MANAGING RISKS

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Outline of Presentation

- Definition of Risk
- Risk Categorization
- Banks are in the Business of Taking Risks
- Evolution of Banking Risks
- General Accounts Management Cycle
- What is a Problem Loan?
- Sources of Portfolio Attrition
- Risk Management
- Drivers of Risk Management
- Mitigating Credit Risk
- Benefits of Managing Risk
- Risk Management Process

Definition of Risk

- A risk is a potential problem – it might happen and it might not
- Conceptual definition of risk
  - Risk concerns future happenings
  - Risk involves change in mind, opinion, actions, places, etc.
  - Risk involves choice and the uncertainty that choice entails
- Two characteristics of risk
  - **Uncertainty** – the risk may or may not happen, that is, there are no 100% risks (those, instead, are called constraints)
  - **Loss** – the risk becomes a reality and unwanted consequences or losses occur

Risk Categorization

- **Known risks**
  - Those risks that can be uncovered after careful evaluation of the project plan, the business and technical environment in which the project is being developed, and other reliable information sources (e.g., unrealistic delivery date)
- **Predictable risks**
  - Those risks that are extrapolated from past experience
- **Unpredictable risks**
  - Those risks that can and do occur, but are extremely difficult to identify in advance

Banks Are In the Business of Taking Risks!

LENDING, as a basic **banking function is unavoidably risk** taking activity.

1. The bank exposes itself to the chance of losing the principal and profits.
2. Incur unexpected expenses in safeguarding or recovering the investment.

Thus, the bank **analyzes the risks** of lending by predicting possible failure in advance:

1. If risks are great and uncontrollable, the bank denies the loan.
2. If the risks are minimal and acceptable, the bank approves the loan.

The Environment and the Evolution of Banking Risks

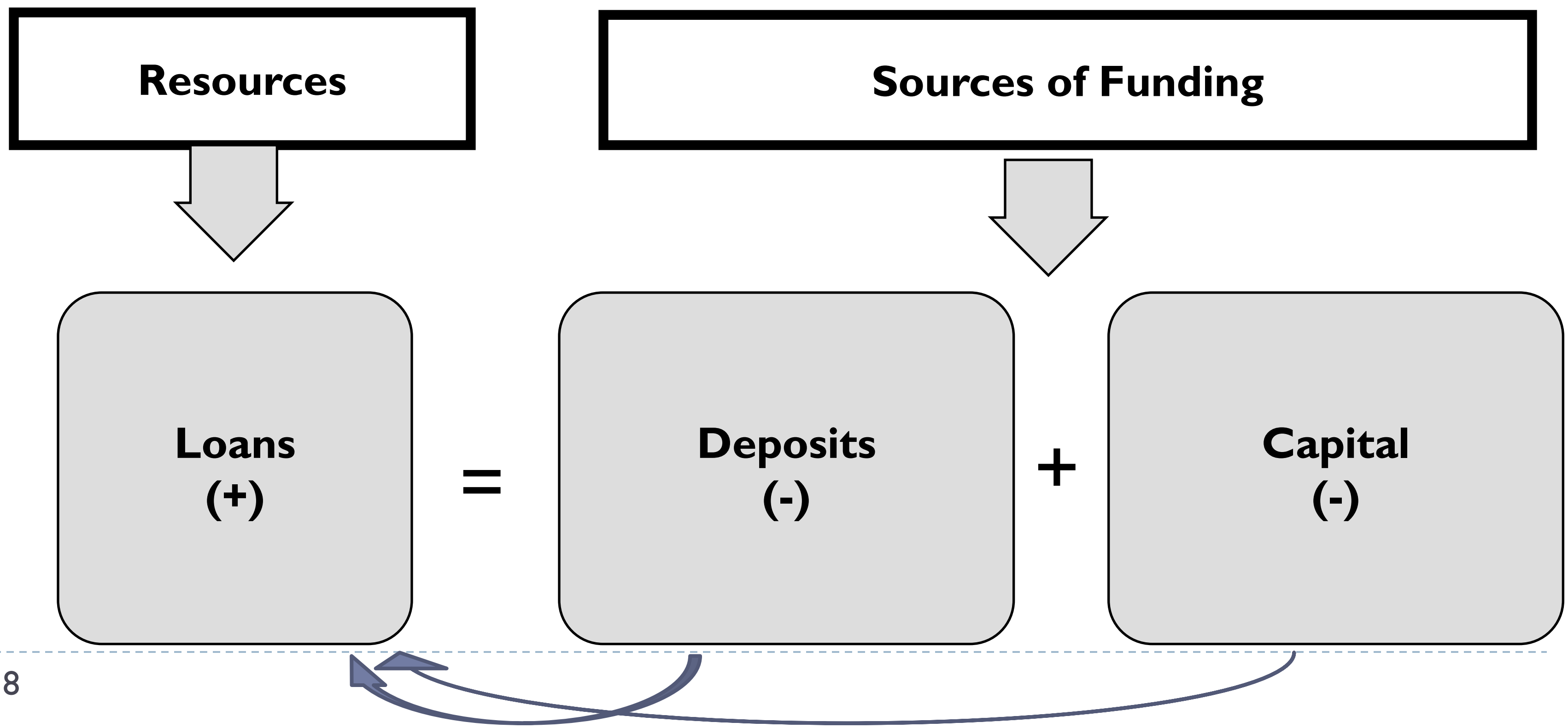
- **Risks increased because of ---**
  - New competition
  - Product innovations
  - Emergence of capital markets
  - Increased market volatility

General Loan Accounts Management Cycle

1. Prospecting and solicitation
2. Loan Packaging, Underwriting & Credit Evaluation
3. Loan Approval
4. Documentation for Loan release
5. Loan administration and management (Loan Relationship Management)
6. Remedial Accounts Management
7. Foreclosure and Litigation
8. ROPA or NPA Management and Asset Recovery
9. CASH Conversion of recovered Assets

Accounting Equation

Assets = Liabilities + Owners' Equity



What is a problem loan?

A **PROBLEM LOAN** is defined as one in which there is major breakdown in the repayment agreement resulting in:

1. Undue delay in collection or
2. In which it appears that legal action may be required to effect collection, or
3. There appears to be a potential loss.

Past Due Ratio Computation

$$\text{Past Due Ratio} = \frac{\text{Past Due Loans}}{\text{Total Loans}}$$

Current Loan	800,000
Past Due Loan	100,000
ITL	100,000
Total Loan	**1,000,000**

$$\textbf{Past Due Ratio} = \frac{100{,}000}{1{,}000{,}000}$$

$$= \textbf{10\%}$$

Sources of Portfolio Attrition or Reduction

1. Regular payments or amortization
2. Pre-payments / Early payments
3. Maturing Credit Lines that will not renew
4. Loan take-outs
5. Transfer to ROPA
6. Write-offs

What is Risk Management?

- Establishment of controls to minimize the possibility of loss.
- Involves estimating the size of the risk and making sure that returns still outweigh identified risks.
- Primary objectives of Risk Management
  - Preserve the bank's reputation, capital and profits
  - Optimize the allocation of capital
  - Promote a proactive risk culture

Drivers of Risk Management?

What Risk Management can do?

- Serves as a strategy implementation tool
- Develops competitive advantage
- Measures capital adequacy and solvency
- Aids in decision making and planning
- Aids in pricing decisions
- Helps mitigate and control risks
- Directs portfolio management

Mitigating Credit Risk

1. Correct and prudent loan/credit underwriting
   - Use of Cash Flow Analysis vs. collateral based lending
2. Proper loan documentation of loan accounts
3. Proper loan administration and relationship management
4. Pro-active accounts remedial management vs. reactive accounts remedial management
5. Timely decision on whether to:
   - Restructure problematic accounts, or
   - Pursue foreclosure proceedings
6. Proper management of ROPA
7. Quick disposal of ROPA
8. Portfolio diversification

BENEFITS OF MANAGING RISK (1/8)

Why do we have to do Risk Management?

Business: Managing risk well brings about a lot of advantages to a business

Increased profitability

- more efficiency,
- more productivity,
- increased sales,
- maximized return on capital

BENEFITS OF MANAGING RISK (2/8)

Why do we have to do Risk Management?

Business: Managing risk well brings about a lot of advantages to a business

Reduced Loss

- cut out unnecessary activities and improve inefficient ones,
- reduce process failures, minimize non-productive overheads,
- avoid losses through theft or fraud

BENEFITS OF MANAGING RISK (3/8)

Why do we have to do Risk Management?

Business: Managing risk well brings about a lot of advantages to a business

Higher Credit Ratings

By demonstrating the above, an entity can improve the rating given to it by the global credit rating agencies (Moody's, Standard and Poors, etc)

BENEFITS OF MANAGING RISK (4/8)

All in all, what does risk management allow us to do?

- Improved Predictability
- Exploiting Opportunities
- Improved Investor/Stakeholder Confidence
- Compliance

BENEFITS OF MANAGING RISK (5/8)

All in all, what does risk management allow us to do?

Improved Predictability

Exploiting Opportunities

Compliance

- Avoid unexpected or unidentified events impacting the organization's short and long term performance
- Planning that includes risk assessment and control will improve results predictability at business levels
- Helps functional and business managers to justify their plans and budgets
- Help the Board understand the risks and improve confidence in planning

BENEFITS OF MANAGING RISK (6/8)

All in all, what does risk management allow us to do?

- Improved Predictability
- Exploiting Opportunities
- Compliance

- Satisfactory risk management culture delivers a clear understanding of acceptable risk types and levels to take
- Provides freedom to take more risks with reasonable controls in place
- Board can balance the need to take high risk in some parts of the business against a more consistent revenues in others

BENEFITS OF MANAGING RISK (7/8)

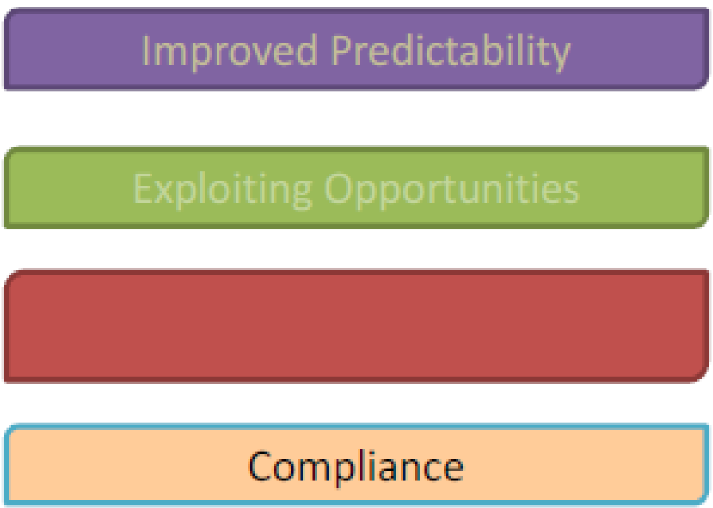
All in all, what does risk management allow us to do?

- Improved Predictability
- Exploiting Opportunities
- Improved Investor/Stakeholder Confidence
- Compliance

- When unexpected events or results occur, investors and stakeholders view their management as an indication of the organization's ability to run the business and achieve expected results
- In case where major incident has been managed, the reputation of the group will be enhanced
- Delivering predicted financial results and no unpleasant surprises will help to increase the confidence of both investors and stakeholders

BENEFITS OF MANAGING RISK (8/8)

All in all, what does risk management allow us to do?



- Proactive approach will improve mandatory compliance with legal, fiscal, and regulatory requirements to include
  - ✓Finance
  - ✓Health and safety legislation
  - ✓Insurance cover

Risk Management Process

Top – Down
Definition of Goals

Bottom – Up
Monitoring and Reporting

Board & Senior Management

Defines target earnings and risk limits

↓

Business Units

Translates bank goals into target revenues, risk limits and policy guidelines

Consolidated Risks, Revenues and Volume of Transactions

↑

Individual Transactions

Thank You!