Risk Management

1. COMMERCE ASSET-HOLDING BERHAD (CAHB)

Risk-taking is an integral part of the financial services business. We at CAHB believe, that strong corporate governance essentially provides a guiding vision in managing risk in an increasingly dynamic and complex environment. An effective risk management system that commensurates with the size and complexity of operations will help ensure that the risks undertaken are well managed within the boundaries of the organisation's risk appetite.

Strategic Risk Management Framework

Acknowledging and thus responding to these challenges, in January 2004, the Group Risk Management Committee (GRMC) initiated a Strategic Risk Management Framework (Framework) project. The project was completed and approved by the Board in June 2004. The approach taken in this Framework reflects the Group' s risk aspiration, profile, philosophy and strategy.

The prime objective of the Framework is to put in place integrated risk management capabilities that enable the holding company to achieve a single view of risks across CAHB and its various subsidiaries and business operations and to gain strategic competitive advantage from its risk management capabilities.

The framework provides a holistic approach by segmenting financial risk management into four areas that covers strategy, organisation, process and measurement.

<u>3 Key Principles of Strategic Risk Management Framework</u>

Principle 1:	Retain the dynamism of the Group and the subsidiaries' autonomy in risk management and risk organisation
Principle 2:	Drive Holding Company risk management through: (i) Analysing comprehensive and timely information on subsidiaries' risk and performance status through Group Risk Dashboard (ii) Building processes to speedily control wayward situations if required (iii) Enhancing consistency in risk management approaches through periodic intra-group risk management dialogue
Principle 3:	Build the Group's capabilities for pro-active economic capital management

Integrated within our Framework, we have developed the Group Risk Dashboard (Risk Dashboard) to enable CAHB to monitor the Group's risk exposure and risk-return performance. The Risk Dashboard is structured to capture the key indicators of CAHB and its subsidiaries' risk profile and performance. In combination, the key indicators aim to provide a 'helicopter' view of the 'health' of the Group and its subsidiaries.
Recognising the fact that the business is dynamic and constantly changing, the Framework also recommends identifying any shifts from the approved strategy and evaluating the resulting impact.

Group Risk Management Committee

During the year, the GRMC has sat four times deliberating and discussing amongst others the Risk Dashboard and various risk related matters.

The GRMC is chaired by an Independent Non-Executive Director. The composition of GRMC is as follows:

Tan Sri Datuk Asmat Kamaludin (Chairman)
Independent Non-Executive Director

Dr Rozali Mohamed Ali
Executive Director/Group CEO

En Mohd Salleh Mahmud
Non-Independent Non-Executive Director

The GRMC is primarily responsible for the effective functioning of the integrated risk management function within the Group which includes formulating and reviewing the risk strategy, approving and periodically reviewing the Group's risk management policies in line with the risk strategy, defining the risk management objectives across risk categories and business lines, setting appropriate risk appetite, reviewing the risk based economic capital, reviewing the overall risk profile, approving the contingency plan for dealing with various extreme internal/ external events and disasters, and ensuring a risk aware culture within the Group.

The Risk Management Department (RMD) has been entrusted by GRMC to complement the functions of GRMC and to implement several Group wide risk related initiatives to cultivate and increase the risk awareness within the Group. During the year, RMD has arranged a number of meetings for directors and senior management of the Group. Internal discussion on and sharing of risk related matters are encouraged in order to optimise and improve the Group's strengths.

2. MAJOR SUBSIDIARIES IN THE GROUP

At our major subsidiaries, the risk management initiatives undertaken have advanced further as elaborated in the following paragraphs:

a. Bumiputra-Commerce Bank Berhad (BCB) Group

At BCB Group, the BCB's Board Risk Management Committee (RMC), which comprises only Non-Executive Directors, sits at the apex of the risk management structure of BCB Group. The RMC provides an oversight and direction of BCB Group's risk profile and risk appetite, including formulation of risk policies; and reviews and ensures risk exposures are within the defined parameters and risk limits. Supporting the RMC are three specific risk committees, namely Credit Risk Committee, Market Risk Committee and Operational Risk Committee that meet monthly to review and deliberate on the risk exposure profile reports and accordingly recommend suitable follow-up actions. These committees are in turn supported by independent risk management units that report to RMC.

BCB's Risk Management Framework includes risk identification, assessment, control, monitoring, and compliance with regulations, which are duly addressed in the Board-approved Risk Management Policy. The implementation of BCB's Board-approved Risk Management Policy and the monitoring of compliance with the policy and limits set are embedded across the risk committees.

During the year, several new initiatives have been introduced and the key risk management initiatives that have been put in place are further refined and improved to be in line with the current development in the market and to achieve compliance with Bank Negara Malaysia (BNM) guidelines, Basel II and other regulatory authorities.

Credit Risk
Key to the credit risk management is to ensure that structures and processes are in place to maintain and continuously enhance BCB Group's risk assessment capabilities in major areas of credit. These include sound credit policies and procedures, quality credit approvals, appropriate risk measurement and methodology, strong credit controls with independent reviews and effective and workable recovery strategies.

BCB's Credit Risk Management is vested upon the Credit Risk Committee (CRC). The CRC reports to and assists the Board (through the RMC) in its oversight role on management of credit risk of BCB Group. Regular meetings are held to monitor credit risk exposures and to deliberate on appropriate measures to minimise any adverse financial implications based on the conduct of accounts and on a portfolio basis.

As an initiative to achieve compliance to Basel II, a Basel Programme Office has been set up during the year to facilitate its implementation at BCB Group. As an immediate focus, the Basel Programme Office has assessed the key issues and identified critical success factors for implementing the Basel II Standardised Approach for credit risk. The Basel Programme Office meets monthly and on a need basis and reports directly to the Management Committee and RMC.

Market Risk
BCB's risk management framework, processes and comprehensive governance surrounding market risk-taking activities are undertaken by the Market Risk Committee (MRC) with the assistance from Asset and Liability Management (ALM) and Treasury Risk Management (TRM).

During the year, TRM has initiated enhancement to the Treasury Risk Management Policy to incorporate a new methodology in risk management (Value-at-Risk) and a Treasury Trading Statement Policy to comply with the BNM's market risk adequacy framework. ALM has also developed a methodology to compute an Internal Base Lending Rate in response to the introduction of BNM's New Interest Rate Framework. The Funds Transfer Pricing Policy which was drawn up since last year to centralise the management of interest rate risk, improve performance evaluation and assist asset liability management is currently being implemented.

For liquidity management, MRC has approved a Liquidity Contingency Plan and has adopted several measures in addressing liquidity risk, taking into account market conditions, prevailing interest rates, liquidity needs and the desired maturity profile of its liabilities. ALM reports to the MRC on maturity mismatches during normal conditions, BCB's liquidity position based on BNM's New Liquidity Framework, concentration of funding sources and liquid asset ratio. Additionally, stress test is conducted on the net interest income including worst-case scenario analysis as well as generation of gap and simulation reports which are furnished to MRC on a timely basis. BCB uses derivative products, such as Interest Rate Swap and Cross-Currency Interest Rate Swap, to hedge interest rate risk in fixed rate loans. All derivative hedgings are done back-to-back with counter-parties.

Recognising liquidity risks from treasury activities, BCB's investments portfolios are monitored and marked-to-market by TRM regularly and reported to the Investment Committee and MRC on a monthly basis. TRM also monitors the trading cut loss limits and reports to senior management of any breaches for further escalation.

Operational Risk
BCB's Operational Risk Committee (ORC) has the functions of managing and mitigating operational risk. ORC also ensures that there are clear and predefined roles and responsibilities among ORC and other risk committees, business units as well as Internal Audit. In order to carry out these functions, ORC is guided by a comprehensive Operational Risk Policy that forms part of the Board-approved Risk Management Policy which outlines the risk identification, controls, mitigation and prioritisation issues; and supported by the Operational Risk Management Department that acts as the central resource for quantifying and managing the portfolio of risks as a whole.

There is ongoing monitoring and reporting on the effectiveness of operational risk management processes. Some of the initiatives currently undertaken are the introduction of risk framework for development of new products and services, the development of Internal Watchlist Database and Loss Event Database to track and monitor actual and potential operational losses. Other projects being implemented are Control Risk Self Assessment programme and development of Key Risk Indicators.

Substantial progress has also been achieved in some of the ongoing initiatives including the implementation of new anti-money laundering report for tracking of possible money laundering activities, a cheque fraud management tool for customers who issue large volume of "printed" cheques, development of Business Continuity Planning manuals, review of controls in outsourced operations at EPIC-I, promotion of a risk culture as well as communication on operational risk alerts.

b. CIMB Berhad (CIMBB) Group

At CIMBB Group, enterprise-wide risk management framework (EWRM) is adopted to manage its risk. The EWRM framework involves the ongoing process of identifying, managing and reporting significant risks that may affect the achievement of its business objectives. With EWRM, the Board and management are equipped with comprehensive methodology to anticipate and manage both the existing and potential risks. This proactive approach is cascaded down to the rest of the companies in CIMBB Group through management's efforts of embedding a strong risk and control culture at the operational level.

The risk management structure begins with the Board Risk Committee which comprises five Non-Executive Directors and reports directly to the Board of CIMBB Group. It oversees the entire EWRM and provides strategic guidance and reviews decisions made by the various risk committees as well as establishes the yearly allocation of risk capital to support all risks taken by CIMBB Group.

The day-to-day responsibility for risk management and control has been delegated to the Group Risk Committee, which reports directly to the Board Risk Committee. The Group Risk Committee comprising the senior management of the CIMBB Group performs the oversight function for capital allocations and overall risks limit guided by the risk appetite as defined by the Board. The Group Risk Committee is further supported by four specialised sub-committees; namely Market Risk Committee, Credit Risk Committee, Liquidity Risk Committee and Operational Risk Committee. These are all Board delegated committees that meet at least on a monthly basis with respective responsibilities as summarised in the following sub heading.

Market Risk
Market risk arises from changes in market prices such as interest rates, exchange rates and share prices. Market risk is managed through risk limits set by the Group Risk Committee. The Market Risk Committee oversees the exposure to interest rate, foreign exchange and equity risks and determines that trading, investment and underwriting arrangements are within defined limits. CIMBB Group has adopted a value-at-risk (VaR) approach in the measurement of interest rate, foreign exchange and equity risks.

Credit Risk
Credit risk arises from the losses due to unexpected default or a deterioration of business partner's creditworthiness. The Credit Risk Committee ensures that the risk exposures undertaken match the risk appetite of the CIMBB Group, and proper authorisation procedures are adhered to. As an immediate effort in implementing Basel II to be inline with BNM's requirements, CIMB has adopted Standardised Approach for credit risk.

Liquidity Risk
Liquidity risk relates to the funding and liquidity management of the CIMBB Group's activities. The Liquidity Risk Committee's role, amongst others, is to oversee the overall liquidity management of CIMBB Group and to ensure compliance with the liquidity framework prescribed by BNM. At CIMBB Group, the liquidity risk management focuses on avoiding over dependence on volatile sources of funding, diversification of sources of funds and their funding maturity structure, and maintenance of sufficient liquid assets.

Operational Risk
Operational risk relates to the potential for losses arising from a breakdown in controls and the implementation of safeguards to ensure the proper functioning of people, systems and facilities. This includes legal and regulatory issues and the need to ensure that all work undertaken by CIMBB Group is adequately documented and meets regulatory standards. These responsibilities have been delegated to the Operational Risk Committee. In anticipation of the implementation of Basel II, Operational Risk Sub-Committee has been formed to develop and implement enterprise-wide operational risk framework and initiatives.

c. PT Bank Niaga (PTBN) Group

At PTBN Group, an integrated risk management policy have been developed and implemented in which control and monitoring are conducted through several executive committees which comprise Audit Committee at the level of Board Commissioners and the following committees at the level of Board of Directors.

- Risk Management Committee
- Credit Risk and Policy Committee
- Asset/Liability Committee (ALCO)
- Market Risk Committee
- Operational and Information Risk Committee

Members of these committees are primarily from the Board of Directors and senior management of PTBN Group. The Risk Management Committee (which meets at least in every three months) determines PTBN Group's risk appetite based on analyses of risk profiles of business within the PTBN Group, the business opportunities involved and its capital adequacy. The decisions made in the executive committees meeting are strategic decisions that become operating policies and guidelines for all operational level of PTBN Group.

The Risk Management Committee reviews:

1. Framework and governance in risk management
2. Direction, strategy and risk management programme
3. Risk profile and capital adequacy analysis
4. Policy and implementation for risk management
5. Contingency plans for extraordinary events
6. Adequacy of provision made for losses

The responsibility of the other executive committees are summarised under the sub-heading of credit, market, liquidity and operational risks below.

The Risk Management Group supports all risk management activities in PTBN Group that include providing data for risk analysis. The availability of adequate and accurate risk data is very crucial for the formulation of the PTBN Group's policies. In addition, the Risk Management Group is responsible to conduct review of delegation of authority on various limits in PTBN Group, including reviewing the quality and progress of various investment portfolios, improving the system on internal control, both directly and indirectly through the improvement of the existing policies and procedures.

In addition to the executive committees role, independent supervision and control over the PTBN Group's operations is conducted by the PTBN Group's Internal Audit Unit, a working unit led by the Comptroller.

Credit Risk
The credit strategy and goal setting are planned and established by the Credit Risk and Policy Committee who is also responsible for managing credit portfolio and credit risk. The Credit Risk and Policy Committee meets at least six times a year and is chaired by Director of Compliance and Risk Management and attended by the President Director and the other Board of Senior Executive members.

Credit risk is managed based on the review of:

1. The diversification of credit risk and portfolio (business segment/ industry sector/ largest borrowers composition)
2. Credit policy and procedure (including target market and risk acceptance criteria)
3. Adequacy of provisions for loan losses
4. Other major risk indicators and methods of credit risk measurement

In respect of compliance with Basel II, at present PTBN has opted for Standardised Approach for credit risk.

Liquidity Risk

ALCO is responsible for managing liquidity and asset-liability position. The committee meets with business, treasury, credit and other relevant units on a monthly basis to ensure that PTBN's liquidity objectives are met.

PTBN sets the interest rate through interest sensitivity gap simulation and adjustment between the interest rate of asset and liability and source of fund composition.

PTBN manages its liquidity by focusing on cash inflow and cash outflow. The gap in cash flow is anticipated through its first tier assets such as reserve requirements and highly liquid short-term marketable securities. Second tier assets are managed through short-term placements with other banks and available-for-sale long-term marketable securities. Liquidity is also achieved through prudent structuring of PTBN's funding. This includes maintaining proper check and balance in the concentration of the depositors, as well as the amount and maturity of deposits. In addition, PTBN assures liquidity by maintaining its ability to access the financial market, which is dependent upon its credibility and market standing.

Market Risk

Market risk involves the possibility of losses incurred from changes in interest rate and foreign exchange rate due to market volatility. PTBN monitors these changes and their impact on its portfolios as well as net open positions as part of its market risk management, through the Market Risk Committee.

The Market Risk Committee defines acceptable limits on trading exposures, including daily net open position limits and potential losses on current positions. Factors considered in setting these position limits include risk and return levels acceptable by management. Position limits are reviewed at least twice a year, although in periods of extreme volatility they are scrutinised more often or suspended altogether momentarily.

Trading limits are monitored daily on a mark-to-market basis and by applying the VaR concept. Thus, by keeping track of its daily VaR, PTBN is in a position to liquidate its gap, which indicates a potential loss greater than the allowable limits.

PTBN is currently preparing the implementation of Treasury and Risk Management System Automation to enhance the effectiveness and efficiency of its treasury and risk management.

Operational Risk

Operational risk includes the risks that arise from failure of internal processes. Operational risk is less direct than credit and market risk but managing them is equally critical. For this purpose, PTBN Group has an Operational and Information Risk Committee which defines the roles and responsibilities for managing and reporting operational risks arising from the daily operation of PTBN Group.

PTBN has a Risk Library and performs operational risk self-assessment using Control Risk Self Assessment (CRSA) tool to identify a specific operational risk profile (high risk potential) for business lines. The CRSA is also used for identifying emerging operational risk issues and determining how these issues should be managed. PTBN continuously reviews its Risk Library and if necessary, revises its policies, procedures and risk limits to mitigate operational risks arising from data reconciliation process, money-laundering activities, transaction processing, systems interruptions, fraud management and new product introduction processes.

PTBN is in the process of enhancing operational risk management practices through the development of additional operational risk management tools, including Loss Event Database, Key Risk Indicator and Risk Dashboard.

3. OTHER SUBSIDIARIES IN THE GROUP

a. Commerce Life Assurance Berhad (Commerce Life)

At Commerce Life, the Risk Management Committee is responsible to implement the Risk Management Framework which has been approved by the Board of Directors in 2002. The committee is scheduled to meet four times annually. Additionally, the monthly Board of Directors meeting provides the avenue for the Board to cascade downwards to the management the level of acceptable risk.

b. Commerce Asset Ventures Sdn Bhd (CAV)

At CAV, a risk management framework has been implemented during the financial year to manage its risks through a mechanism of an enterprise-wide Risk Control Report to assist the Board in reviewing and monitoring the risks. The management of the risks is under the overall strategy determined by the CAV's Risk Management Committee and the implementation is coordinated by the CAV's Risk Management Division. Major risks identified will be discussed in the Management Committee meeting for possible solutions. The implementation of the proposed solutions will be carried out by the risk owner and monitored by the Risk Management Division.

c. Commerce Assurance Berhad (formerly known as AMI Insurans Berhad) (Commerce Assurance)

Commerce Assurance has adopted an Enterprise Risk Management Framework during the financial year intended to consider the balance between risk and reward in day-to-day planning, execution and monitoring of the strategy and the achievement of its corporate goals in order to optimise the rewards gained from business and operational activities. The approach to the management and control of risks is determined by the appetite and tolerance level as defined by the Board.

The adoption of the Framework is the responsibility of the Board, while its implementation is delegated to the Chief Executive Officer. A Risk Management Committee comprising a minimum of 3 non-executive directors supports the Board in carrying out its role. The Risk Management Committee oversees senior management's activities in managing key risk areas and ensures that the risk management process is in place and functioning effectively.