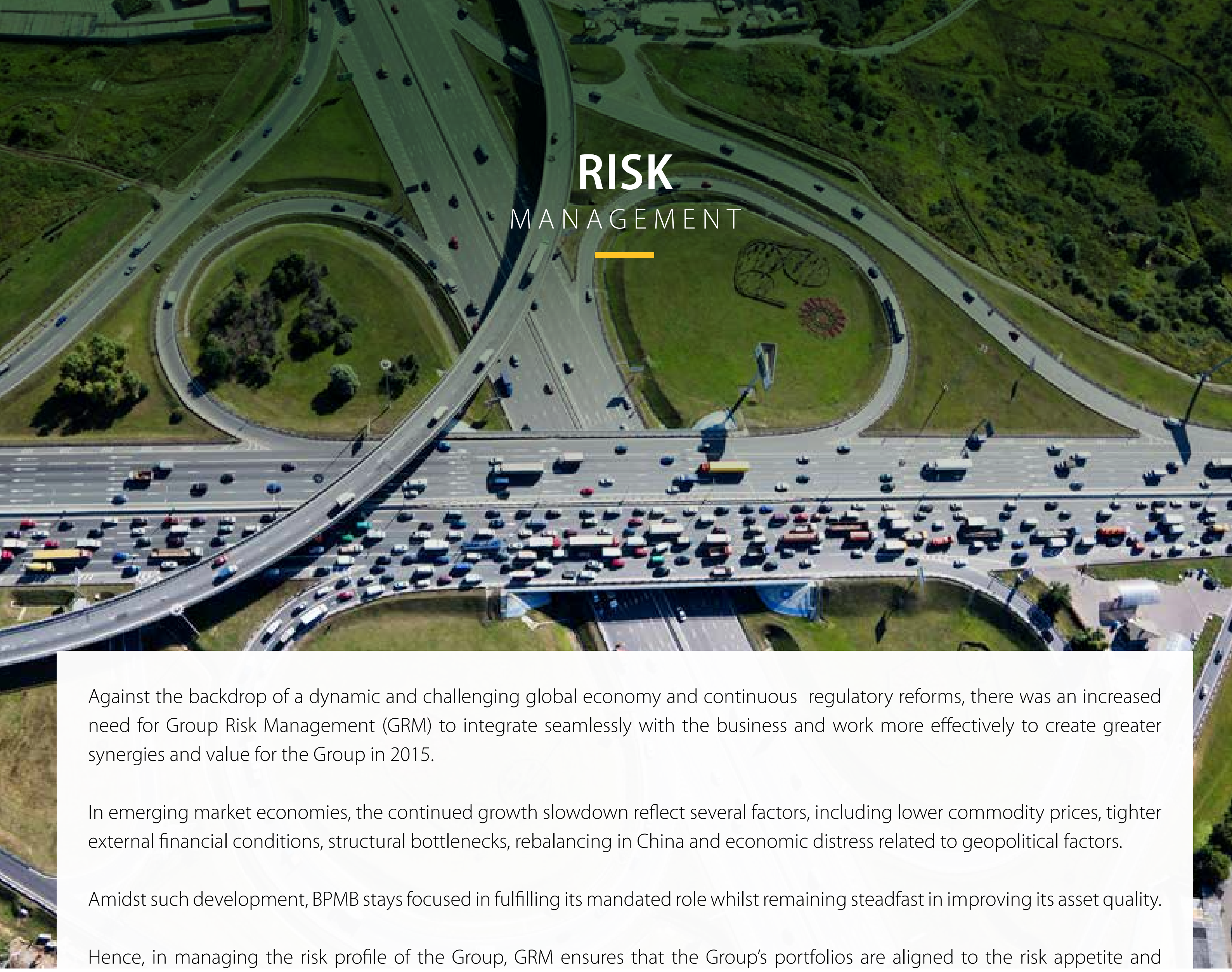

RISK MANAGEMENT

Against the backdrop of a dynamic and challenging global economy and continuous regulatory reforms, there was an increased need for Group Risk Management (GRM) to integrate seamlessly with the business and work more effectively to create greater synergies and value for the Group in 2015.

In emerging market economies, the continued growth slowdown reflect several factors, including lower commodity prices, tighter external financial conditions, structural bottlenecks, rebalancing in China and economic distress related to geopolitical factors.

Amidst such development, BPMB stays focused in fulfilling its mandated role whilst remaining steadfast in improving its asset quality.

Hence, in managing the risk profile of the Group, GRM ensures that the Group's portfolios are aligned to the risk appetite and strategy as well as to refresh and update the Group's respective risk management frameworks to be forward looking.

RISK MANAGEMENT FRAMEWORK

Risk is an inherent component in all aspects of the Group's businesses. The management of risk has evolved into an important business driver for strategic decisions in support of the Group's business objectives, balancing the appropriate level of risk taken proportionate to the desired level of reward, while maintaining the sound financial position and capital of the Group.

The Group's approach to the management of risk involves the establishment of risk principles and strategies as the core foundation in driving strong risk management culture and practices across the Group. The Group manages its risk actively guided by its risk management governance and framework.

i. Risk Management Governance

The following illustrates the Risk Management Governance structure adopted by the Bank, which is guided by BNM's Risk Governance Policy, Guidelines on Corporate Governance for Development Financial Institutions and the Shariah Governance Framework for Islamic Financial Institutions.

BOARD OF DIRECTORS

The Board of Directors has the ultimate responsibility for the sound and prudent management of the Group. This includes responsibility for risk oversight and to ensure appropriate risk management frameworks and policies are established and implemented accordingly for the various categories of risk exposures within the Group.

BOARD LEVEL COMMITTEES		
RISK MANAGEMENT COMMITTEE (RMC)	**CREDIT COMMITTEE OF THE BOARD (CCB)**	**REMUNERATION COMMITTEE (RC)**
The RMC is a Board level Committee responsible to perform oversight on the Group's risks. It is primarily responsible to oversee senior management's activities in managing the key risk areas of the Group and to ensure the appropriate risk management infrastructure, resources and processes are in place and functioning effectively.	The CCB is tasked by the Board to review financing approvals and credit risk portfolio.	The RC is appointed to oversee the establishment and implementation of remuneration policy and structures; including to ensure such policy and structures do not induce excessive risk-taking and able to reinforce prudent risk-taking.

SHARIAH COMMITTEE
The Shariah Committee reports directly to the Board and undertakes a fundamental role in ensuring the Group's compliance with Shariah requirements. The Shariah Committee is responsible to deliberate and make decisions, provide views and advice on Shariah matters/issues, as well as Shariah compliance oversight on the Group's Islamic financial business operations/activities.

MANAGEMENT LEVEL COMMITTEES	
EXECUTIVE RISK MANAGEMENT COMMITTEE (ERMC)	**GROUP CREDIT COMMITTEE (GCC)**
The ERMC is a Management level committee responsible for the management of all material risks within the Group.	The GCC forms part of the risk governance for managing credit/ investment risks within the Group. The Committee is empowered to approve credit/investment related proposals, which falls within their authority.

To ensure that risk governance remains strong and relevant, GRM continues to embed robust risk governance and accountability across the Group as well as ensure the adherence to the dynamic global and local regulatory requirement and risk management practices across the Group.

ii. Risk Appetite Statement and Strategy

The risk appetite framework defines the Bank's boundaries and drivers of doing business. The risk appetite is a critical component of the Bank's robust risk management framework and is driven by both top-down Board leadership and bottom-up involvement of management at all levels. The risk appetite enables the Board and Senior Management to communicate, understand and assess the types and levels of risk that the Bank is willing to accept in pursuit of its business objectives.

The Bank's development of its risk appetite has been integrated into the annual strategy and business planning process and is adaptable to changing business and market conditions. The Bank's risk appetite balances the needs of all stakeholders by acting both as a risk gatekeeper and as a driver of future and current business activities.

The articulation of the risk appetite is done through a set of risk appetite statements which includes a comprehensive view of all material risks to the Group and is as follows :

iii. Risk Management Ownership

Group Risk is moving towards adopting an integrated risk management approach towards the effective management of Group-wide risks.

In accordance with the Group's structure, GRM has continuously enhanced its integrated risk management approach towards the effective management of enterprise-wide risks. The Group's risk governance model provides a transparent and effective governance structure which promotes active involvement from the Board and Senior Management in the risk management process to ensure a uniform view of risk across the Group.

The governance model aims to place accountability and ownership whilst facilitating an appropriate level of independence and segregation of duties. The structure is premised on the three lines of defence and defines the lines of authority, roles and responsibilities to efficiently manage risk across the Group. Hence, the structure the Group adopts where risks are collectively managed by all functions based on their respective role can be reflected below :

APPROACH	RESPONSIBILITY	FUNCTIONS
1st Line of Defence	Risk Taking Functions	Business and Support Functions, who are the risk takers, are primarily responsible for managing risk exposures in their daily activities.
2nd Line of Defence	Risk Control	The risk control responsibility lies with Group Risk Management (GRM), Group Compliance, Credit Appraisal and Technical Assessment. Group Risk Management (GRM), being an independent Function to support the Risk Management Committee is responsible for establishing, implementing and maintaining Risk Management frameworks, policies, guidelines, tools and methodologies, as well as providing independent risk management oversight. Compliance is responsible for ensuring the Group's compliance to applicable laws, regulations, Shariah rulings, internal policies, guidelines and procedures, including establishing and maintaining policies and procedures to detect and minimize risk of non-compliance. Credit Appraisal provides independent risk assessment on all credit/investment proposals and credit review proposals. The Function also develops and maintains the Bank's credit risk rating models and system, being one of the measures to manage the Bank's credit risks. Meanwhile, Technical Assessment provides independent assessment on technical aspects and risks of projects in respect of credit proposals.
3rd Line of Defence	Risk Assurance	Group Audit & Examination is responsible to conduct independent review and provide assurance on the adequacy and effectiveness of risk management processes and level of compliance.

iv. Risk Management Process

With the risk management process in place, the principal risks and how the Group manages these risks are given below (further details on the key risks can be found in the Bank's Key Risk Indicators).

CATEGORIES OF RISK	BROAD DEFINITION	RISK MANAGEMENT PRACTICES
Credit	Losses in principal or income arising from the failure of an obligor or counterparty to perform their contractual obligations in accordance with agreed terms.	• The Group has a strong credit culture which incorporates a clear credit policy, robust credit evaluation and approval as well as sound credit portfolio management. • Credit risk in the portfolio is continuously evaluated and reviewed by the business sectors together with the risk units. Senior Management and the Board have good oversight of the credit risks and play an active role in the overall credit risk management.
Concentration	Concentration exposures that have the potential to produce losses that are substantial enough to threaten the financial condition of the Group and its core operations.	• The Group adopts a proactive, robust and controlled policy-driven approach in portfolio diversification. • The Group's guiding principle in its lending activity is to diversify its loan portfolio mix and avoid any undue concentration of credit risks in its portfolio. Independent assessment on the Group's portfolio profile is undertaken to mitigate concentration risk.
Operational	Losses due to failed internal processes, people or systems or from external events.	• The Group has an Operational Risk Management Framework that is aimed at managing operational risk throughout the Group. It is periodically reviewed and aligned against the Group's business strategy and directions ensuring the business objectives and operational risk management objectives are aligned and consistent. • Various tools and techniques are also used to minimise operational risk to an acceptable level. • In addition, the Group also has in place a robust crisis management and business continuity management program to ensure continuity of essential business services during unforeseen events.
Market	Losses or adverse impacts on earnings or capital from changes in the level of volatility of market rates or prices such as interest rates, foreign exchange rates, commodity prices and equity prices.	• The Group measures, manages and controls its market risk exposure using industry best practices. • The enhancement of market risk triggers and controls are an ongoing effort. The Group plans to continue with such enhancements to ensure prudence in managing the market risks are well contained. • Although it is non-compulsory for the Group to adopt Basel II initiatives, it is currently observing practices derived from Basel II.
Liquidity & Funding	Risk that the Group will not be able to meet both expected and unexpected current and future cash flow and collateral needs effectively without affecting either daily operations or the financial condition of the Group.	• The Group uses a range of tools to monitor and control liquidity risk exposure such as liquidity gaps, early warning signals, liquidity indicators and stress testing. • The liquidity positions of the Group are monitored regularly against the established policies, procedures and limits. • The enhancement of liquidity risk triggers and controls are an ongoing effort. The Group plans to continue with such enhancements to ensure prudence in managing the liquidity risks are well contained. • Although it is non-compulsory for the Group to adopt Basel II initiatives, it is currently observing practices derived from Basel II.

CATEGORIES OF RISK	BROAD DEFINITION	RISK MANAGEMENT PRACTICES
Interest Rate	Risk arising from the change in market interest rates that adversely impact the Group's financial condition in terms of earnings or economic value.	• The Group measures, manages and controls its interest rate risk by adopting and employing both qualitative and quantitative approaches. • Such controls include Earning at Risk (EAR), Economic Value of Capital (EVE), Total Rate Sensitive Asset/Liabilities Ratio, Stress Testing etc. • Each has a limit of which is monitored and reported regularly against the established frameworks, policies and procedures.
Reputational	Risk that the Group's reputation is damaged by one or more reputation event, as reflected from negative publicity about the Group's business practices, conduct or financial condition.	• The Group's reputation is preserved through managing all the risks that affect the Group's reputation through good corporate governance, effective risk management processes and a structured management of reputational events when they occur.
Information Technology (IT)	Risk which impacts information and services related to the Group's use of technology. This includes risks that customers or the Group may suffer from service disruptions, losses arising from system defects, illegal use of computer systems and breach of data via computer systems perpetrated either by internal or external parties, including any damage to the reputation of the Group.	• The Group ensures and creates awareness among its internal and external customers of this risk.
Regulatory	Change in regulations which could threaten the Group's competitive position and capacity to conduct business effectively.	• The Group keeps a close watch on all key regulatory developments in order to anticipate changes and potential impact on performance with the focus of continuously improving the risk governance structure and framework.
Business & Strategic Risk	Risk of current or prospective impact on the Group's earnings, capital, reputation or standing arising from changes in the environment the Group operates in and from adverse strategic decisions, improper implementation of decisions or lack of responsiveness to industry, economic or technological changes.	• The Group has a well-established risk governance structure and recently established dedicated team that reviews the overall strategic risk facing the Group. • The Group adopts appropriate strategies to balance risk and return taking into account changing conditions through the economic cycle and monitoring of economic trends in the market closely. • The respective Risk Management sub-functions continuously review the suitability of its risk policies and controls.

v. Risk & Compliance Culture

A vital component in strengthening the Group's risk governance structure is its risk and compliance culture. Culture forms the fundamental building block of risk management and serves as the foundation upon which a strong enterprise wide risk management structure is built.

The risk and compliance culture of the Group is driven from the top and complimented with the tone from the middle, that are ingrained in all levels of business and activities. As an essential building block for effective risk governance, it is continuously promoted to ensure that the right risk and compliance culture is embraced and exhibited in the behaviour of each individual within the organisation.

As part of the risk and compliance culture, the Group has also tried to instil a compliance culture where the Board, Senior Management and every employee of the Group is committed to adhere to the requirement of relevant laws, rules, regulations and regulatory guidelines. The Group's commitment is clearly demonstrated through the establishment of strong compliance policies and guidelines to ensure that the Group's non-compliance risks are effectively managed. Such measures help lower the cost of doing business arising from regulatory penalties, as well as protects the Group's integrity and reputation.

STRATEGIC PRIORITIES FOR 2015

GRM's strategic priorities for 2015 continue to build around managing its key focus areas of asset and liabilities management. The notable risk management achievements to date are :

a. Deepened risk & compliance culture;
b. Enhanced the assessment of sectorial risk profile and portfolio management;
c. Strengthened liquidity risk management;
d. Enhancement of operational risk management;
e. Institutionalized operational risk management;
f. Improved credit underwriting quality;
g. Optimized capital management;
h. Broadened the scope of Stress Testing;
i. Implemented the Risk Appetite Statements.

GRM has considered both external and internal drivers during the setting of the Strategic Priority for 2015. They were :

i. Key External Drivers

- Challenging economic and cost environment;
- Increased data and IT infrastructure requirement;
- Regulatory pressures on business model and cost structure.

ii. Key Internal Drivers

- Compliance to regulatory requirement;
- Enhance shareholders' value;
- Optimization of resources;
- Risk ownership at various functions;
- Deepening risk awareness culture at all levels.

KEY ACHIEVEMENTS IN 2015

Although Basel II-compliant is not yet a requirement, the Group has taken the initiative to adopt a more forward looking approach to capital management and develop a more rigorous risk management techniques.

Hence, to facilitate the Bank's aspiration in adopting the full Basel II, the following initiatives were undertaken :

i. Implemented the Bank's Internal Capital Adequacy Assessment Process (ICAAP);

ii. Established the Bank's Risk Appetite Statement Framework;

iii. Initiated the Bank's Risk Appetite Statement and implemented the RAS Dashboard;

iv. Established the Model Validation Framework;

v. Reviewed the New Liquidity Framework (NLF) Behavioural Assumption;

vi. Enhanced the Contingent Funding Plan;

vii. Strengthened Middle Office function;

viii. Initiated the Basel II Gap Analysis & Capital Impact Study;

ix. Enhanced the liquidity risk management controls namely Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR);

x. Broadened the scope of Group Stress Test;

xi. Refined the Model Risk Adjustment (MRA) for the computation of the Collective Allowable Assessment (CAA);

xii. Enhanced operational risk assessment templates and data collection;

xiii. Enhanced the Group's Shariah Non-Compliance Risk Catalogue;

xiv. Deepened Group-wide risk management via Knowledge Sharing Sessions, Employee Induction Program, Risk Portal etc.

The Group's state of implementation of these initiatives were reported to the ERMC, RMC and Board on a regular basis, thus ensuring that the Management and Board of the Group are aware and continue to maintain oversight of the risks undertaken by the Group.

OUR PRIORITIES FOR 2016

Risk Management priorities

Initiatives to adopt Basel II requirements would further enhance the Bank's risk management infrastructure and practices, inculcate risk awareness culture, optimize capital management and support business decisions. Such initiatives entail :

1. Establishing the infrastructure towards meeting the requirements of the Standardised Approach for computation of credit risk capital charge;

2. Enhancing risk management practices and controls throughout BPMB Group;

3. Enhancement of the Bank's internal credit rating model with the goal of qualifying for the more advanced capital computation approach, which would enable allocation of the right capital size;

4. Preparing the building blocks for adoption of The Standardised Approach ("TSA") for future computation of operational risk capital charge;

5. Enhancing Risk Management capabilities within the Group by :
   i. Leveraging on Information Technology ("IT") to provide the risk intelligence for better risk monitoring and control, as well as to facilitate risk informed decision and pricing;
   ii. Building reliable, consistent, complete and timely database within the Group.

6. Enhancement of Group Stress Test, establishment and revision of risk controls/limits and operationalization of the Group's Risk Management Framework throughout the Group;

7. Continuous risk awareness initiatives/programs throughout the Group;

8. Building capable staff force with the right skills and knowledge to support the implementation of such initiatives.

EMERGING RISKS

Identifying and monitoring top and emerging risks are integral to the Group's approach to risk management. The identification and prioritisation of key risks facing the Group will be important in order to enable the Group to proactively plan for a holistic management of these risks, amongst others, across the Group. Some of the key concerns for the Group that continues going into 2016 are :

a. Challenging Business Environment

The economy as a whole is vulnerable to external shocks, both regionally and globally. Growth looks threatened by global economic instability and a fall out in global demand.

The prospects for economic growth in 2016 remain cautious with continued economic difficulties in Europe, slower growth in emerging markets and a slowing China. The spill-over effect may trickle domestically, hence impacting the Bank's existing customers and target market. The impact of lower energy and commodity prices are also expected to lead to further uncertainty in economic growth. Domestic weaknesses, such as infrastructure shortages/deferment, budget deficits and inflationary pressures coupled with external uncertainties are expected to impact economic growth.

b. Regulatory Changes and Requirements

One of the key risks going into 2016 is the evolving landscape of regulatory requirements and the equipments to new regulations. Governments and regulators in numerous jurisdictions are expected to continue to develop regulations which may impose new requirements, including but not limited to the areas of capital and liquidity, corporate structures, conduct of business, corporate governance and operational risk.

c. Concentration risk and connected lending.

Concentration risk arises because the Bank's credit is to the local economy and the Bank's limitation in providing to its mandated role and business sector. Credit to a few big local groups of connected borrowers is now close to regulatory ceilings, and on some instances had exceeded its prudential limits. Some of these are highly leveraged borrowers whose performance could have systemic effects.

Although the Bank has yet to observe the Single Counterparty Exposure Limit, its adoption is imminent and inevitable. The Bank is required to aggregate its exposures to a single counterparty together with its exposure to persons connected to the single counterparty as they may present a common risk to the banking institution, such that difficulties faced by either the single counterparty or persons connected to it may affect the funding or repayment capabilities of either one.

d. Movement in Interest Rates

Rising interest rate will have an unfavourable impact on the margins of the Bank's fixed rate loan portfolio due to its inability to reprice. This portfolio is consistent with its mandated role, business model and product offering to finance infrastructure projects that is susceptible to interest rate risk. However, the interest rate risk is managed within the risk appetite of the Bank and controls established.

Notwithstanding this, BNM is expected to maintain the overnight policy rate (OPR) at 3.25% in the first half of 2016, reflecting the supportive monetary policy stance and taking into account emerging weaknesses in the external environment, falling commodity prices and continued moderation in aggregate domestic demand.

e. Data

Modern techniques of risk management, reflected in the methodological approach of Basel II, involve the estimation of probabilities of default on the lender's loan portfolio, as well as of loss-given-default. Data integrity continues to be an integral part of the evolution of provisioning methodology at BPMB. The lack of integrity and accuracy of input data for PD, EAD and LGD/collateral value would determine the outcome of the Bank's provisioning amount.

f. Changes in market structure and growing competition

Changes in market structure (privatisation, increased entry by commercial banks, financial innovations) have significantly altered the competitive environment faced by the Bank. Commercial banks intensify competition because of security and access to cheaper financing. Their competitive advantages are often enhanced by greater operating efficiency and better technology. The implications for risk management and financial stability are mixed.

On one hand, the erosion in pricing power (ie less ability to lower deposit rates and raise loan rates) reduces earnings and increases the incentives for risk-taking on the part of the banks. Moreover, competitive pressures might also lead to mispricing.

The presence of other commercial banks can also enhance financial stability by improving risk management among competitors. Improvements in measuring expected and unexpected loss are also needed in order to increase the use of risk-based pricing.