FIRST+

Financial **I**nstitution **R**esilience & **ST**rengthening

Effective Risk Management:

Tools and Practices

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Agenda

Session 1:	Opening and Introductions
Session 2:	Risk Appetite
Session 3:	Management Risk Committee
Session 4:	Next Steps

What is risk management?

- Financial institutions are in the risk business.
- Risk department needs to **understand** the risk, **measure** the risk and **communicate** the level of risk.
- The senior management and board of directors decide if the risk should be minimized, controlled, or deleted.

Poll:

Which statement reflects your institution's use of a risk appetite statement?

- The risk appetite statement is fully used by the institution. The targets and benchmarks are reviewed by management and the board often during the year.
- My institution has a risk appetite but the risk department is monitoring the targets and benchmarks.
- My institution has a risk appetite but not used consistently.
- My institution does not have a risk appetite.

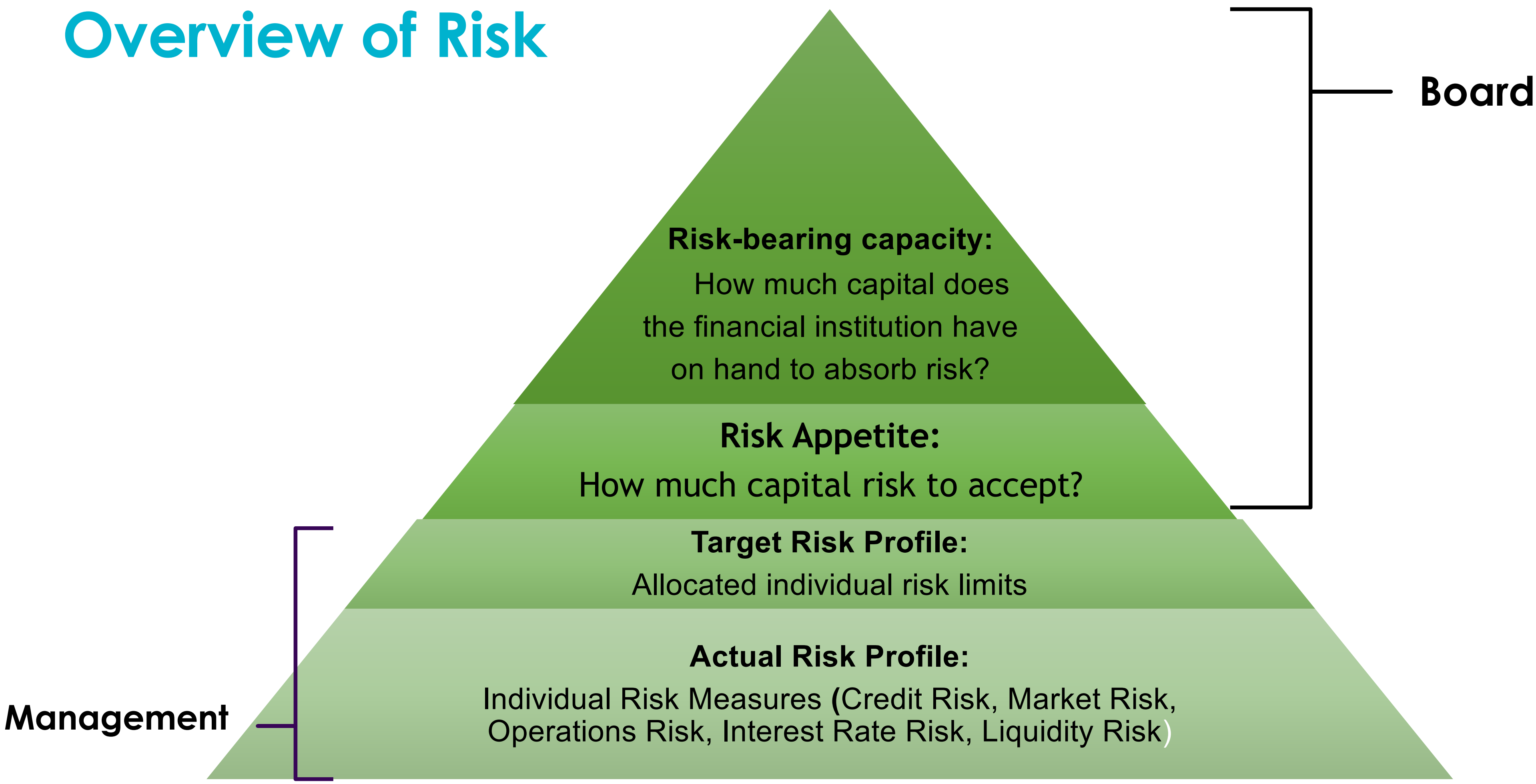
Financial Institution's Risk Appetite

- Financial Institutions need to establish specific, measurable goals and benchmarks for all risks.

- Goals and benchmarks are the outgrowth of the financial institution's <u>credit culture</u> and <u>risk profile</u>.
    - Credit culture is the financial Institution's credit values, beliefs, and behaviors.
    - Risk profile describes the various levels and types of risk on the balance sheet.

- Two different risk appetites:
    - Bosnia and Herzegovina:
        - Less than 1% Portfolio at Risk over 30 days and no charge offs
        - 3% loan portfolio growth annually
        - Acceptable profit level
    - Republic of Moldova:
        - 90% recovery rate (no Portfolio at Risk benchmark)
        - 15% loan portfolio growth annually
        - Very high profits

Overview of Risk



Statement of Risk Appetite

- Board level document
- Quantifies and qualifies the desired level of risk (that an institution is willing to take)
- Expressed in terms of risk **limits**
- Normally refreshed at least annually
- Should not be a statement of what the financial institution aspires to.

Do not say "The company wants to be the largest financial institutions in Ghana"

Say "The company does not accept risks that could result in a significant loss of its revenue base."

Statement of Risk Appetite
Examples of Benchmarks

Quantitative:

- **Earnings**: Do not deliver a below market average of earnings forecast.
- **Capital**: Capital ratio should not fall below 6%

Qualitative:

•**Manage growth effectively**: Monitor early warning indicators of non-sustainability

•**Business Activities:** Limit business activities to retail and commercial lending.

•**Zero Tolerance Risk:** No flagrant breaches, fines or headlines. No breach of delegated authority.

Poll:

Which statement reflects your institution?

- The institution has a management risk committee that meets regularly and is effectively monitoring and managing risk.
- The institution has a management risk committee but the Risk Officer is mainly monitoring the risk.
- The institution does not have management risk committee but it does have a Risk Officer.
- Risk is being managed by the executive committee and internal audit (or compliance officer)

Management Risk Committee

Per the Bank of Ghana's Corporate Governance Directive 2018:

- The Board "ensure….a risk management function (Chief Risk Officer or equivalent) with sufficient authority, stature, independence, resources, and access to the Board."
- "Senior Management is "responsible for the oversight of the day to day management of risk."

Management Risk Committee

- Management Risk Committee meets monthly (at a minimum)
- Possible Participants: President/CEO, CFO, Risk Officer, Manager of Lending, Manager of Operations. (Internal Auditor may 'sit in' meetings but is not allowed to vote.)
- The process of determining if the risks we take are appropriate to the rewards we want
- A forum for the free flow of ideas!!

Issue: Many Financial Institutions feel a committee is not important—if there is a Risk Officer!

Management Risk Committee
Meeting Agenda

- **Current economic conditions**: Interest Rates, Inflation/Deflation, Currency
- **Asset Mix:** Cash & Investments, Loans to fund
- **Funding Mix:** Deposits, Debt
- **Specific Risk Discussions:** Credit Risk, Interest Rate, Foreign Exchange and Liquidity Risk
- **Internal Controls**
    - Risk Assessment Matrix
    - Audit Reviews
    - Examination Reviews
- **Pricing** (Interest Rate Margins)
- **Proposed new products & services**

Pros and Cons

Management Risk Committee

Pros	• More eyes/opinions • Risk is contemplated by entire management • Is forward looking (remember no surprises!)
Cons	• May take more time to make decisions • If no person developing reports, can be inefficient and ineffective • Could allow for 'group thinking'

Handout: Management Risk Committee Charter

Management Risk Committee * Asset/Liability Committee * Internal Audit

Asset Liability Committee

- Can be a subset of management risk committee
- Focused on balance sheet risk

Management Risk Committee

- Looks at overall risk
- Usually encompasses all senior managers
- Can provide recommendations in setting the audit agenda

Internal Audit

- Evaluates and improves the effectiveness of a financial institution's risk management , control, and governance processes and suggest practical recommendations.
- Eyes and ears of the board.
- Can sit in Risk Mgt meetings but not an active participant

Risk Matrix
Overview

- **The tool** should be reviewed by management risk committee on a quarterly basis.
- Matrix is completed by ***compiling information*** such as liquidity reports and credit inspection reports will allow the committee to assess the risk.
- Matrix ***summarizes*** risk priorities and directs attention to high risk areas.
- Matrix is ***managed by the risk officer*** but is a result of communication with heads of departments.

***Quarterly review* is required because risks are unique to each financial institution and change over time.**

Matrix: Aggregate Risk Profile

Quantity of Risk		Quality of Risk Management		
		Weak	Acceptable	Strong
	High	High	Moderate	Moderate
	Mod	Moderate	Moderate	Low
	Low	Moderate	Low	Low

Risk Direction:

- Increasing
- Stable
- Decreasing

Example: Risk Matrix

Activity	Aggregate Risk	Risk Direction	Comments
BUSINESS LENDING			
Credit underwriting	High	Increasing	- New lending team & leadership - Increase in volume and complexity of deals
Collateral valuation	Moderate	Stable	
Collection practices	Moderate	Stable	

Example Risk Matrix

Activity	Aggregate Risk	Risk Direction	Comments
LOAN ADMINISTRATION			
Loan review	Moderate	Stable	
Loan monitoring	Moderate	Increasing	-- New loan monitoring procedures --- Hot-button area of focus for regulator exams

Risk Matrix
Problems and Issues

- **Not reviewed often enough**…risk is not static, but changing continuously
- Not presented clearly and **not supported by information/data**
- **No actions** developed from findings
- **Responses are not honest**…no one wants to admit increased risk within their department
- **Not tailored** for the specific institution

Handout: Example of a Completed Risk Matrix

What's next?

- Handouts, tools, and this presentation will be sent to you in 24 hours
- We will be addressing risk management in multiple ways over the next year
- Upcoming webinars:
  - December 1: Developing a digital strategy
  - January:
    - Introduction to Investment Readiness
      - Audience: financial institutions that haven't sought large investors before
    - Advanced Investment Readiness
      - Audience: financial institutions who have a large investor and are looking for more

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