

Risk Management Framework in Banks

March 2014



Agenda

- Risk Management Framework – The Concept
- Regulatory Evolution Of Risk Management In Pakistan
- Risk Management Framework – SAARC Overview
- Modern Day Risk Management
- EIRM
- EIRM – Beyond Regulatory Compliance
- Risk Management – Future Perspective

Concept

Risk Management Framework – The Concept

“A comprehensive document that systematically and practically defines an implementation approach helping organisations, regardless of size; of mission, to identify events and measure, prioritize and respond to the risks challenging its most critical objectives and related projects, initiatives and day-to-day operating practices”

What it aims for?

It enhances an organization’s ability to effectively manage uncertainty

Regulatory Evolution of Risk Management - Pakistan

Regulatory Evolution of Risk Management in Pakistan



Strengthening Risk Management – Basel and Capital Management



Strengthening Risk Management – ICAAP and Stress Testing

2005

Encompassing techniques for Stress Testing, framework for regular Stress Testing, scope of Stress Testing, methodology and calibration of shocks for interest rate risk, exchange rate risk, credit risk, equity price risk and liquidity risk.

Reporting format for the above mentioned was also prescribed

Stress Testing

2008

First guidelines on ICAAP encompassing the following areas:

- Board and Senior Management oversight
- Sound capital assessment
- Comprehensive assessment of Pillar 1 and 2 risks
- Monitoring and Reporting requirements
- Internal control review
- Risk aggregation

ICAAP

2012

Revised and much more detailed Reporting Template for ICAAP released containing all details of:

- Structure and Operations
- Governance
- Risk assessment and capital adequacy
- Stress testing
- Capital planning
- Design, approval and review of ICAAP process
- Risk appetite statement calculation and methodology

ICAAP

2012

Advanced and scenario based Stress Testing encouraged together with further advanced concepts for Reverse Stress Testing

Stress Testing

Strengthening Risk Management – Internal Controls

2004

Requirements on:

- Management's statement on Internal Controls (**Financial, operational and compliance**)
- **Management's evaluation** of Internal Controls
- **BOD's endorsement** of the management's statement
- **Statutory auditors' attestation** on Board's endorsement regarding effectiveness of ICFR
- Statement of Internal controls together with auditors' attestation to be published in **Annual Reports**



2008

Statutory auditors required to give opinion **and report on BoD's endorsement regarding efficiency of ICFR**



2009

Banks required to develop a roadmap for completion of ICFR till December 31, 2009.

Statutory auditors required to submit opinion on ICFR



2010

Banks required to submit, a review report on ICFR to SBP to **assess the stages of the roadmap completed, approved by BOD or BAC.**

Statutory auditors to submit **Long Form Report (LFR)** for onward submission to SBP.



Risk Management – SAARC Overview

Risk Management – SAARC Overview*

Afghanistan

- Capital Adequacy Regulations
- AML

India

- Risk Management
- Internal Controls
- Basel II/III
- Capital Adequacy Regulations
- AML
- Stress Testing

Sri Lanka

- Risk Management
- Internal Controls
- Basel II/III
- Capital Adequacy Regulations
- AML

Maldives

- Capital Adequacy Regulations



Nepal

- Risk Management
- Basel II/III
- Capital Adequacy Regulations
- AML
- Stress Testing

Bhutan

- Internal Controls
- Capital Adequacy Regulations
- AML

Bangladesh

- Risk Management Guidelines
- Internal Controls
- Basel II
- Capital Adequacy Regulations
- Stress Testing
- AML

* The information presented above may vary with respect to degree to accuracy as it is based on publically available information. There may be certain works in pipeline and several other supervision and inspection tools to support implementation of best practice risk management frameworks.

Modern day Risk Management

Modern day Risk Management



Modern day Risk Management – Entity wide integration



Modern day Risk Management – Lines of Defense

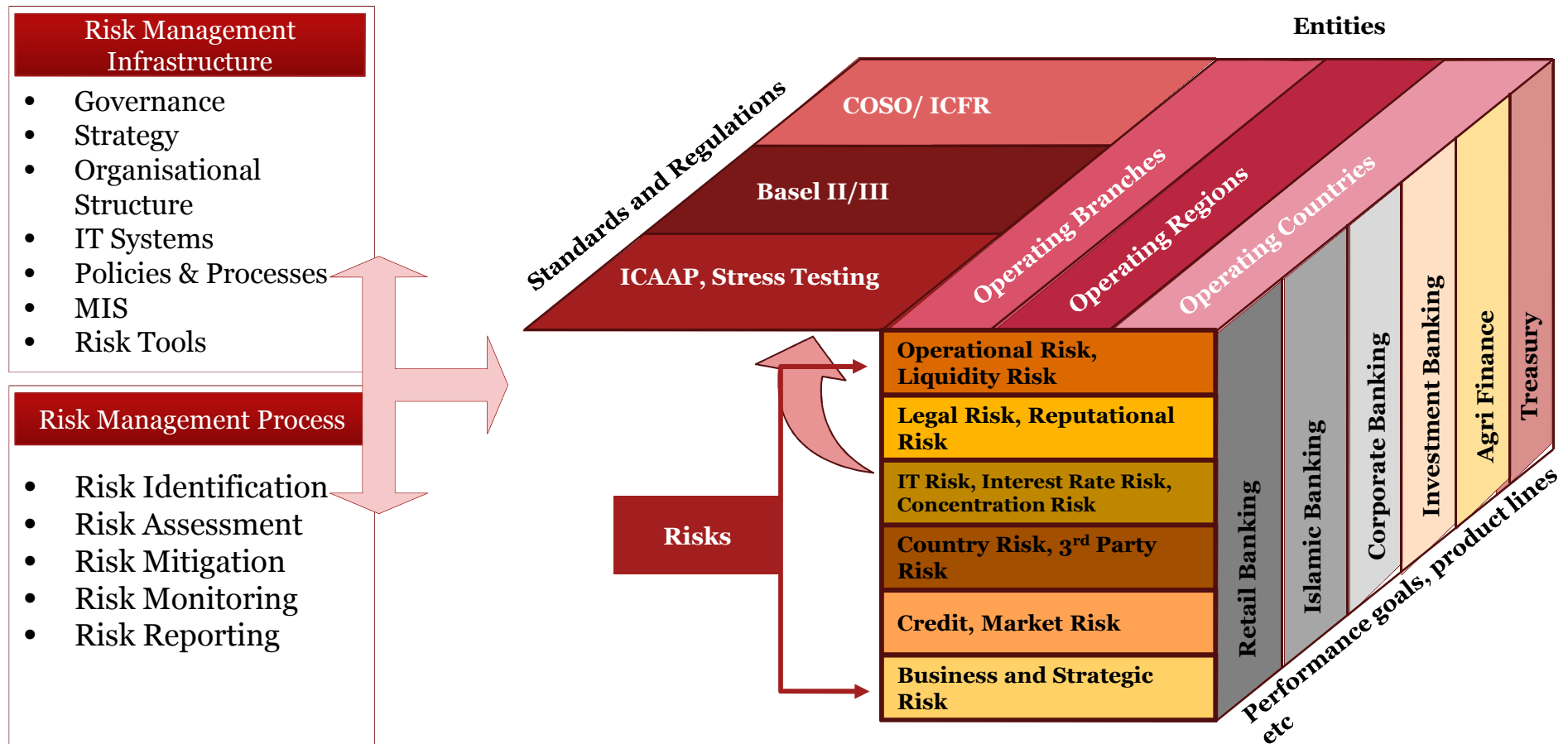
Risk Area	1 st Line of Defense	2 nd Line of Defense	3 rd Line of Defense
Credit <ul style="list-style-type: none">▪ Retail▪ Commercial	CIBG CRBG	Risk Management & Compliance	Internal Audit
Market <ul style="list-style-type: none">▪ IRR▪ Liquidity▪ Price Risk (Investments)	Treasury		
Operational <ul style="list-style-type: none">▪ Operations (Assets/ Liabilities)▪ Technology▪ Fraud▪ Accounting/ Financial Controls▪ HR▪ Model	All Business & Support		
Compliance			
Business/ Strategic			
Reputational			



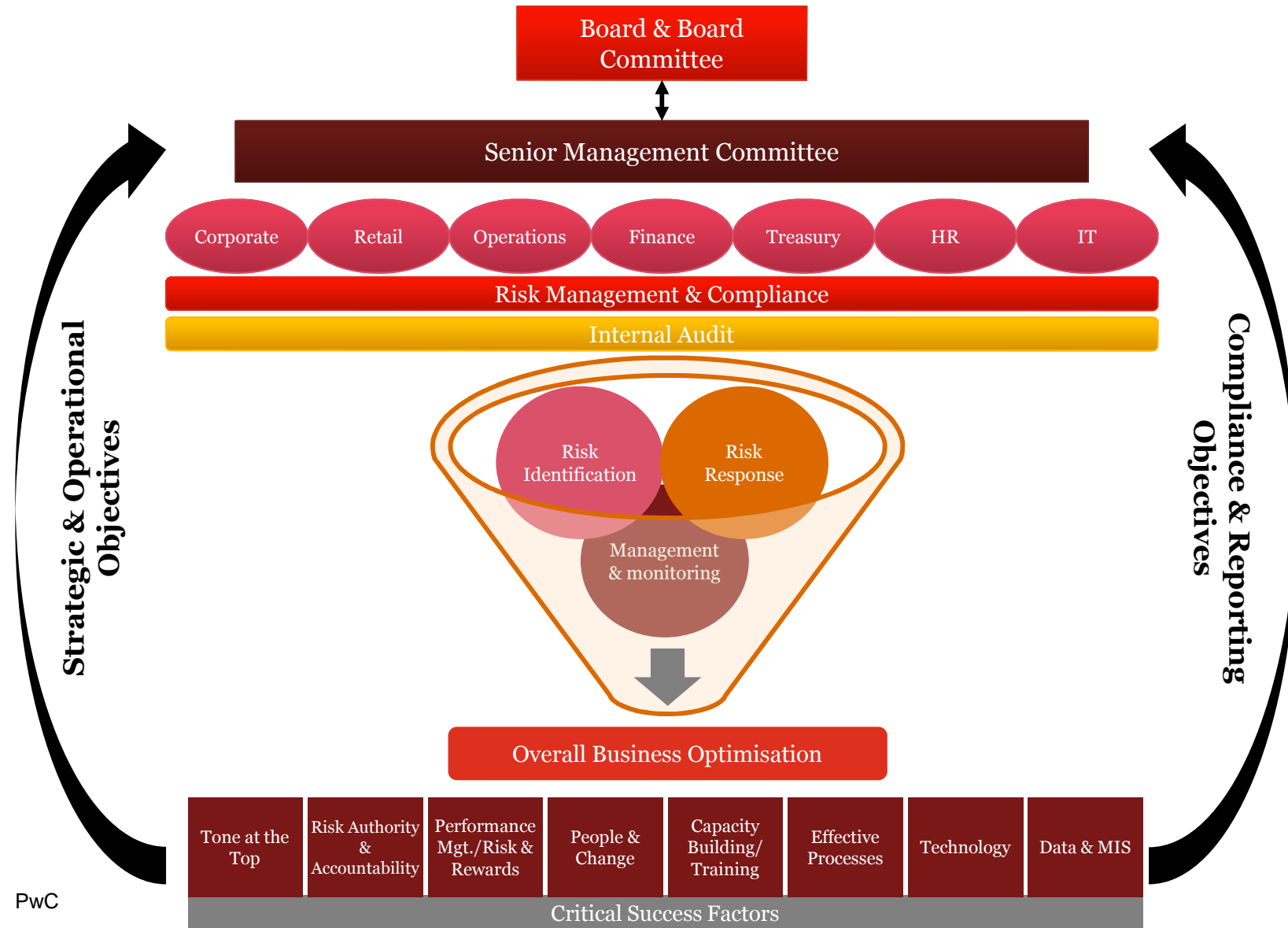
Enterprise-wide Integrated Risk Management

Single View into Risk Management

The next generation of risk management solutions calls for an EIRM approach that encompasses all dimensions of entity and risks



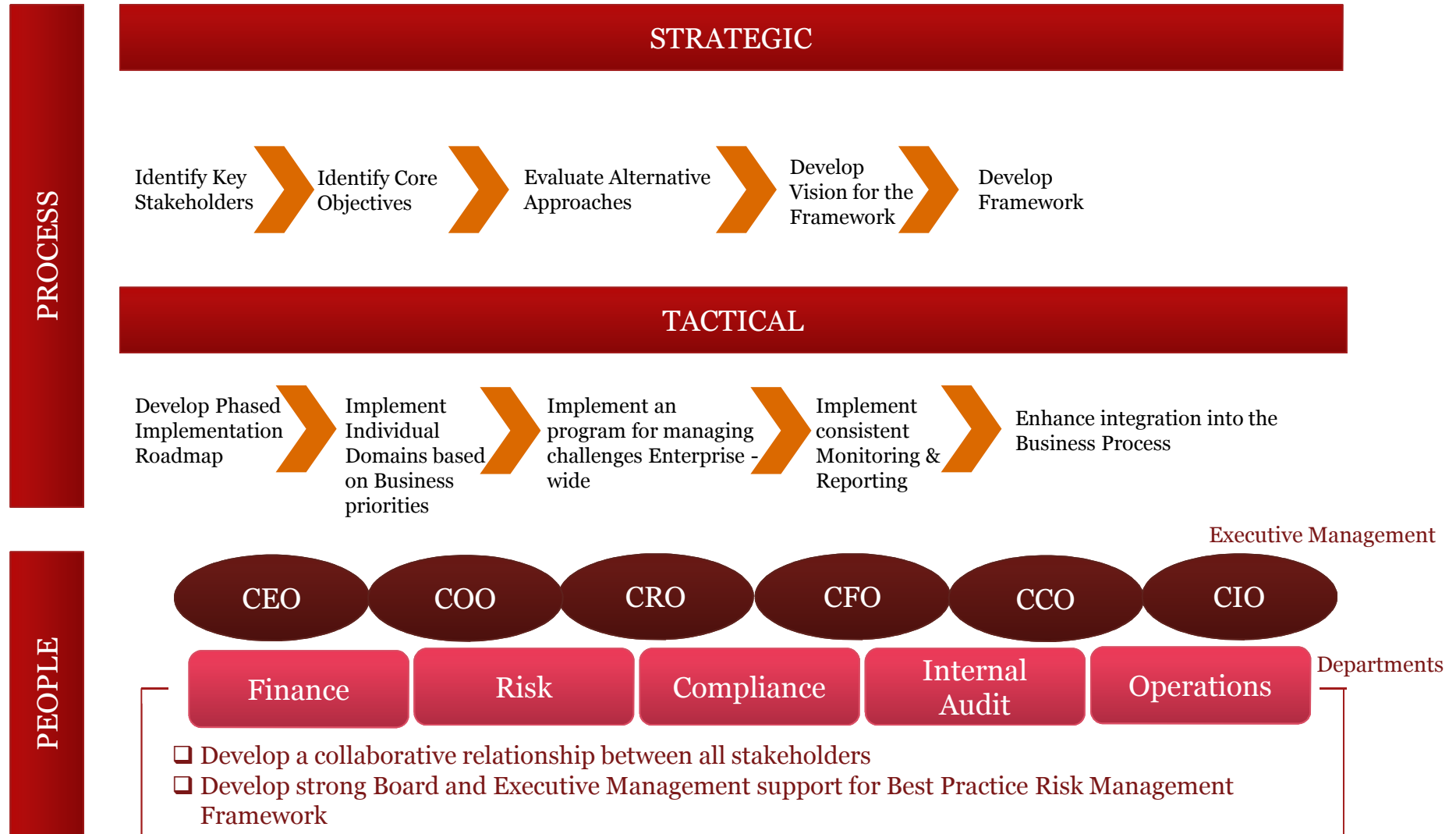
Enterprise-wide Integrated Risk Management



Enterprise-wide Integrated Risk Management - Objectives & Goals



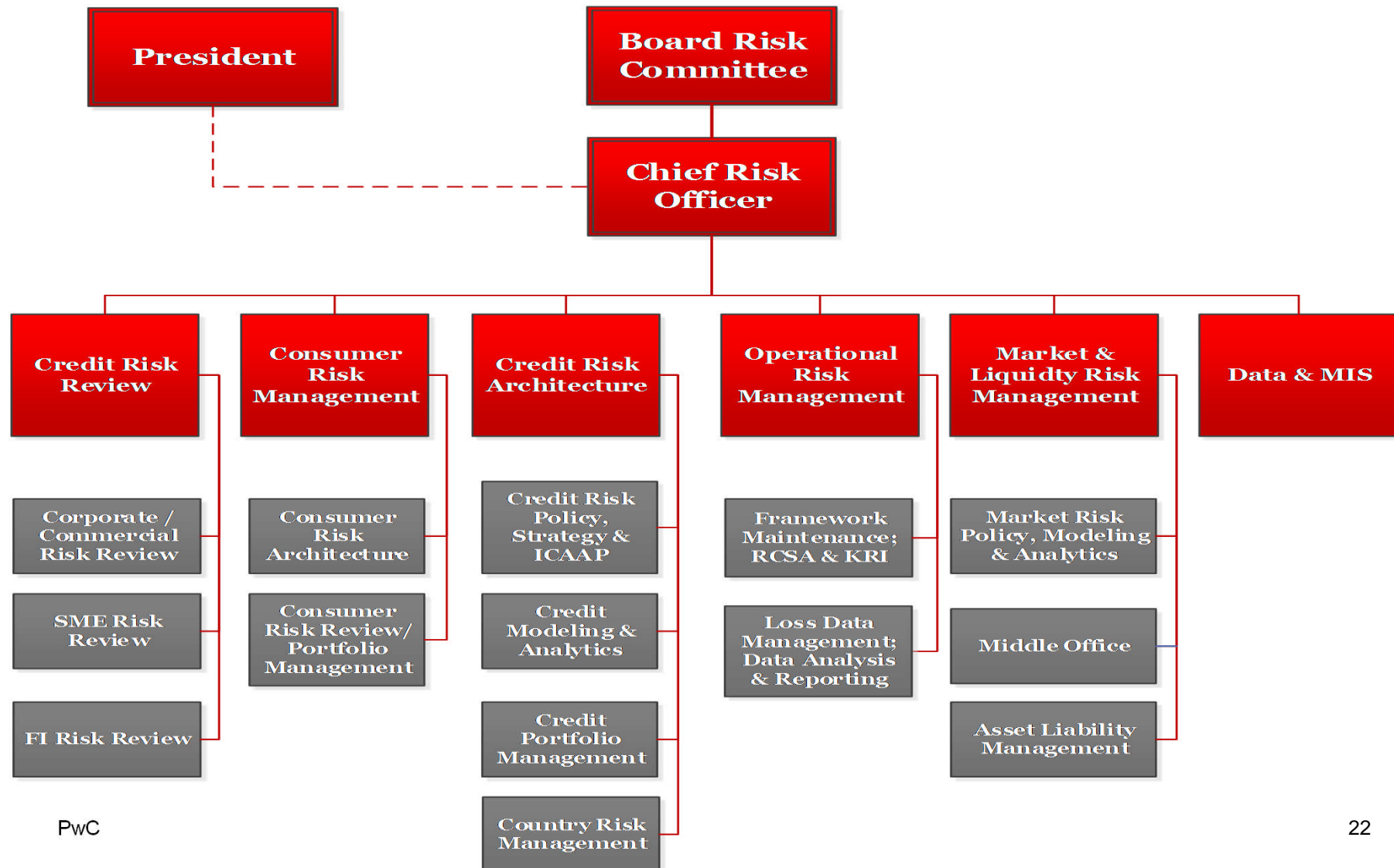
Framework Implementation



Risk Management – Organisational Structure

Risk Management Structure

A dedicated Risk Management Function – An Illustration



Risk Management – Risk Areas

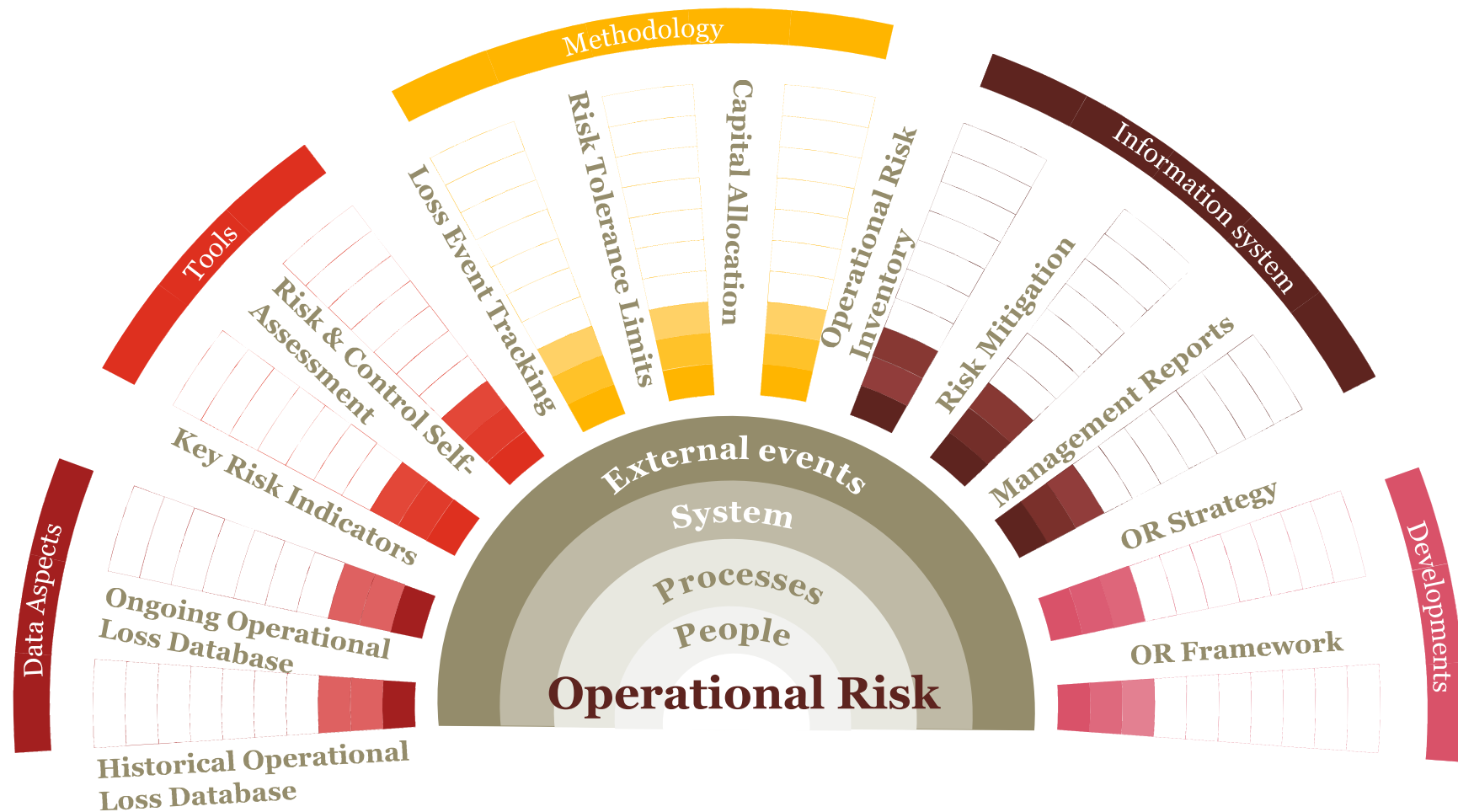
Credit Risk



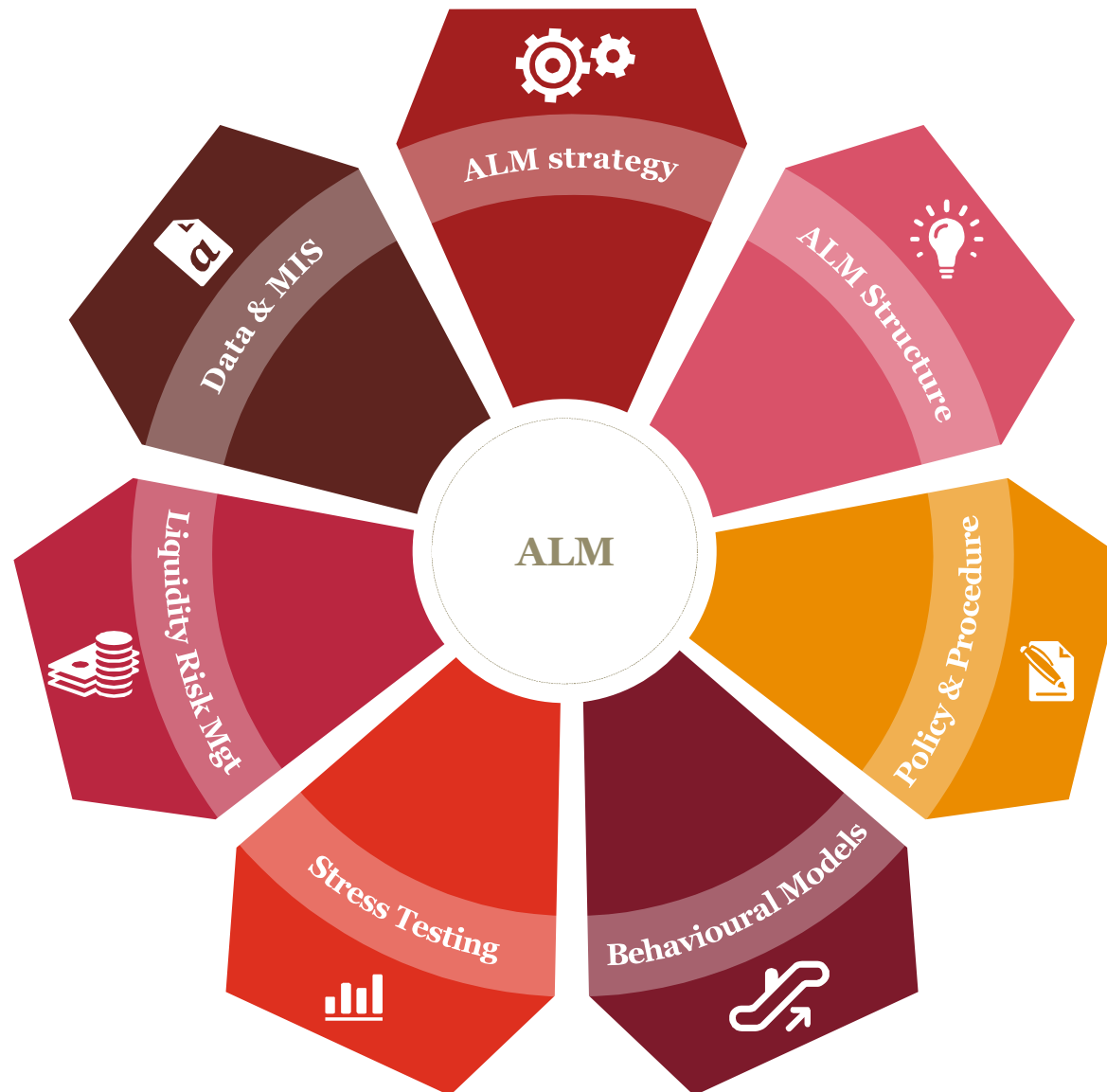
Market Risk



Operational Risk



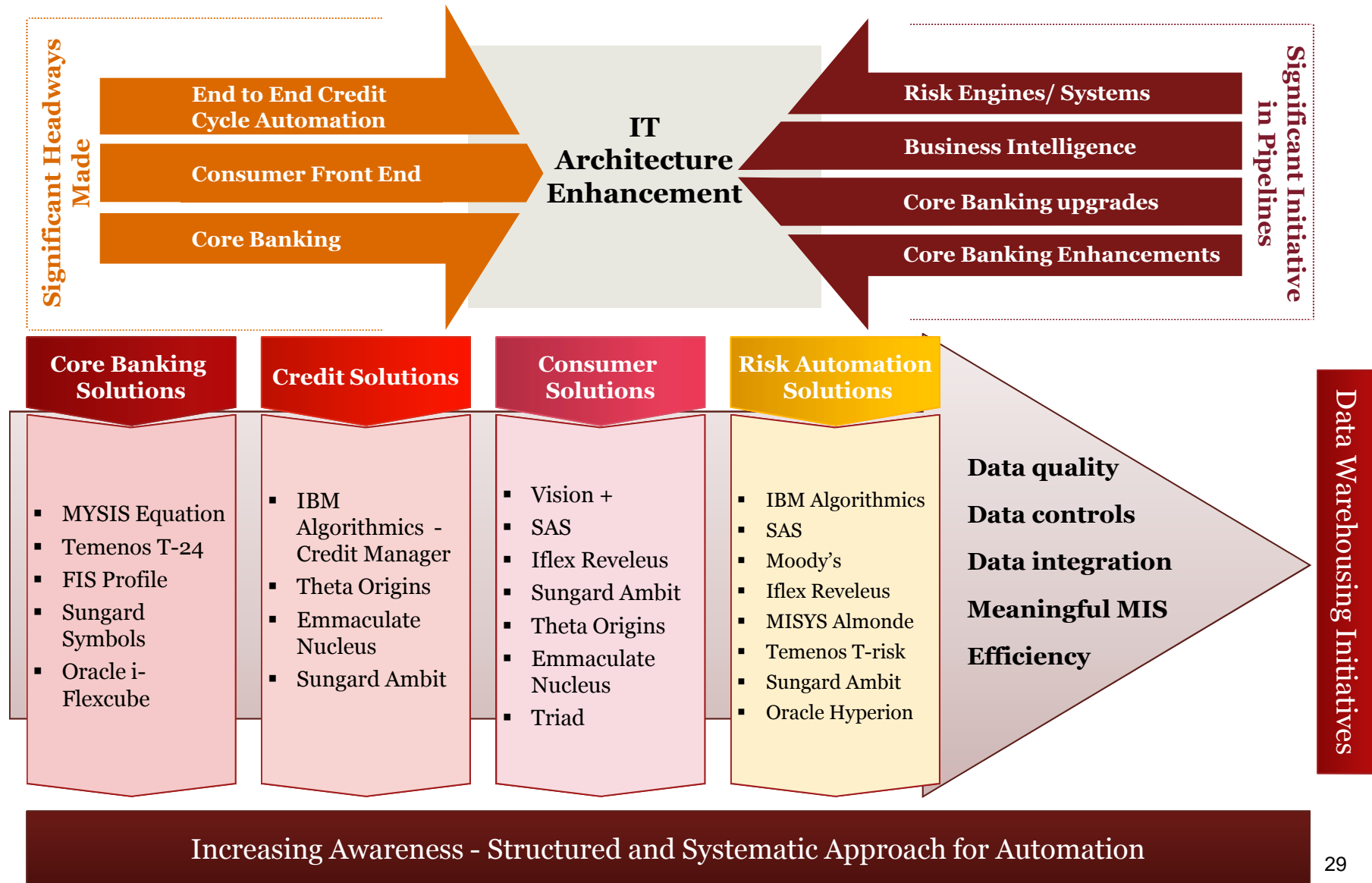
Asset Liability Management



Key Initiatives

- Risk Governance and Independence
- Credit Risk Model Upgradations
- Risk Technology Investments
- Data Enrichment
- Concentration Management
- Internal Control Programme
- Operational Risk Advancements
- Relatively Advanced Stress Testing
- Independent Risk Review
- ALCO's role in ALM

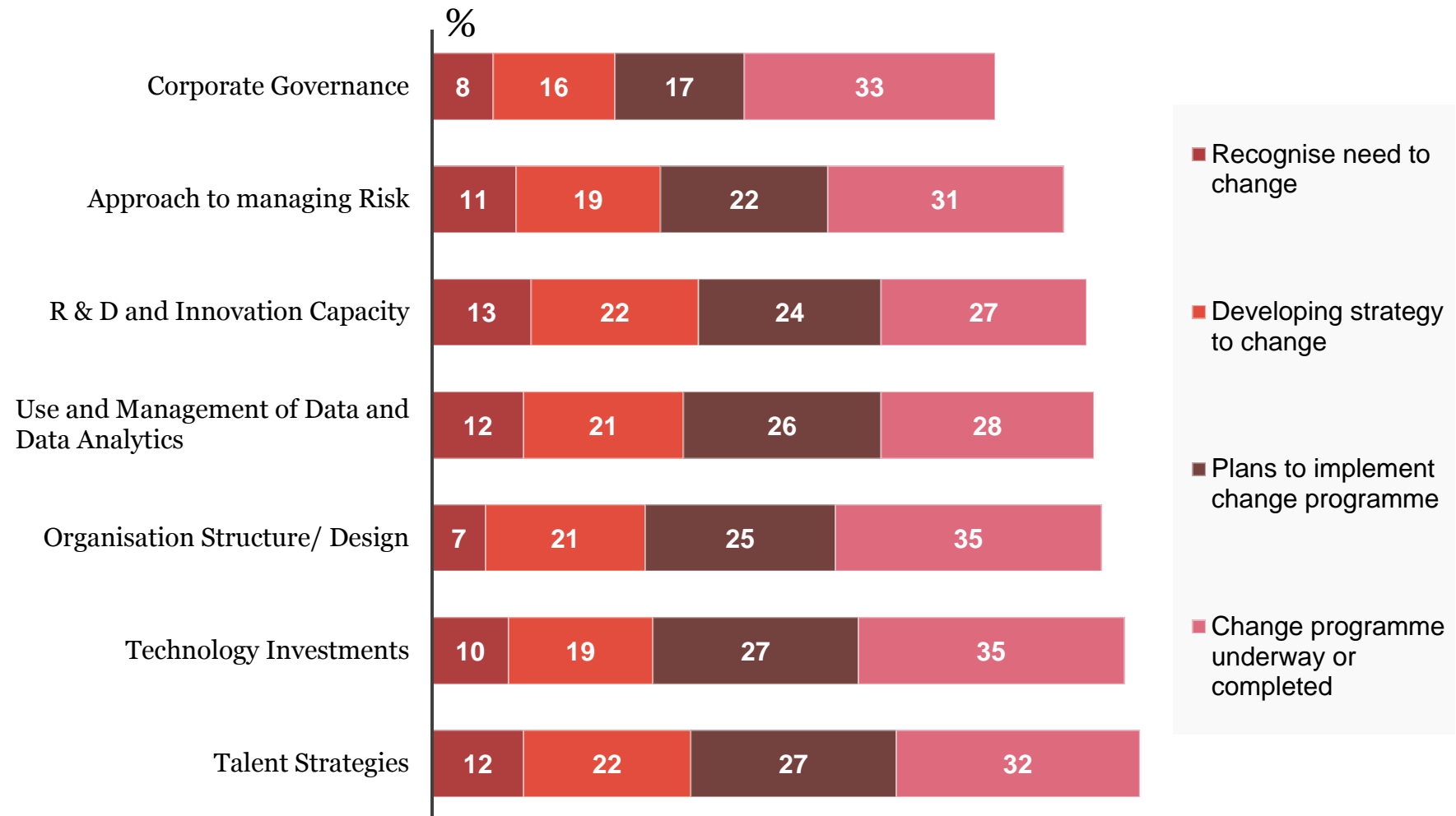
Systems and Automation



Key Challenges

- WALL between Risk Management and Business
- Resistance to Change Management
- Entity-wide Risk Management Awareness
- Compliance vs. Business Approach to Implementation
- Risk Talent and Retention
- Individual vs. Corporate Ownership and Succession Planning
- Risk Authority, Accountability, Performance Management and KPIs
- Supporting Strategic and Operational Frameworks
- Data and MIS Structure as well as Quality
- Risk and Supporting Core and Analytical Applications
- Meaningful Industry Assessments and RAACs
- Risk Model Predictability and Back Testing
- Programme Breaches and Inefficiencies (reasons such as multiple projects, resource planning etc.)
- Risk Integration into Strategic Planning
- Model Integration with Business Decisions
- ICAAP

Globally acknowledged need for change

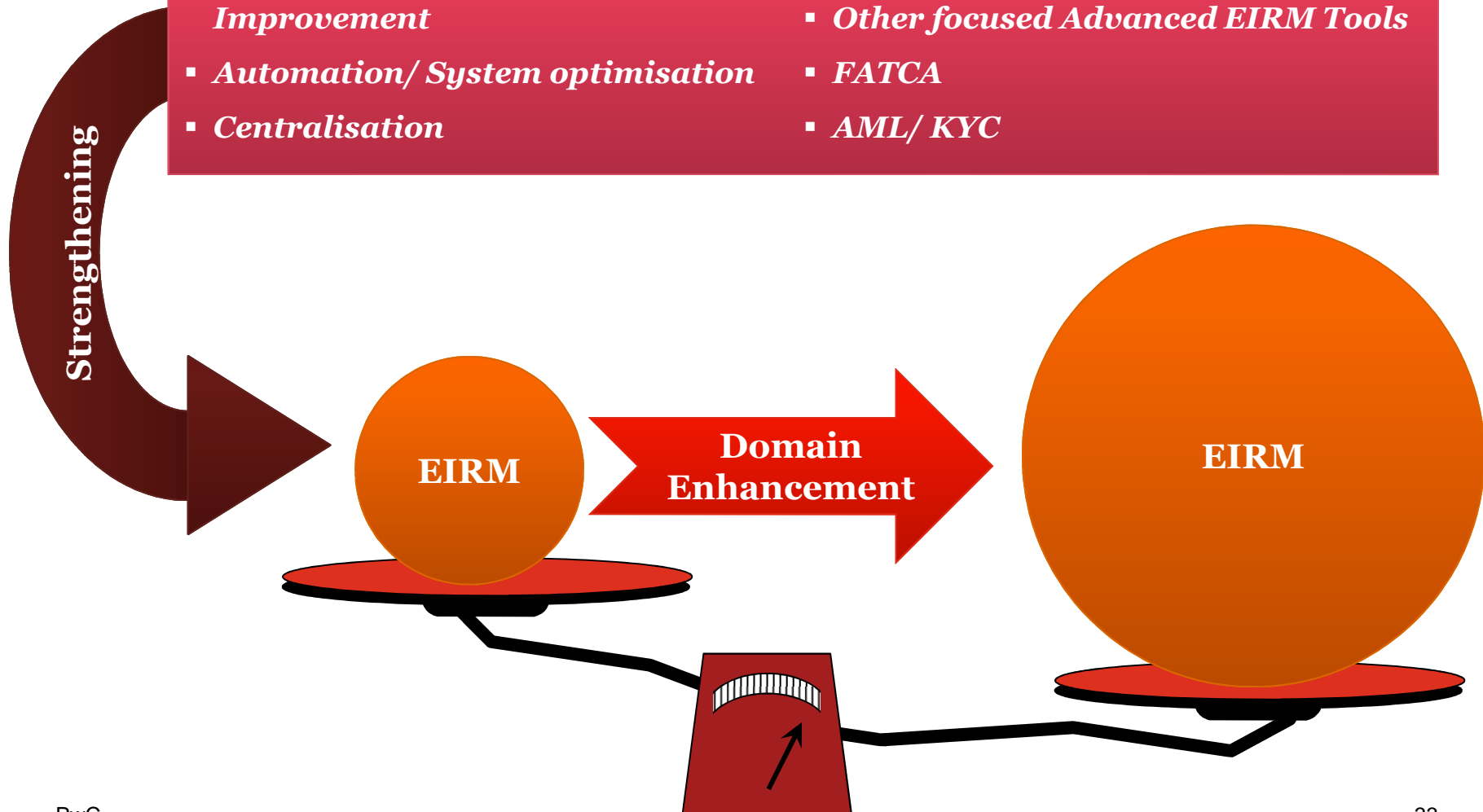


Source: PwC Global 17th CEO Survey

EIRM - Beyond Regulatory Compliance

Initiatives strengthening EIRM

- *Business Process Re-engineering/ Improvement*
- *Automation/ System optimisation*
- *Centralisation*
- *Organisational Restructuring*
- *Other focused Advanced EIRM Tools*
- *FATCA*
- *AML/ KYC*



EIRM - Moving beyond regulatory compliance

Advanced Risk Management and Monitoring

1 *Econometric Credit Models*

2 *VaR based Market Models*

3 *Econometric Behavioural Model for ALM*

4 *Behavioural Scorecards for Consumer*

5 *Quantification of Risk Appetite/ Tolerance*

6 *Risk Based/ Adjusted Capital*

7 *Predictive mechanisms for Risk Management*

Risk Management – Future Perspective

Future of Risk Management

CRO

CROs need to play a pivotal role in organisational success for dealing with evolving regulatory, business and operational challenges and global trends

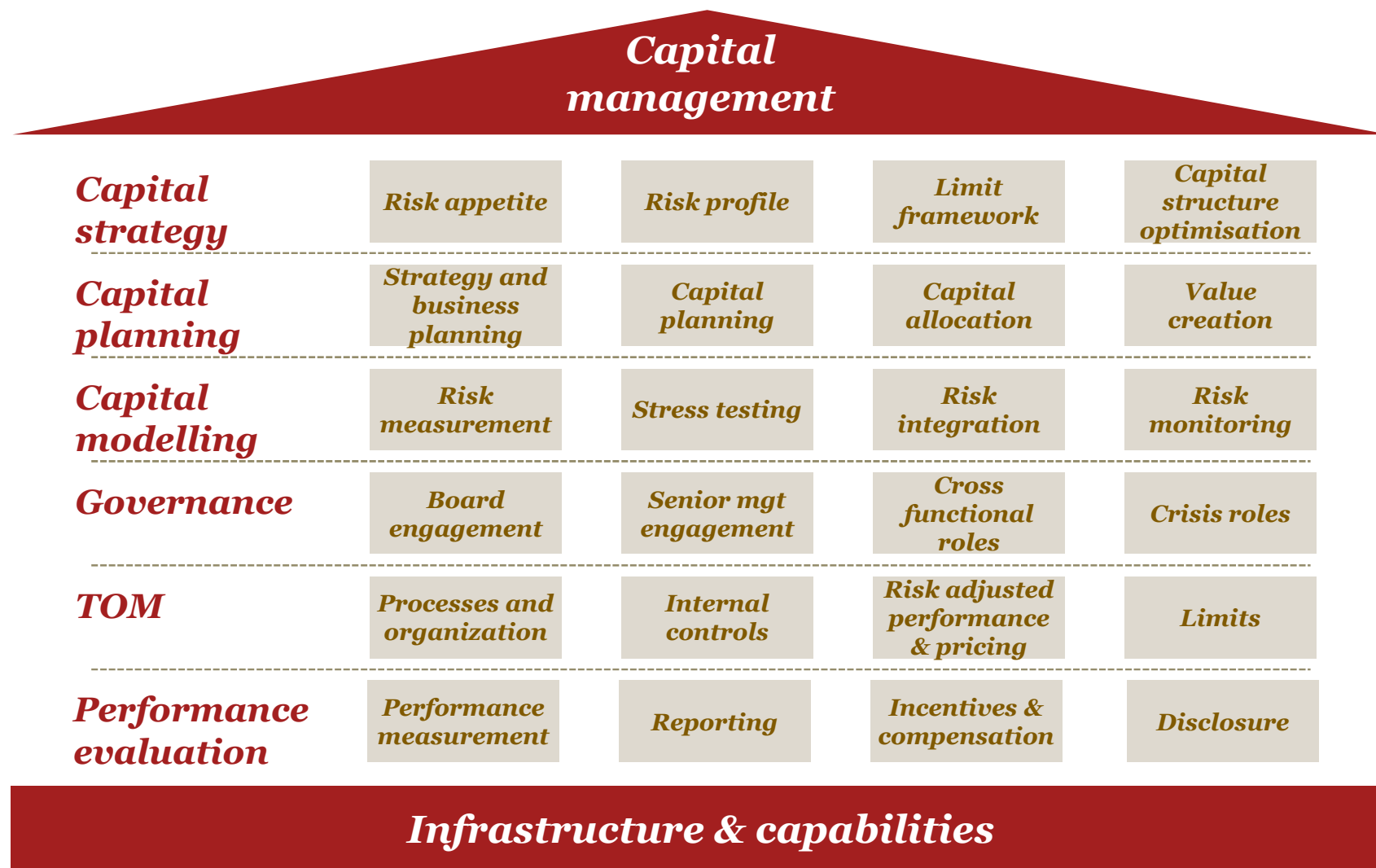
Local challenges

- Portfolio Rationalisation
- NPL Management
- New Products and Markets
- New Processes/ Process Improvements
- New Projects
- Capital Management aligned with Strategic Outlook
- Industry Assessments and Ratings
- Model Integration into Decision Making
- ALM and Balance Sheet Management
- Evolving Regulatory Requirements (liquidity, leverage and capital surcharges/ buffers)

Global trends

- Basel III
- Sound Capital Planning Process
- Risk Data Aggregation and Reporting
- AML/ KYC Enhancements
- Foreign Account Tax Compliance Act (FATCA)
- OECD Common Reporting Standards

Risk Based Capital Management





Risk Advisory Services

Delivering Success

-  Clients
-  People
-  Community