



RISK MANAGEMENT POLICY FRAMEWORK

1. Introduction

Risk Management constitutes a structured and ongoing approach to recognizing, measuring, and controlling all potential risks and opportunities capable of influencing the realization of strategic and financial objectives at the Merchant Bank of Sri Lanka & Finance PLC (MBSL). In the financial sector, especially for institutions like MBSL, the intricacies of the business environment introduce elevated levels of risk compared to other commercial entities. The imperative to navigate these complexities underscores the necessity for MBSL to adopt a methodical and comprehensive approach to risk management.

Within this framework, the systematic process encompasses the identification of potential risks, their quantification in terms of impact and probability, and the subsequent implementation of strategies to mitigate or capitalize on these risks. This multifaceted approach aligns with MBSL's commitment to safeguarding its strategic and financial goals. Recognizing that financial institutions are inherently exposed to a myriad of risks, MBSL's adoption of systematic risk management is not just a regulatory requirement but a strategic imperative to ensure resilience and sustainable growth in an ever-evolving financial landscape. Risk Management Policy framework provides guidance in managing risks in effective and efficient manner in order to achieve goals & objectives of MBSL.

2. Objectives, Policy and Principles of Risk Management

2.1 Objectives

The main objective of the risk management policy document is to ensure a coordinated approach in managing risks within the MBSL and to ensure sustainable business growth along with stability. Also, it intends to promote a proactive approach in reporting, evaluating and mitigation of risks associated with the MBSL.

The key objectives of the Risk Management Policy are:

- I. Establishing a risk governance structure and identifying roles and responsibilities of Board of Directors (BOD) Integrated Risk Management Committee (BIRMC), Corporate Management Committee (CMC), Other Risk Management Committees, Risk Management Division and employees of MBSL.
- II. Establishing a framework for the Company's risk management process and to ensure its implementation.

- III. Ensure that all relevant current and future potential material risk exposures are identified, assessed, quantified, mitigated and managed.
- IV. Providing guidelines to identify, evaluate, mitigate and manage Credit, Market, Liquidity and Operational risks exposures.
- V. Ensure that MBSL comply with all the applicable rules, regulations and guideline issued by the regulated and other authorities.
- VI. Establishing guidelines for timely reporting on identified risks to the BIRMC and the BOD of MBSL.

2.2 Risk Management Policy

Define the MBSL systematic approach to identify, asses and manage risks effectively and establish an embedded risk awareness culture within the organization.

2.1. Risk Management Policy Statement

“Embed best practices in identification, assessment, evaluation and report of risks and use effective strategy to mitigate risks, safeguard and effective utilization of MBSL assets”

2.2. Scope and Extent of the Application

The risk management policy is applicable to all the divisional activities and processes of the Head office, all branches of MBSL. All the employees are responsible and shall strictly adhere to MBSL risk policy.

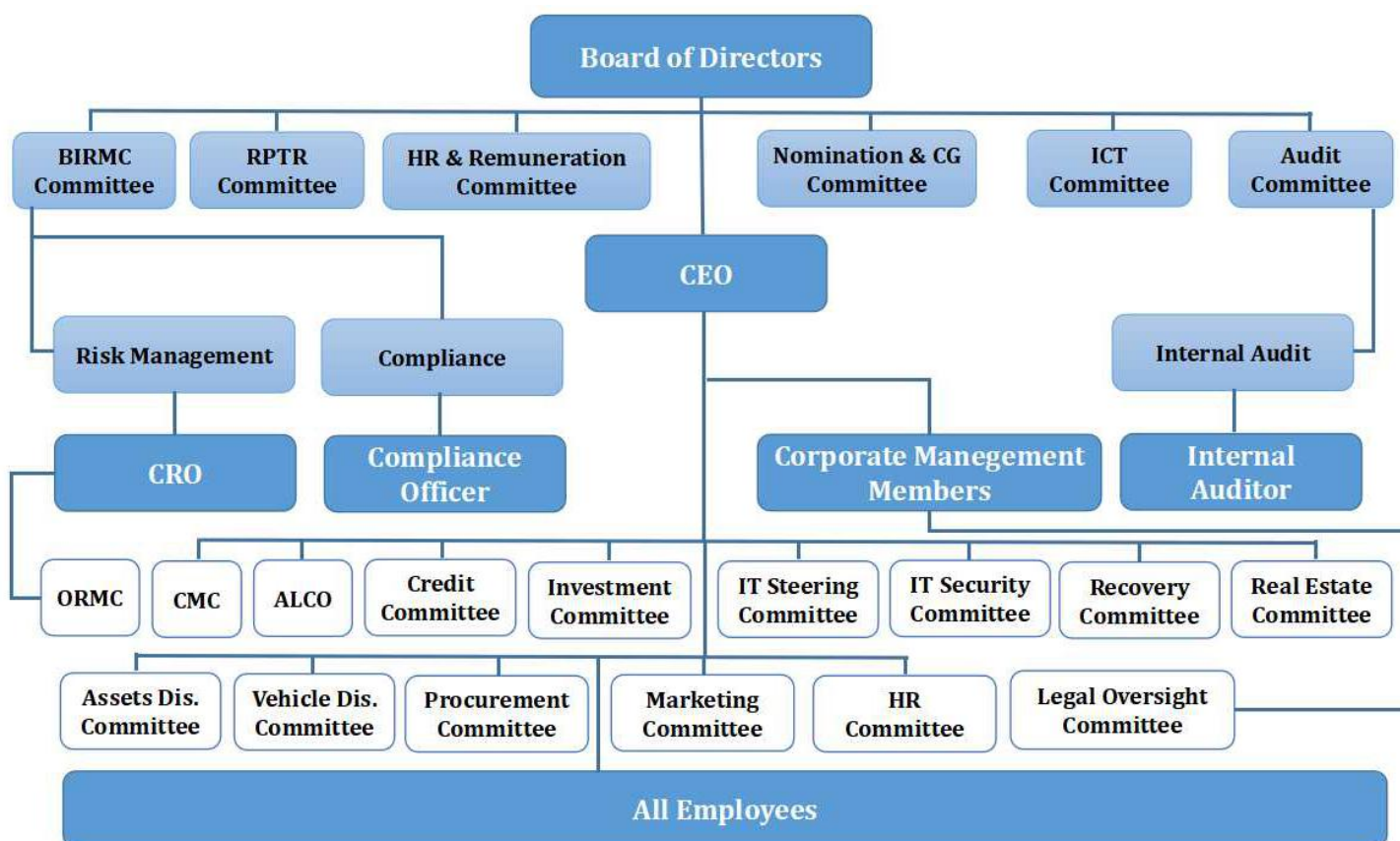
2.3. Principles of Risk Management

- (I) All major business decisions of the Company will be made with the prior information and acceptance of risk involved.
- (II) The policy shall provide for the enhancement and protection of the business value from future losses.
- (III) Use cost effective methods and strategies to identify and mitigate risks.
- (IV) All employees of the Company shall be aware of their roles and responsibilities in managing risks and their mitigation measures.
- (V) All employees of the Company must effectively participate in the risk management process.
- (VI) Risk mitigation measures adopted by the Company shall be effective in the long term and they should be embedded in the business processes of the Company.

(VII) Risk management policies will be periodically reviewed and decided upon depending on the change in the Company's strategy.

(VIII) The occurrence, progress and status of all risks will be promptly reported and appropriate actions be taken thereof.

3. Risk Management Framework



4. Risk Management

4.1. Risk Management Process

Risk management process consists with the generally accepted local and International Standard and Best Practices.

Risk Management Steps:

- I. Identifying and analyzing the risks faced by the Company.
- II. Evaluating the identified risks and deciding whether that risk is acceptable or unacceptable.
- III. Taking necessary actions to mitigate unacceptable risks. The action would be reducing the probability or consequences of an event, transferring the risk to another party, acknowledging residual risk or forming contingency plans.

- IV. Documenting the processes and report findings to BIRMC and the BOD
- V. Ongoing monitoring, communication and review.

4.2. Risk Identification & Evaluation

Risk is the probability that actual return will be different from the expected results. In other word, risk includes the possibility of harmful or negative impact on the achievement of the organization's objectives. MBSL expected to manage following risks prudently in order to achieve its strategic objectives.

4.3. Monitoring and Reviewing

- I. The risk assessment process should be monitored and reviewed as on-going process of MBSL. Changes in influential factors or circumstances may change or invalidate the risk assessment and responses.
- II. Therefore, the influential factors and circumstances should be specifically identified as a part of on-going monitoring and review process. According to the identification, the risk assessment methods can be updated where necessary.
- III. The BOD and the BIRMC shall review the adequacy of risk management policies and strategies periodically and may suggest any improvements or changes required.

4.4. Reporting

The Risk Management Department shall directly report to the BIRMC & BOD of the MBSL on any resulting negative or positive events relating to MBSL risk management process.

However, the Risk Management shall provide necessary information/risk analysis/dash boards to CMC and Branches where CMC and Branches are responsible to implement risk mitigation actions on reported matters at divisional and/or branch level. Progress of the implementation of risk mitigation actions by divisions/branches shall be reported to the Risk Management Divisions periodically

5. Three lines of defense in Risk Management of MBSL



6. Risk Audit

Risk Audit which is a set of independent reviews by the BOD & Corporate Management to obtain confirmation that procedures and controls are maintained effectively & efficiently on risk management, and thereby discipline and adherences are maintained up-to the required standards. In this regard the Internal Audit Division (IA) has a vital role to play in examining the risk control measures adopted by various departments & authorities, ensuring they are in conformity with the required standards and limits laid down by the Risk Management Department or/and BIRMC. Relevant risk/compliance reports shall be submitted by the IA periodically to the said committee.

Further, the IA is responsible to conduct independent audits based on the Risk Based Approach on Branches, Internal Divisions & its Processors. The IA shall assign audit risk rating for each branch, divisions & processors based on detailed analysis of branch profiles and associated risks, which shall reviewed & update periodically by the IA. Based on the audit risk rating, high risk branches, divisions and processors must be audited frequently (at least annually). Existing audit risk rating of the branches, divisions & processors with changes during the period shall be informed annually to BIRMC .

7. Stress Testing Framework

7.1 Objectives of stress testing

- ❖ Consider the Stress Testing process as an integral part of the overall governance and risk management culture of the bank.
- ❖ Stress testing addresses existing or potential firm-wide risk exposures.
- ❖ Promotes material risk identification, control and provides a complementary risk perspective to other risk management tools.
- ❖ Stress testing take account of views, across the company in order to cover a range of perspectives, scenarios and techniques including forward-looking aspects.
- ❖ Stress testing shall be actionable at the appropriate management level, including strategic business decisions of the board of directors and senior management.
- ❖ Stress testing is used as an input for setting the risk appetite of the company and assessed regularly and independently.

7.2 Scope & Reporting of Stress Testing Results

- ❖ Different types of risk variables and stress scenarios are used in the stress testing covering Credit, Market, Liquidity & Operational risks.
- ❖ The outcome of the stress testing process will be reported to the Board Integrated Risk Management Committee (BIRMC) meetings on once in two months by the Risk Management Division.
- ❖ The BIRMC shall review the effectiveness and robustness of Stress Testing Framework periodically to ensure effectiveness in meeting its intended purpose.

8. Policy Review

This policy will be the guiding document for risk management function for all employees of Merchant Bank of Sri Lanka & Finance PLC.

The Board of Directors shall review the policy periodically and when required due to the changes in the existing regulations, standards, and best practices as appropriate.