

SEANZA
FORUM OF BANK SUPERVISORS

December 06- 09 2011

CONTENTS

- 1) **WHY WE MANAGE RISK**
- 2) **HOW WE MANAGE RISK**
- 3) **PRACTICAL ASPECTS**
- 4) **CROSS BORDER ISSUES**

WHY WE MANAGE RISK

WHY WE MANAGE RISK

STRATEGIC PRIORITY

TO BUILD AN INTEGRATED APPROACH TO RISK MANAGEMENT

- 1) Build RM in all business decision making process
- 2) The ability to identify risks
- 3) Develop a set of measure to minimize or prevent them.

Taking **RISK**
is fundamental
in our business

WHY WE MANAGE RISK

WE BUILD OUR CAPABILITY

- 1) Survive in an environment of stability
- 2) Progress and stay ahead of competition
- 3) Regulatory Pressure

WHY WE MANAGE RISK

BUSINESS IMPLICATIONS

- 1) Avoid Surprise Negative News
- 2) Better returns through efficient Capital Allocation
- 3) Improve Banks Rating
- 4) Competitive Advantage
- 5) Banks Image & Brand
- 6) Regulatory Requirement

HOW WE MANAGE RISK

HOW WE MANAGE RISK

BASEL 2 PREVAILS

- 1) Sri Lanka is no exception and banks are practicing the standardized Approach.
- 2) It is embedded in our daily business
- 3) It is becoming complicated

HOW WE MANAGE RISK

RISK CLASSIFICATION

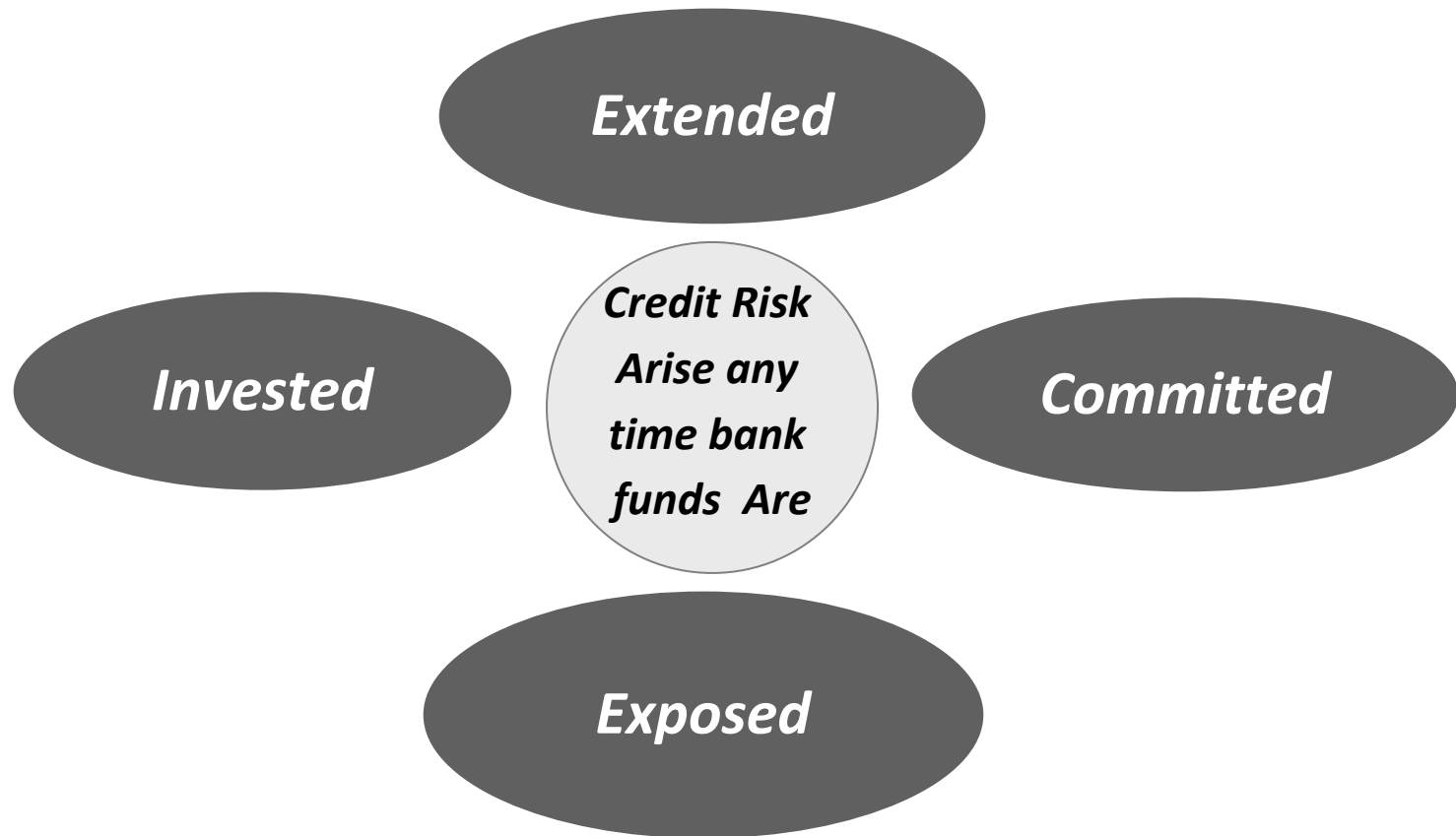
CREDIT

OPERATION

MARKET

LIQUIDITY

CREDIT RISK



Credit Risk is the Potential that a borrower or counterparty will fail to meet its obligation in accordance with the agreed terms and condition

WHERE ARE DO YOU FIND CREDIT RISK

- 1) Investment Portfolio
- 2) Overdrafts
- 3) Letters of credits
- 4) Derivatives
- 5) Foreign Exchange
- 6) Cash Management
- 7) Trade Finance

LIQUIDITY RISK

Definition

The ability to fund increase in assets and meet obligation as the become due

*Very Vulnerable to **Reputation Risk***

MARKET RISK

Definition

- *A movement in the market place will adversely affect the value on or off balance sheet position.*
- *Interest/ fx/ Equity/ Commodity*

Manage Risk

- 1. Setting Norms & Controls*
- 2. Stress Testing*

OPERATION RISK

Basel

The Basel committee to introduced capital charge to protect against this form of risk

Why

Due to number of banks collapsing due to operational risk failures

Definition

The risk of loss resulting from inadequate or failed process, people and system or from external events

WHERE DO WE FIND OPERATION RISKS

- *Internal Fraud*
- *External Fraud*
- *Employment practice and work place safety*
- *Clients, Products and business practices*
- *Damage to physical assets*
- *Business disruption and system failure*
- *Execution, delivery and process management*

HOW WE MANAGE RISK

EMARGING RISK TYPES

Arms & drug Trading

Human Trafficking

Bribery & corruption

Anti Money Laundering

Operational Risk

HOW WE MANAGE RISK

EMARGING RISK TYPES

Reputational Risk

will only manifest itself after the damage to the firm's name has already been done.

If, as many believe, **CSR is moving to the centre of banking activities.**

Sustainability Risk

Organisations are **trying to minimize negative environmental impacts in order to ensure long term profitability and growth potential.**

HOW WE MANAGE RISK

APPROACH

- 1) Originate transactions
- 2) Optimize Returns
- 3) Controls
- 4) Stress Testing
- 5) Communicate

HOW WE MANAGE RISK

RISK PRINCIPLES

- 1) Balance Risk & Returns
- 2) Responsibility
- 3) Accountability
- 4) Anticipation
- 5) Take Competitive Advantage

HOW WE MANAGE RISK

RISK CONTROLS

- 1) Policies
- 2) Exposure limits
- 3) Delegated Risk Authorities
- 4) Audits

HOW WE MANAGE RISK

ENABLERS

- 1) Risk Culture
- 2) People and the Skills
- 3) Infra Structure
- 4) Information and Data Quality

PRACTICAL ASPECTS

HOW WE MANAGE RISK

OUR PRESENT FOCUS

CREDIT
75%

MARKET
15%

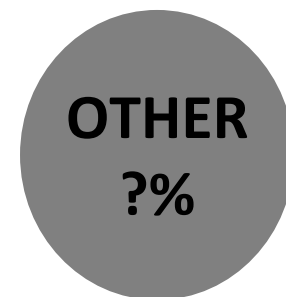
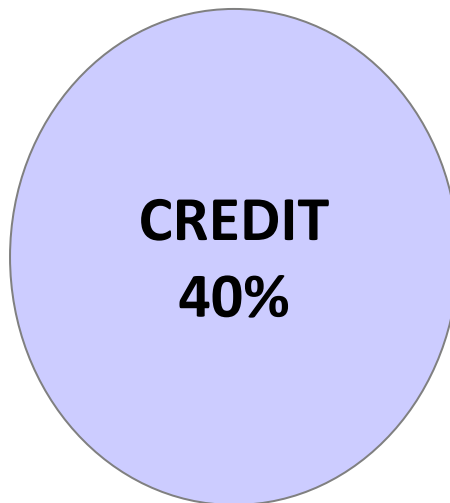
OPERATION
10%

OTHER
?%

HOW WE MANAGE RISK

ARE WE CORRECTLY FOCUSED?

RWA & 75% ...15%...10%...



PRACTICAL ASPECTS

SHIFTING THE CULTURE

Making Risk “Every ones business “

- 1) A significant Shift in the Mindset.
- 2) Retaining Talent

PRACTICAL ASPECTS

THE TOP ENGAGEMENT

Making Risk “ Every ones business “

- 1) Clearly defining roles and responsibilities.
- 2) Establish Accountability
- 3) Re-enforcing the need to change and Training
- 4) Retaining deep risk expertise and the talent base.

PRACTICAL ASPECTS

THE REGULATORS APPROACH

Key object is ensure the soundness of the banking system

- 1) There are clearly define framework & Policies
- 2) We attempt to ensure compliance
- 3) Regulators Approach influence the end objective

PRACTICAL ASPECTS

DATA, DATA, DATA

Data needs to be validated and accurate

- 1) It's difficult to find all these in one place
- 2) We need historical data
- 3) Borrower Name, Segment, Turnover, Credit Grading, Facility
Currency, limit Amount, collateral type, collateral currency,
maturity, negative pledge, country, industry.....

PRACTICAL ASPECTS

POLICIES, SYSTEMS & PROCESS

Need long term commitment & Investments

- 1) Significant shift in the policies
- 2) New process to comply and identify and measure risks
- 3) Technology & Investments

PRACTICAL ASPECTS

THE CREDIT RATING MODEL

Moving towards foundation and Advance

- 1) Understanding the concept
- 2) Collecting the Data
- 3) There are more than 150 pages of minimum requirement in the accord

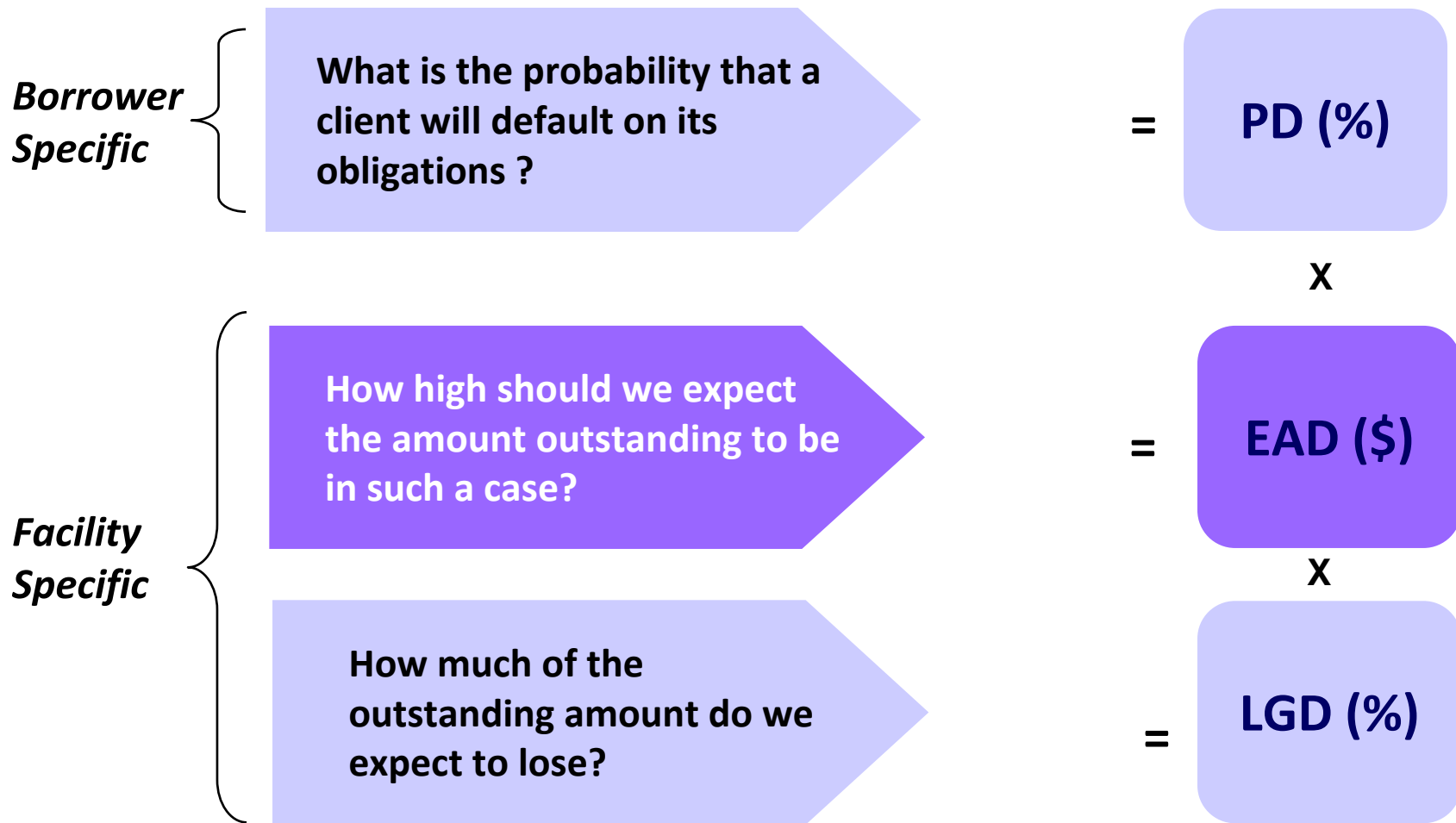
PRACTICAL ASPECTS

MODEL DIFFICULTIES

The Credit Risk Rating Model

- 1) What is EL
- 2) How to get the variables
- 3) Model testing
- 4) Model Application

PRACTICAL ASPECTS



$$EL = PD \times EAD \times LGD$$

PRACTICAL ASPECTS

REGULATORS

Regulators are likely to have one to one sessions

- 1) Can you explain how PD is estimated in your various business
- 2) The Approaches used and the drivers

PRACTICAL ASPECTS

BANKS ARE EXPECTED TO USE

Not merely for calculating regulatory capital

- 1) Credit Approvals
- 2) Limit Setting
- 3) Economic Capital & Regulatory Capital
- 4) Risk Appetite
- 5) Credit Risk Reporting
- 6) Business Strategies
- 7) Profitability & Performance
- 8) Remuneration and Performance

PRACTICAL ASPECTS

STRESS TESTING

Event is quantified and an assessment to be made on the ability to withstand such effect

- 1) Regulators are increasing pressure on this need
- 2) The impact should effect the EL
- 3) What events to stress – severe but also plausible events
- 4) Linking its impact on the economic capital

PRACTICAL ASPECTS

THE COMPENSATION MODEL

- 1) Large bonuses paid for long term products
- 2) Marketers move organization
- 3) Losses can crystallize in the medium and long term.

CROSS BORDER

CROSS BORDER

***CROSS BORDER ACTIVITIES & RISK ARE GROWING
IN PARTICULAR IN WHOLESALE & INTERBANK SEGMENTS***

- 1) The Euro
- 2) Technology innovation
- 3) Reduction in Regulatory Barriers

CROSS BORDER

- Works in the same manner as credit risk.
- Captures cross border risk.
- For International bank country risk accounts to around 20% of credit risk.

$$\text{Country Risk} = \sqrt{\rho(PD)(1 - PD)} * \text{LGD} * \text{EAD}$$

where ρ = Country to country correlation

PD = Probability of country event

LGD = Country loss severity

EAD = Cross border exposure booked in country

CROSS BORDER

COUNTRY RISK

While the benefits of financial Globalization is substantial the issues need to be addressed

- 1) There is substantial cross border risk eg: FX transaction
- 2) The impact should effect the EL
- 3) What events to stress – severe but also plausible events
- 4) Linking its impact on the economic capital

CROSS BORDER

LEGAL ISSUES

Enforceability of the contract

- 1) International Treaties and Conventions
- 2) Recognized principles of law in cross border insolvency
- 3) Private International law
- 4) Comity of law
- 5) Model Law – UNCITRAL (1997)

CROSS BORDER

GLOBAL FLOW IS SLOW

- 1) Domestic Barriers to entry
- 2) Prudential Barriers – Supervisory Approvals
- 3) Risk information between home and host country is not easily accessible, transparent or common understanding
- 4) However the Capital Requirement Directive as helped vastly in the recent times.

THANK YOU