whereas market risk in the Trading Book is managed primarily by Financial Markets based on policies and limits approved by the GRMC/Board.



The bulk of the Group's treasury positions are held under the Banking Book, which predominantly consists of Government bonds with a smaller proportion of corporate bonds. The Trading Book is relatively small, comprising mainly foreign exchange instruments, which are primarily entered into to meet the needs of our wealth management, commercial and corporate customers. The Bank also engages in proprietary trading of bonds and interest rate swaps. These activities are governed by risk limits such as cash limits, sensitivity limits, loss limits and Value-at-Risk.

While the Group offers share financing, stockbroking and unit trust management services to our retail customers, the treasury arm did not undertake proprietary trading of equities and commodities during the financial year ended 31 March 2012.

Group Market Risk Management undertakes the following support roles:

- Formulating and reviewing the Group's market risk and asset liability management frameworks and policies in accordance with the Group's business direction and revised regulatory requirements. This includes developing appropriate risk measures and associated risk limits to manage market and liquidity risks.
- Carrying out independent monitoring of treasury activities on a daily basis, including reporting and escalation of exceptions and scheduled reporting of market and liquidity exposures to senior management and Board of Directors.
- Providing independent market-to-market valuation of treasury positions and risk exposures, using rates obtained from various sources, such as independent market price/information providers.
- Reviewing new product proposal papers (in conjunction with other risk management units) to assess the market and liquidity risks prior to launching new products.
- Providing integrated risk management support activities in conjunction with other Risk Management functions and participating with other departments on joint assignments and projects involving market risk, liquidity risk and asset-liability management and stress testing exercises.

To assist in the management of market and liquidity risks, the Group has invested and established the following risk infrastructure, systems and tools and methodologies:

Risk Exposures	Application System	Tools / Methodologies
Trading Book	Middle Office Module Treasury System 	<ul style="list-style-type: none"> <li>• Notional limits</li> <li>• Sensitivity limit (Price Value of a Basis Point)</li> <li>• Value-at-Risk</li> <li>• Stress testing</li> <li>• Back testing</li> </ul>
Banking Book	Assets & Liabilities Management System 	<ul style="list-style-type: none"> <li>• Repricing gap analysis</li> <li>• Net interest income simulation</li> <li>• Economic value of equity</li> <li>• Liquidity gap analysis</li> <li>• Liquidity ratios &amp; benchmarks</li> <li>• Liquidity stress test</li> <li>• Contingency funding plan</li> </ul>

For the year under review, the Group had implemented the following initiatives:

- Parallel monitoring and reporting of Basel III new capital and liquidity standards in readiness of BNM's implementation of the Basel III guidelines;
- Establishing the internal capital adequacy process inclusive of the Capital Management Framework and Risk Appetite Statement.

## Operational Risk Management

### Risk Definition:

Operational risk is the risk of direct or indirect loss resulting from inadequate or failed internal processes, people and systems or from external events.

### Operational Risk Management:

Management, escalation and reporting processes are instituted through various management committees such as the Group Operational Risk Management Committee and Group Risk Management Committee as well as the Board. The responsibilities of the committees and Board include the following:

- Oversight and implementation of the Operational Risk Management Frameworks;
- Regular review of operational risks reports and profiles;
- Address operational risk issues;
- Ensure compliance with regulatory and internal requirements including disclosures.

The Group has adopted the following guiding principles for operational risk management:

- Sound risk management practices as outlined in the ORM Framework, which is in accordance with Basel II and regulatory guidelines; (For Islamic Banking, a separate ORM Framework has been adopted to ensure compliance with the Islamic Financial Services Board and relevant regulatory bodies.)
- Board and Senior Management oversight;
- Defined responsibilities for all staff;
- Established operational risk methodologies and processes applied in the identification, assessment, measurement, control and monitor of risks;
- Regular dashboard reports submitted to Senior Management and GRMC;
- Continuous cultivation of an organisational culture that places great emphasis on effective operational risk management and adherence to sound operating controls.

## Risk Management (cont'd)

In line with the best practices for management of operational risks, we employ several tools applicable across the Group, such as:

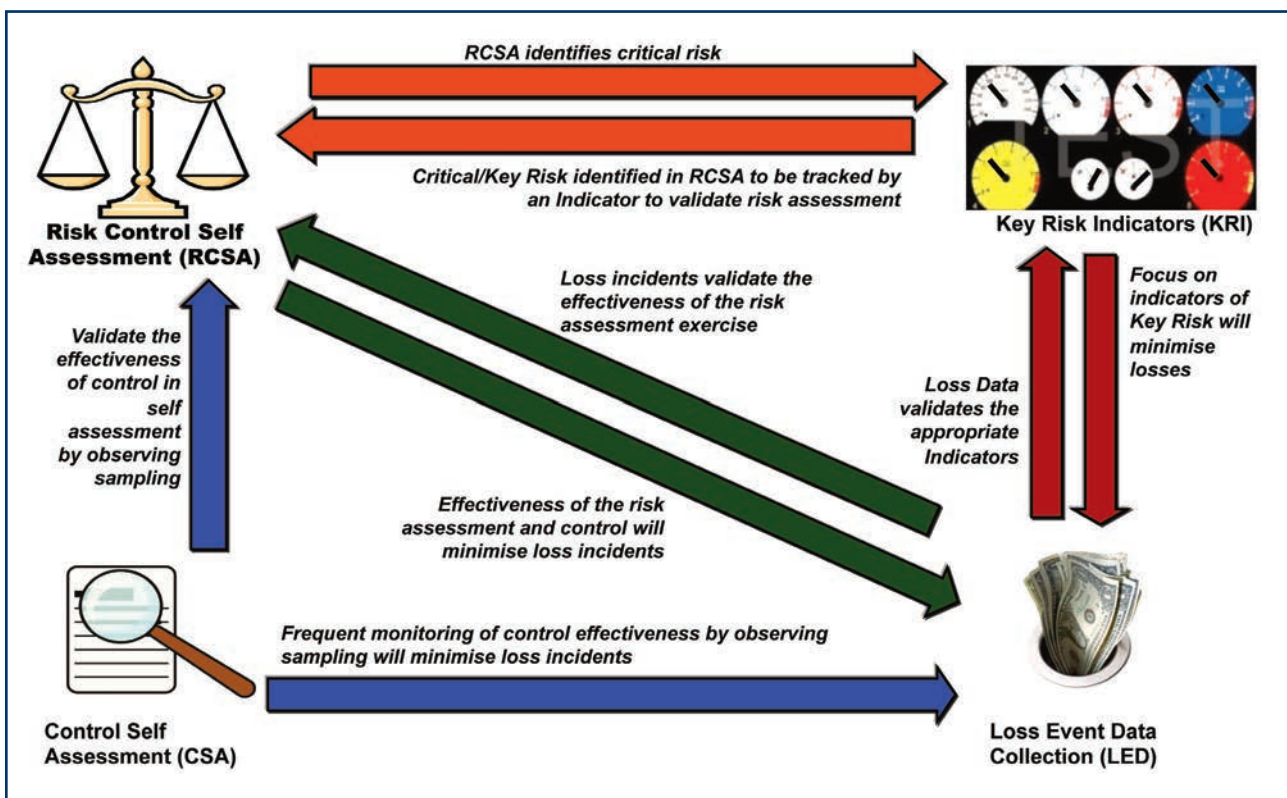
- Risk and Control Self Assessment
- Control Self Assessment
- Key Risk Indicators
- Loss Event Data Collection

The Group also ensures that the operational risk awareness programme is conducted on an on-going basis. The training programme includes emphasis on business continuity planning. Meanwhile, scheduled business continuity and disaster recovery exercises are conducted at periodic intervals.

Internal audit plays its part in ensuring an independent assurance of the implementation of the Framework through their regular audit reviews and reports to the Group Audit Committee.

In the past year, the Group had reviewed internal processes, operational tools and indicators to foster improvements in process and risk mitigation techniques. In addition, the approval process for new products was improved to expedite the approval process whilst balancing risk management.

The illustration below summarises how the operational risk tools complement one another.





## Islamic Risk Management

### **Risk Definition:**

Shariah Compliance risk arises from the risk of failure to comply with Shariah rules and principles determined by the relevant Shariah advisory councils. The Shariah compliance in the Islamic banking activities, *inter alia*, includes prohibition of *Riba* (interest), *Gharar* (uncertainty) and *Maisir* (gambling).

### **Islamic Risk Management:**

Islamic Risk Management focuses on managing Operational and Shariah Compliance Risk, besides managing the credit and market risks in Islamic Banking operations.

Under the Group's Islamic Operational Risk Management Framework, including Shariah Governance Framework, the Group applies several key measures, *inter alia*:

- Adopting sound risk management practices in accordance with the Islamic Financial Services Board, and other relevant regulatory guidelines;
- Providing continuous Board and Senior Management oversight;
- Emplacing qualified Shariah Committee members with capabilities to deliberate on Shariah issues and provide sound Shariah decisions;
- Ensuring at least one representative from the Shariah Committee in the Board of Directors;
- Ensuring that the Group complies with Shariah principles in relation to existing and new products, services and business activities at all times, by having adequate mechanisms and processes;
- Establishing clear lines of roles and responsibilities;
- Providing timely management reports;
- Fostering a risk awareness culture through on-going staff training;

- Deploying the Shariah Review and Audit Team to conduct independent Shariah reviews regularly at various business lines and reporting their findings to the Shariah Committee and Board. The functions cover, amongst others, training, research and regular assessment on Shariah compliance in the activities and operations of the Group;
- Reporting Shariah non-compliant incidents and issues to the Shariah Committee and the Board. Any rectification should only be carried out in consultation with the Shariah Committee and any non-compliant income discovered during the review exercise will be channeled to charities.

For the past year, concerted efforts were taken to improve the Shariah review process to ensure compliance to Shariah principles and requirements. In addition, the Group had commenced the tracking of Shariah non-compliances data via the ORM system in line with the risk assessment process for ICAAP. Regular training on Shariah-related concepts and risk issues is conducted to heighten the risk awareness within the Group.