

# RISK MANAGEMENT

The Bank has been guided by its risk management principles in managing its business risk, which outline a basis for an integrated risk management effort and good corporate governance. Internal controls, policies, guidelines and procedures have been established to govern the activities of operational and support functions of the Bank. Risks arising from these activities are managed by dedicated risk management functions under Group Risk Management, that play a vital role in the execution of risk management activities and strategies through the process of identifying, measuring, monitoring and controlling all material risks faced by the Bank.

Combined with a structured risk governance consisting of a strong Board and Management oversight, a good check & balance systems and a sound risk management practices, the Bank has built a strong foundation towards ensuring an integrated risk management approach that safeguards the quality of the Bank's assets.

## RISK MANAGEMENT GOVERNANCE

The following chart 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 decision on 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 provide decisions, views and advice on Shariah matters/issues, as well as Shariah compliance oversight on the Group's Islamic business operations/activities.

## MANAGEMENT LEVEL COMMITTEES

### EXECUTIVE RISK MANAGEMENT COMMITTEE (ERMC)

The ERMC is a Management level committee responsible for the management of all material risks within the Group.

### GROUP CREDIT COMMITTEE (GCC)

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.

## Risk Management Ownership

The Group adopts the concept of three lines of defence, where risks are collectively managed by all functions based on their respective role as 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	<p>The risk control responsibility lies with Group Risk Management and Compliance.</p> <p>Group Risk Management, being an independent function to support the Risk Management Committees is responsible for establishing, implementing and maintaining Risk Management frameworks, policies, guidelines, tools and methodologies, as well as providing independent risk management oversight.</p> <p>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.</p>
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.

## RISK MANAGEMENT APPROACH

Recognizing risk management as a crucial element towards achieving a profitable and sustainable business, the Bank continuously work towards strengthening its risk management approach and capabilities to ensure risk exposures are effectively managed. The Bank's Risk Management Framework is established in line with best practices, which includes adopting Basel II and Basel III recommendations, where applicable.

Given the present business model, the bank is progressively adopting risk-based assessment as a cornerstone to develop sustainable business strategies. From a regime that was focused on loss prevention and compliance at the lower end of the scale, the Bank has progressed to risk quantification and risk measurement models.

The Bank aspires to move up the value chain to leverage on these quantitative tools developed to align to business strategies. This will ensure the Bank's targets and objectives are attainable so as to enhance value for the stakeholders.

## Strengthening Risk Management



## Key Risk Management Principles

The Group adopts the following Risk Management principles:

1. The Board retains the ultimate responsibility in establishing the maximum level of risks that the Group will tolerate in pursuit of its mandate and performs its oversight via the Risk Management Committee.
2. The relevant regulatory requirements, market standard and international leading practices are adopted in the formulation of risk management frameworks, policies, procedures and guidelines to ensure robust risk management approaches are employed.
3. Risk management is implemented on an enterprise-wide basis based on the three lines of defence concept, whereby risks are managed collectively by all functions, namely the Business/Support functions, Group Risk Management, Compliance and Group Audit and Examination.
4. Risk management within the Group is governed by Risk Management Frameworks that covers the Group's key risk exposures including (but not limited to) credit risk, market risk, liquidity risk and operational risk to effectively identify, assess, measure, monitor and mitigate risk exposures.
5. Risk management activities are carried out in line with the Group's corporate strategies. The Group's risk management policies, frameworks, procedures and guidelines are not static; it changes through annual review that aligns with the organization's objectives and needs.
6. The Group's risks are regularly assessed and managed by balancing the eventual trade-off between risk and return.

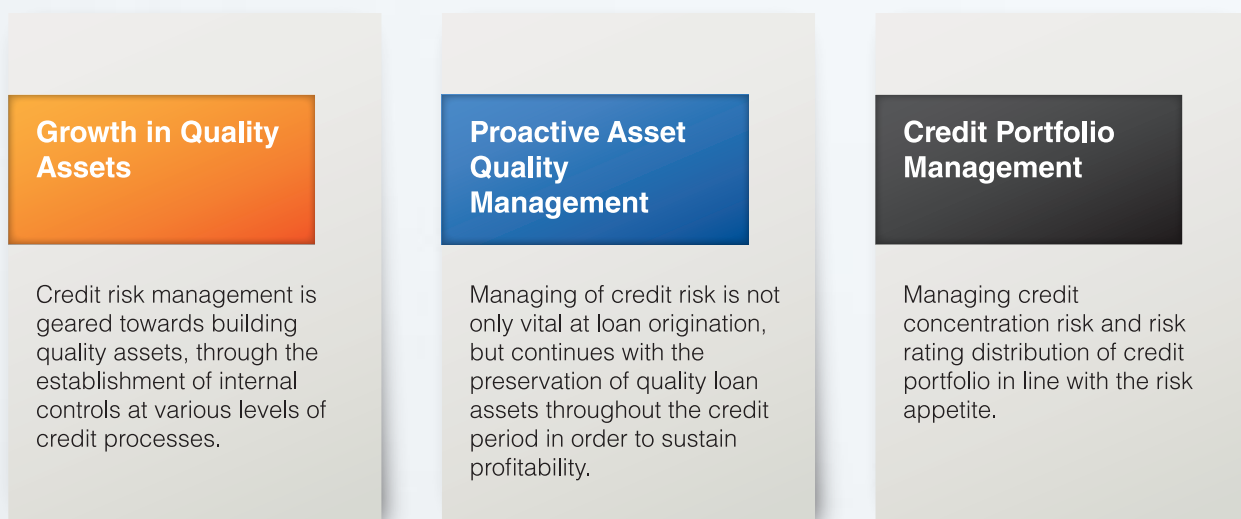
## CREDIT RISK MANAGEMENT

Credit Risk is the potential loss of revenue, arising from the failure or unwillingness of counterparties or borrowers to honour their contractual financial obligations as and when they are due.

Management of credit risk encompasses establishing internal controls with a check-and-balance structure to ensure the Bank thrives on a portfolio of quality credit. Group Risk Management is supported by a dedicated Credit Risk team which is responsible for overseeing the implementation of credit risk management process at operational functions to meet this objective.

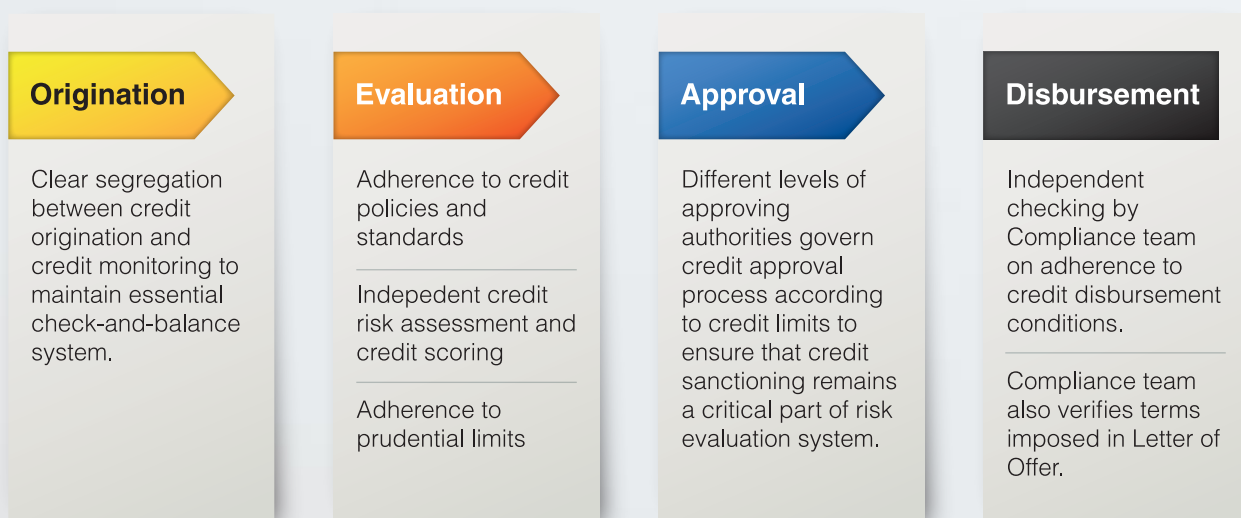
### CREDIT RISK MANAGEMENT FRAMEWORK

The process of managing credit risk involves risk identification, risk assessment and measurement, risk monitoring and risk control, which are governed by Credit Risk Management Framework encompassing the following elements:



### GROWTH IN QUALITY ASSETS

As financing forms the major part of the Bank's financial assets, credit risk management governing credit processes has therefore been the main focus of the Bank's risk management activities. Credit proposals are prudently assessed to ensure that only quality credits are approved for financing. Credit risk identification, assessment, monitoring and control in credit processes are further elaborated as follows:



## Policy and standards

- Credit operation activities are governed by Credit Operations Policy and Credit Operations Guideline, which determines the credit features, credit granting criteria and credit administration, set by Management in accordance with the best practices and the Bank's risk appetite.
- Adherence to regulatory requirements, directives and guidelines as prescribed under the Development Financial Institutions Act 2002 (DFIA) are adhered to, which have assisted the Bank in achieving its corporate objectives within an acceptable risk profile.

## Independent Credit Risk Assessment

- Prudent credit assessment is enforced by mitigating credit risk at pre-approval stage through the provision of independent credit risk assessment by Credit Risk team to ensure proper conduct in the operations of credit granting activities, which contributed towards minimizing the Bank's and the Group's non-performing credit and provisions arising from financing and investment activities.
- The originating teams are required to respond to Credit Risk team on credit risk issues raised, prior to the submission of credit proposals to the approving authority so as to ensure that all credit issues are adequately addressed and mitigated.

## 2013 Initiatives

Continuous enhancement in credit processes was made during the year which saw an enhanced 'two-way communication' between the originating team and Credit Risk team. The engagement and deliberation between the two teams are focused on the risk assessment and mitigations. This process has successfully build a healthy risk culture in the originating team.

Credit risk assessment using a more structured format has been implemented for the Bank's subsidiary, with the aim of enhancing efficiency and effective credit risk assessment.

## Prudential Limits

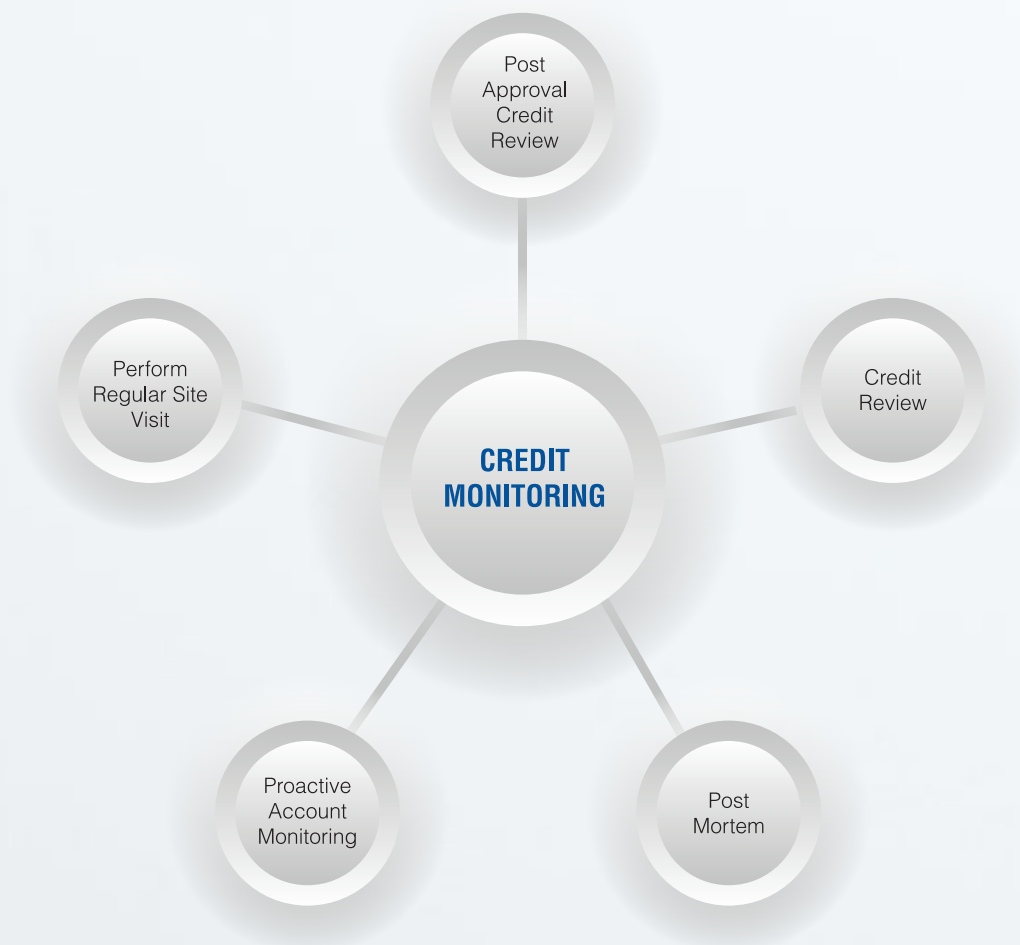
- Prudential limits are established to manage concentration risk. Limits are continuously monitored and any breaches or critical level of exposure are reported to the relevant committees, with appropriate strategies to mitigate such risks.
- The Bank diversifies its credit portfolio and avoids any undue concentration of credit risk in its credit portfolio by setting credit limit to single customer. Group Single Customer Limit is also in place to manage the Bank's and subsidiaries' concentration risk to common group of customers at group level.
- Sector limit for commercial lending is observed to monitor undesirable concentration which could expose the Bank to higher risk of lending. The limit by commercial business sector is reviewed where necessary.

## Credit Scoring

- All credit proposals are rated using a two-dimensional internal credit rating system to measure each borrower's risk of default and facility risk, which focuses on Probability of Default (PD), Exposure at Default (EAD) and Loss Given Default (LGD). Ten (10) credit rating models were developed to cater for various business sectors financed by the Bank.
- The rating model produces Expected Loss (EL) which provides a high-level overview of a borrower's credit quality in terms of potential loss amount, given a certain level of probability of default. Only viable credit proposals with well-mitigated risk are considered for financing.
- The rating model is subject to review to maintain its predictive power and stays robust to suit the Bank's financing portfolio and market environment.
- The Bank has formalized a Credit Rating Guideline to provide clarity and common understanding among the users in conducting credit risk rating for the borrowers of the Bank.
- The Bank has also established an updated mapping of internal rating grades to external rating grades to serve as a reference in gauging credit risk level of the borrowers (on the Bank's internal rating scale vis-à-vis the external rating).
- Selection criteria for Maritime Projects rating model and General Shipping model has been enhanced to address forward looking elements.

## PROACTIVE ASSET QUALITY MANAGEMENT

The Bank continues to monitor the quality of credit throughout the credit period to detect any deterioration so that corrective measures could be taken.



### Regular Site Visit

Site visits are conducted in two stages as follows:-

- Disbursement Stage:  
Prior to the disbursement of the financing facilities, Technical team verifies the progress completion of the project.
- Periodical Credit Review:  
Credit Management team carries out regular site visits with the assistance from Technical team to detect early warning signal.

### Credit Review

Credit review is conducted at least once a year and more frequent on high-risk credit under watch – list accounts to proactively manage any delinquencies, maximise recoveries and to ensure timely recognition of asset impairment. Submission of quarterly management accounts apart from audited accounts are included as part of loan covenants to detect any adverse transactions and issues that may affect the borrowers' financial health, which could lead to non-payment risk.

Watch-list accounts (based on assessment under FRS 139) are reviewed quarterly and half yearly depending on the degree of vulnerability based on the scores established under the internal guidelines of FRS 139. A systematic mechanism for prompt identification/classification of loan/financing is formulated whereby the classification is based on the total scoring assigned to individual borrower.

Credit reviews are rated to reflect current credit risk level of the customers, taken into consideration the current market situation and economic environment that the customers are operating in.

### Post Approval Credit Review

As part of the internal control, post approval credit review on approved credits is conducted by a team within the internal audit to provide an independent judgement on both the quality of credit appraisal and the quality of the credit portfolio of the Bank.

### Proactive Account Monitoring

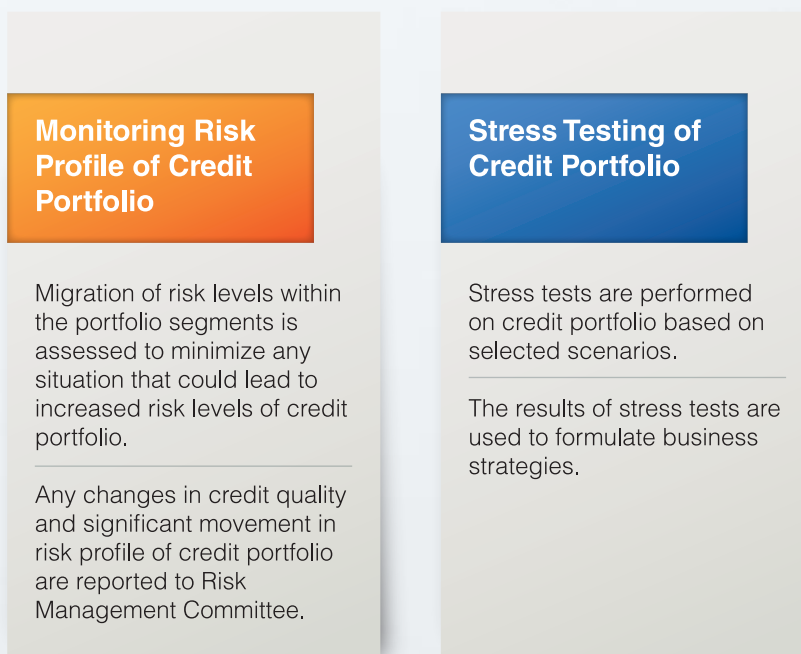
The movement of delinquent loans is also monitored to gauge deterioration in credit quality that could potentially turn the accounts into impaired status. The movement of credit impaired rate is also tracked in monthly Credit Portfolio Report with the objective of monitoring the impairment level.

### Post Mortem Review

To better understand how problem credit developed and to identify lapses in credit and monitoring process, system and people, post mortem reviews are conducted on impaired credit. Observations and findings are communicated as feedback and actions are taken to improve credit risk management process.

## CREDIT PORTFOLIO MANAGEMENT

Credit risk exposures are managed through a robust credit monitoring process, which include the following activities:



### Reporting

Reporting of credit risk activities is made to the ERM before deliberations at the RMC. The ERM that meets monthly, deliberates issues on the quality of credit risk of borrowers to preserve the quality of loan assets, with the objective of preventing them from turning impaired. The ERM recommends action on all credit risk related matters including loan asset quality, credit portfolio composition and adequacy of strategies and controls to manage overall credit risk activities. The ERM also deliberates periodical report on credit risk prior to submission to RMC.

## INDEPENDENT ASSESSMENT BY INTERNAL AUDITOR

As part of the corporate governance, Group Audit & Examination (GAE) undertakes an independent assessment of “credit compliance” to policies and procedures. The findings are communicated to the respective functions and further deliberated at the Audit Committee meeting. Issues raised are followed-up by GAE to ensure that corrective measures are implemented.

## MARKET RISK MANAGEMENT

Market risk is defined as the potential loss in value of the Bank due to changes in market prices and rates including interest rates, credit spreads, equity prices and foreign exchange rates. Market risk has a direct impact on earnings and impacts the economic value of BPMB for structural interest rate risk and banking book assets.

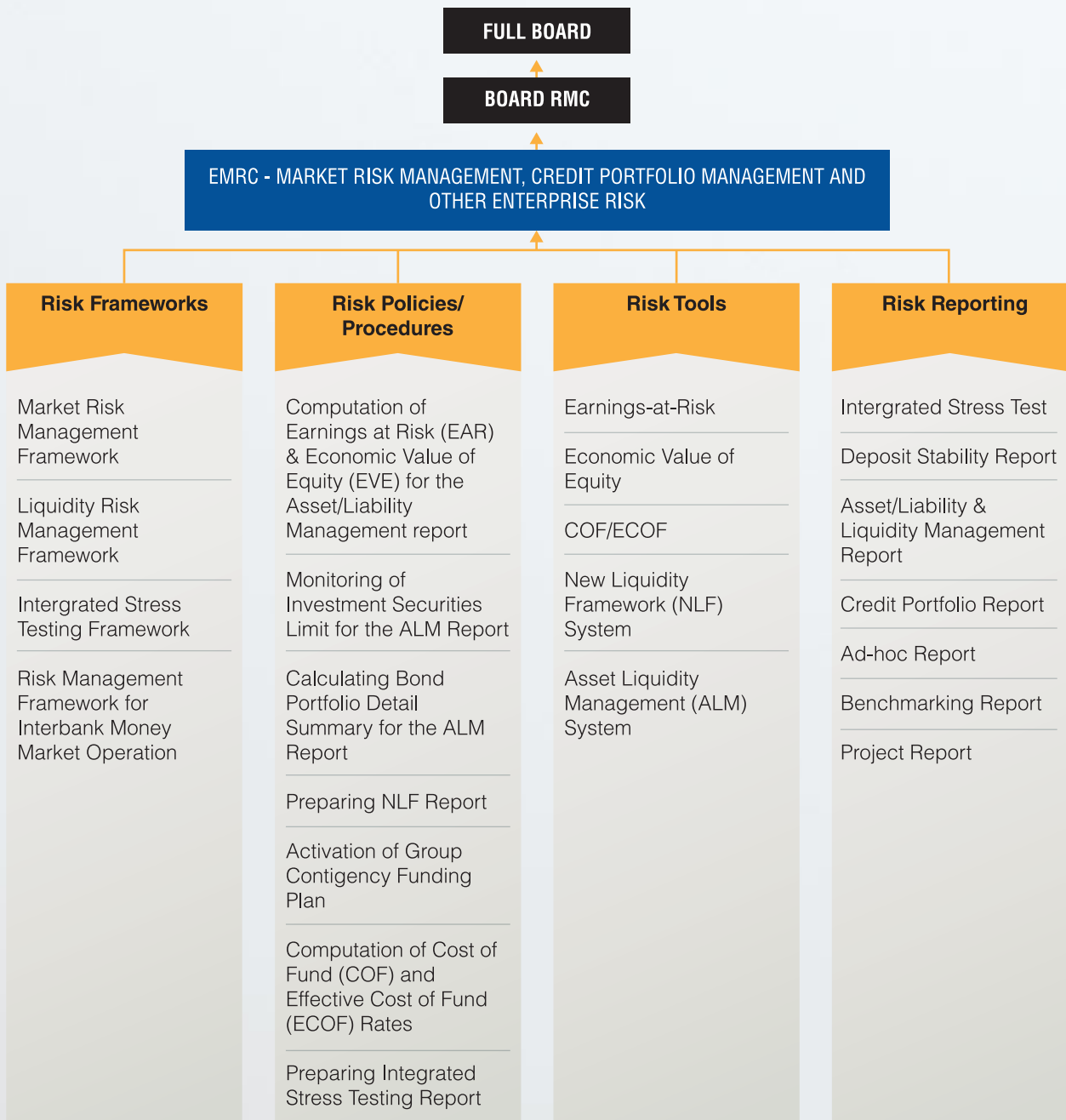
## LIQUIDITY RISK MANAGEMENT

Liquidity risk is the risk that BPMB is unable to generate sufficient funding to meet its payment obligations when due in a timely and cost-effective manner.

The common source of liquidity risk arises from mismatches in timing and value of cash inflows and outflows, both from on and off-balance sheet exposures.

## ASSET LIABILITY MANAGEMENT

Asset Liability Management is a practice in managing risks that arises from mismatches between assets and liabilities. In order to maximize earnings and attain strategic goals within the overall risk/return preferences, BPMB is guided by the structure below :





The Bank currently adopts an internal voluntary observation of Basel II and III liquidity ratios and targets.

In 2013, the following key initiatives were also completed to further strengthen the Group's risk management :

- Enhancement of Integrated Stress Testing Report;
- Development of Group-wide Aggregated Risk Report;
- Quarterly Sectoral Outlook and Monthly Assessment Reports.

## INTEGRATED STRESS TEST

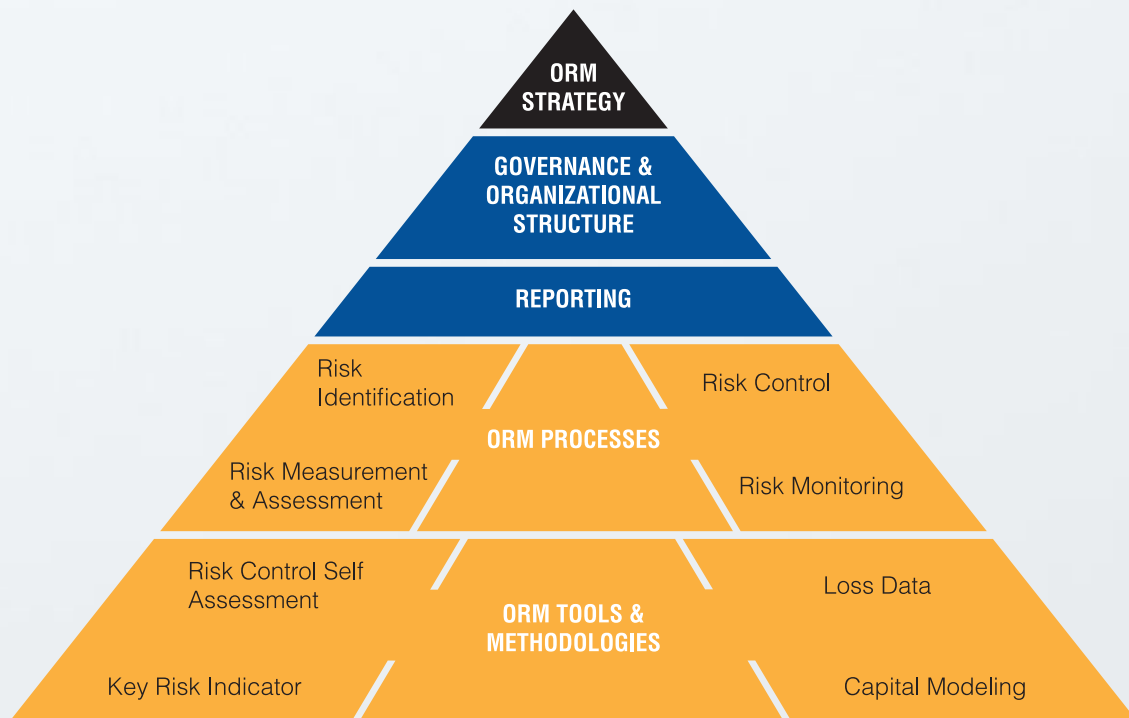
In line with Bank Negara Malaysia's (BNM's) Stress Test Guidelines, the Bank has designed a stress test framework which is tailored to the nature of its business activities.

BPMB had conducted four (4) quarterly Integrated Stress Testing exercises in 2013 by simulating events that could potentially impact its capital position. The main emphasis was on credit, liquidity and market risks.

From all the integrated stress test done for 2013, it was found that BPMB would continue to be able to absorb the shock arising from the stress assumptions.

## OPERATIONAL RISK MANAGEMENT

For effective management of operational risk, the Group is guided by the Operational Risk Management (ORM) Framework which was developed in line with Basel publications and BNM Guidelines to provide clear, consistent and systematic ORM approach. The key components of the Framework include:



The risk strategy provides the overall ORM principles, philosophy, objectives and goals. It drives the implementation of ORM within the Group. The framework clearly defines the governance structure as well as roles and responsibilities of various functions within the organization with regards to operational risk management. The ORM processes of risk identification, measurement/assessment, control and monitoring are performed in line with best practices by applying the Risk Control Self-Assessment, Key Risk Indicator and Loss Data Management processes throughout the Group. The Business/Support functions as the risk owners are responsible for managing their risks. To facilitate effective implementation of ORM, dedicated Operational Risk Liaison Officers have been appointed for each function to ensure risks are actively identified, controlled and monitored.

Introduction of new products and IT systems are also subject to risk review to ensure risk exposures are appropriately mitigated. Day-to-day operational risk is managed through establishment of internal controls, processes and requirements, which are documented in policies, frameworks, procedures and guidelines.

Business Continuity Management is an important component of the Group's risk management framework to increase the organization's resilience to business disruption arising from internal and external events and to reduce the impact on its business operations, reputation or profitability. The Group's Business Continuity Plan and the Disaster Recovery Plan are continuously being updated and tested in line with Bank Negara Malaysia's (BNM's) requirements.

Enhancing risk awareness forms part of the Group's ORM objective towards cultivating a culture that places high priority on effective management of risk, adherence to sound operating controls, ethics and values. Continuous training efforts are undertaken to achieve this objective.

Although Basel II Operational Risk capital charge is not imposed on DFIs, BPMB continues to build its ORM infrastructure and capabilities towards fulfilling the relevant requirements, to further strengthen its ORM as well as preparing the organization should the same be made compulsory later. The Executive Risk Management Committee and Risk Management Committee are kept regularly updated of the ORM initiatives and operational risk exposures.

In 2013, the following key initiatives were also completed to further strengthen the Group's ORM :

- Establishment of Shariah non-compliance risk catalogue to facilitate the risk owners in identifying, monitoring and controlling of Shariah non-compliance risks.
- Shariah Non-Compliance Risk Control Assessment exercise to gauge the Group's Shariah non-compliance risks exposure and to identify areas for control improvement.
- Established the Shariah non-compliance reporting procedure to facilitate reporting of Shariah non-compliance events within the Group.
- Established the Enterprise risk profile monitoring and reporting for BPMB subsidiary to enable assessment of risks exposures and monitoring of risks and actions taken by the subsidiary.