Risk Strategy
Risk Appetite/Business Strategy

X Bank
Risk Strategy

• The fundamental principles with respect to its risk appetite while balancing the need for competitive return on equity to the shareholders are;

• 1. Stay comfortably above regulatory minimum capital requirements, even under stressful conditions e.g. nowadays..
Risk Strategy

- 2. Maintain external debt ratings

- 3. Maintain sufficient cushion of capital (or ready access to capital) to take advantage of market opportunities, including organic or non inorganic growth
Risk Strategy

• The following constraints should be kept in perspective while conducting all the business activities;
• Regulatory constraints – breaches of regulatory framework, either domestic or international
• Reputational – The reputation and the perception by customers and business partners must not be discredited. Integrity and reputation is vital.
Risk Strategy

• Earnings constraints – Maintain ability of generating profits in order to provide an attractive dividend to its shareholders.
• Rating constraints – Retain favourable debt ratings by adherence to appropriate capital adequacy ratios
• Strategic constraints – Business activities must be in accordance with its imposed business model and strategic objectives
Risk Strategy – Define Risk Appetite

- Maintain target ratios on an ongoing basis i.e. at each assessment;
- Pillar 1 Ratio; is the ratio of total regulatory eligible capital over risk weighted assets (per Basel II). The target for the pillar 1 ratio is 12%. Generally > minimum of 8%. Greater than minimum to ensure a comfortable regulatory capitalization. Idea is to ensure that a slight deterioration in portfolio quality / or tier capital does not compromise the banks capitalization for regulatory purposes.
Risk Strategy – Risk Appetite

• 2. Tier 1 ratio: Tier 1 / risk weighted assets (basel II). Target is 9%.

The buffer i.e. 3% on top of pillar 1 tier 1 capital requirements is chosen as sufficient large to maintain the regulatory requirement (6% on tier 1) also within a scenario of a slight decrease in portfolio quality and/ or Tier 1 capital supply
Risk Strategy – Risk Appetite

• Economic Capital Adequacy Ratio; Ratio of available financial resources over economic capital applying a 99% confidence level. The target of the Capital adequacy ratio can be > or = to 120%

  The buffer i.e. difference of 20% to 100% is sufficiently large to ensure banks capability to deal with both stress scenarios and a planned growth in business volumes.
Risk Strategy – Risk Appetite

• Liquidity Ratio ; ratio of assets over liabilities with maturity of 30 to 90 days respectively, with target of > or equal to 90% or 80%.

  The target ratio for the 30 days to 90 days liquidity ratios are discussed and approved in the asset and liability committee of a bank.
Risk Strategy – Risk Appetite

• Aside from the discussed constraints, a set of constraints are defined. These are subject to periodic monitoring. These require senior management awareness;
  • External Ratings; views taken by Moodys, S&P and Fitch. Target ratings are;
    S&P..
    e.g. Long term A, Outlook- Stable, Short term A-1 etc..
Risk Strategy – Risk Appetite

• Funding Plan Analysis; the affect of a breakdown of the inter bank borrowings should be able to be compensated by additional available resources i.e. the difference between these additional resources and the funding gap under stress should remain positive for each time bucket i.e. the target is $> 0$. 

Risk Strategy – Risk Appetite

• Loan to Deposit; the ratio of total outstanding loans and advances over available deposits – target 100%

• Interest rate shock by 200bp; monitoring the decline in net interest income due to an interest rate shock of 200 bp, with a change in net interest income over Total capital (tier 1 and 2) of < or equal to 20% - this is required for Basel II (June 2006 para 764)- regulatory compliance
Risk Strategy – Risk Appetite

• Real Estate Ratio; total real estate exposure over total customer deposits, with a target of 20% (regulatory compliance)

• Earnings at Risk; Planned net income less Economic capital, should be greater than planned dividend payments or loss threshold. Etc…
Risk Strategy- Business Strategy

• The business strategy or plan drives the risk strategy and risk appetite. Going forward the bank would have to consider the macro economic environment and consistently adjust the business strategy?

• This will require an adjustment to the business plan and the risk appetite (upward or downward).
Risk Strategy – Business Strategy

• The business strategy can be shifted from asset and balance sheet growth to margin optimization.

   Implies that given the tightened capitalization levels, the efficient allocation of capital becomes more important and is reflected in business decisions.
Risk Strategy – Business Strategy

• As an example we may have the following business strategy for a bank....

Vision – ‘to be globally recognized as the leading and most dynamic financial services provider based in Asia
Risk Strategy – Business Strategy

• The strategy aims at further diversifying the income sources and strengthening and expanding its major business lines, e.g. Retail banking, Wealth Management, Corporate and Investment banking etc..
The bank aims to grow through organic and inorganic growth both domestically and also internationally through the existing branch network and through strategic merger and acquisition activity, where the bank management sees added value in the proposition.
Risk Strategy – Business Strategy

• The bank aims to expand into new geographic business areas domestically and new business segments such as private banking and SME businesses.

• Across the banking group the goal is to further increase fee based income to international best practice levels and to leverage internal product capabilities e.g. treasury, asset management etc......
Risk Strategy – Business Strategy

• The bank aims to capture opportunities in say islamic banking through its subsidiary and sell products thru its conventional branch network.

• Evaluate and assess the local and regional market for good target banks for merger and acquisition keeping in mind optimization of synergies.
Risk Strategy – Business Strategy

• Given the existing global economic situation with scarce liquidity, pressure on profitability and potentially deteriorating asset quality, the following three strategies can be considered;
  • Optimize Balance Sheet
  • Drive profitability
  • Risk Management
Risk Strategy – Business Strategy

• The business strategy is to cautiously grow the asset book while focusing on funding, especially deposit gathering. While improving customer profitability through re-pricing and cross selling the aim is to improve the overall cost position significantly.

e.g. drive a performance improvement program and increase process efficiency across the organization.
Risk Strategy – Business Strategy

• Therefore;
  • The bank-wide risk taking is governed by risk limits set out in the banks risk appetite statement.
  • The Risk strategy translates the risk appetite in quantifiable measures.
  • This allows monitoring, controlling and managing the banks risk profile in terms of businesses and portfolios.
## Business Strategy - Parameters

<table>
<thead>
<tr>
<th></th>
<th>2008 (Forecast)</th>
<th>2009 (Plan)</th>
<th>2101 (Plan)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues/ambition to generate..</td>
<td>13%</td>
<td>15%</td>
<td>13%</td>
</tr>
<tr>
<td>Return on equity</td>
<td>15%</td>
<td>13%</td>
<td>13%</td>
</tr>
<tr>
<td>Return on Risk Adj. Capital</td>
<td>n/a</td>
<td>15%</td>
<td>15%</td>
</tr>
</tbody>
</table>
## Business Strategy - Parameters

<table>
<thead>
<tr>
<th>Economic Capital Distribution</th>
<th>2008 (Actual, Q3/2008)</th>
<th>2009 (Plan)</th>
<th>2010 (Plan)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit Risk</td>
<td>85%</td>
<td>84.50%</td>
<td>84%</td>
</tr>
<tr>
<td>Market Risk</td>
<td>2%</td>
<td>1.50%</td>
<td>1.75%</td>
</tr>
<tr>
<td>Operational Risk</td>
<td>3%</td>
<td>4%</td>
<td>4.25%</td>
</tr>
<tr>
<td>Interest Rate Risk</td>
<td>3%</td>
<td>3%</td>
<td>3%</td>
</tr>
<tr>
<td>Business Risk</td>
<td>7%</td>
<td>7%</td>
<td>7%</td>
</tr>
</tbody>
</table>

The high allocation for credit reflects banks strong lending and credit business.
## Business Strategy - Parameters

<table>
<thead>
<tr>
<th>Balance Sheet Total Footings</th>
<th>2008 (Actual)</th>
<th>2009 (Plan)</th>
<th>2010 (Plan)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total on Balance Sheet</td>
<td>$290 bn</td>
<td>$300 bn</td>
<td>$310 bn</td>
</tr>
<tr>
<td>Total off Balance Sheet</td>
<td>$82 bn</td>
<td>$86 bn</td>
<td>$89 bn</td>
</tr>
</tbody>
</table>

Risk weighted approach on risk limitations.
## Business Strategy - Parameters

<table>
<thead>
<tr>
<th>Sectoral Exposure</th>
<th>2008 (Actual)</th>
<th>2009 (Plan)</th>
<th>2009 (Plan)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture and Allied Activities</td>
<td>5% of SF or 2% of TL</td>
<td>5% SF or 2% of TL</td>
<td>5% of SF or 2% of TL</td>
</tr>
<tr>
<td>Services</td>
<td>200% of SF or 20% of TL</td>
<td>200% of SF or 20% of TL</td>
<td>200% of SF or 20% of TL</td>
</tr>
<tr>
<td>Financial Institutions</td>
<td>200% of SF or 20% of TL</td>
<td>200% of SF or 20% of TL</td>
<td>200% of SF or 20% of TL</td>
</tr>
<tr>
<td>Real Estate (direct)</td>
<td>20% of total bank deposits</td>
<td>20% of total bank deposits</td>
<td>20% of total bank deposits</td>
</tr>
<tr>
<td>SF – shareholders funds</td>
<td>Includes strong focus on</td>
<td></td>
<td></td>
</tr>
<tr>
<td>TL- Total Lending Assets</td>
<td>govt and sovereign exposures?</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>No cap on govt exposures?</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
## Business Strategy - Parameters

<table>
<thead>
<tr>
<th>Provisions- size as a % of credit portfolio</th>
<th>2008 (Actual)</th>
<th>2009 (Plan)</th>
<th>2010 (Plan)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Specific provisions as a percent of total credit exposure</td>
<td>1.12%</td>
<td>2.05%</td>
<td>1.65%</td>
</tr>
<tr>
<td>General Provisions as % of total credit exposure</td>
<td>0.24%</td>
<td>0.45%</td>
<td>0.35%</td>
</tr>
</tbody>
</table>

The provisions in 2009-2010 may look higher than the norm at previous years – it's a reflection of the negative economic outlook. In 2010 the market is expected to recover?
# Business Strategy - Parameters

<table>
<thead>
<tr>
<th>Market Value at Risk</th>
<th>2008 Historical</th>
<th>2009 (Actual)</th>
<th>2010 (Plan)</th>
</tr>
</thead>
<tbody>
<tr>
<td>FX VaR Limit</td>
<td>n/a</td>
<td>$1.3 Mn</td>
<td>$1.3 Mn</td>
</tr>
<tr>
<td>IRD VaR Limit</td>
<td>n/a</td>
<td>$2.0 Mn</td>
<td>$2.0 Mn</td>
</tr>
</tbody>
</table>

Expect a growth in the market value at risk due to new trading and hedging activities. Prior to 2009, no Var limits were applied.
Business Strategy - Parameters

• **Islamic Finance** – a potentially large market, offering a possibility for prudential lending standards. Need to recognize and understand the risk specifics of the islamic products. Going forward the management believes a growth in islamic banking will be supported?

• **International Diversification** – Banks intention to grow its presence regionally. It will assist in reducing concentration risk and is in line with the goal to diversify geographically. .. Via expanding branch network, strategic acquisitions.
Business Strategy - Parameters

- Investment Portfolio Risk – At present managed on a transaction by transaction basis with approvals from investment committee. Going forward develop portfolio management strategy including implementation of risk appetite agreed to by the Executive Committee etc….

- Operational Risk – These risks could lead to severe financial losses and damage banks reputation. Identification, assessment and proper management of these risks are of significant importance to mitigate event risks. Going forward, foster a process to collect and analyze historic loss events and to derive measures to mitigate the risk.
Risk Strategy and Performance Metrics on Risk Management

- In order to measure its (non project) performance, Risk Management has set Key Performance Metrics:
  - Asset and Liability Committee – package to achieve sufficient lead time for the preparation of committee members – 1 day/1 week ahead of any scheduled meeting
  - Quarterly Risk Report – Key instrument for the transparent communication of a bank’s risk profile – the report is expected to be ready 30 days after quarter end
  - Economic capital report – comprehensive reporting should be done no later than 3 months post quarter end
Risk Management – Given the Global economic crisis

- In order to maintain a banks position in the market and to maintain the risk profile within acceptable and approved levels, the key aspects of the crisis can be addressed as follows:

- Credit Risk – to manage the impact of the market turmoil, the strategic emphasis can be on tighter monitoring and controlling standards of the existing portfolio, reduction of limits as well as pricing adjustments for new products.

- Property Market – the drying up of mortgage financing and the exceptional growth of property prices may see increased number of defaults. Tighten credit standards and intensify analysis.
Global Crisis

- Liquidity Crisis – The liquidity crisis continues to impact refinancing capabilities. Therefore, risk intensify the monitoring of liquidity and refinancing and furthermore assist business in the adjustment of business plans.

- Spread Crisis – the crisis brought about a break in the longstanding correlation of US inter bank and local inter bank exchange rate (despite the existing peg) and the credit spreads widened? Risk to closely monitor such developments and support the treasury and business units.
Global Crisis

- Economic Recession – Develop framework that quantifies stress scenarios for all segments of the business. Link them to key risk factors macro economic/ bank specific and performance indicators, assess their impact, suggest hedges to actively manage risk exposures and minimize potential losses.