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INTEGRATED RISK MANAGEMENT POLICY & PROCEDURE

Policy Owner : **Chief Risk Officer**

BIRMC Presented Date : **14 / 05 / 2024**

Board Approved Date : **29 / 05 / 2024**

Abbreviations

ALCO : Assets and Liabilities Committee

BCC : Board Credit Committee

BCP : Business Continuity Plan

BOD : Board of Directors

BIRMC : Board Integrated Risk Management Committee

CBSL : Central Bank of Sri Lanka

CP : Contingency Plan

CRM : Credit Risk Management

ECC : Executive Credit Committee

EIRMC : Executive Integrated Risk Management Committee

ESG Risks : Environmental, Social, Governance risks

IC : Internal Capital

ICAAP: Internal Capital Adequacy Assessment Process

IFP : ICAAP Framework Policy

IRMF : Integrated Risk Management Framework

ORM : Operational Risk Management

RAPM : Risk Adjusted Performance Measurement

RC : Regulatory Capital

RG : Risk Governance

RMD : Risk Management Department

RMP : Risk Management Policies

LCBF /Company : Lanka Credit & Business Finance PLC

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1 Introduction and Purpose

The Integrated Risk Management Framework, (IRMF) hereinafter referred to as the " Integrated Risk Management Policy " or " IRMP ". Sets out the principles adopted by Lanka Credit and Business Finance PLC, (LCBF) hereinafter referred as the "Company", to measure, monitor and manage its material risks, and also to assure that adequate capital is held to meet the various risks to which the Company is exposed.

The IRM Framework aims at establishing the foundation rules for the Risk Management Function in terms of

1. Risk management governing principles and objectives.
2. Risk governance, including specific roles and responsibilities for all relevant stakeholders.
3. Defining the components / stages of the risk management process
4. Risk identification, assessment / measurement and management /mitigation.
5. Guidelines for the formulation Risk Appetite Statement (RAS)
6. High-level Risk Identification & Assessment (RIA).
7. Setting out standards for documentation of specific risk policies.
8. Defining guidelines for Integrated Risk Management Reporting (IRMR).
9. Defining the underlying principles for comprehensive risk assessment (i.e. Pillar 2 risks)
10. Risk & capital budgeting (Internal Capital Adequacy Assessment Process – ICAAP)

1.1 Risk Management Principles

P1. Risk Management shall ensure the long-term viability of the Company.
Risk management has to ensure that business grows sustainably and shareholder value is preserved.

P2. Risk is taken within a defined / approved Risk Appetite.
The RAS is defining the risk boundaries within which risks are underwritten by the Company. All risk control elements (Risk Limits, Risk Monitoring reports, Risk Review procedures etc.) have to ensure that at all times the Board approved RAS holds. Deviations from the approved RAS have to be reported.

P3. Specific responsibilities for risk taking have to be defined.
Every material risk taken by the Company needs to have an Owner, Approver and an Independent Reviewer. Through the governance model (see next principle) the Company should aim at segregating the three roles ensuring independence.

P4. Risks taken needs to be adequately compensated.
The Company should aim at correlating pricing with risk through the implementation of

internal capital models, Risk Adjusted Return On Capital (RAROC) and Risk Based Pricing Policies (RBPP).

P5. Risk Management shall be supported by a strong risk management culture.
The risk management culture shall be fostered by the Board and should cascade downwards into the operational levels of the Company, supported by an appropriate communication policy.

P6. Risk Governance has to follow best international practices.
The governance models have to be designed and periodically reviewed in order to comply with leading international practices. It has to adhere to the principles of independence of control functions, three lines of defense, segregation of duties and proportionality (see Risk Governance section for more details)

P7. Business incentives shall be risk sensitive.
Incentives for risk originators, approvers and underwriters should be set in such as way ensure long term viability of the business. Risk control elements shall be embedded in the incentive structure for the Company’s employees.

P8. Risk Planning has to be fully aligned with the business objectives of the Company.
Risk strategy and risk appetite are defined based on the Company's strategic plans in order to align risk, capital and business performance targets. Risk Management function should be actively involved, at an early stage, in the elaboration of the Company’s strategy.

P9. Risks shall be assessed comprehensively.
No material risk sources shall be left outside the scope of the Risk Management Framework. Therefore, risks shall be assessed covering all material risk types, business lines and relevant entities within the Company.

P10. Risks shall be managed by all relevant stakeholders.
The management of risks should not be confined to the risk management function. It should be primarily the responsibility of the management and staff in all business lines and they should be aware of their accountability in this respect.

2 The Integrated Risk Management Framework (RMF)

2.1 Integrated Risk Mgt Framework Elements

The Risk Management Framework consists of all the elements set out by the Company to attain the general objectives of risk management set out in the IRMF. The main components are

(i) **Integrated Risk Management Framework (IRMF)**
Ground rules for the Risk Management Framework (RMF) including without limitation risk governance, Risk Appetite Statement (RAS) guidelines, definition of the Risk Management Processes (RMP), as well as Risk Management Policy (RMP) documentation and reporting guidelines. The IRMF is also catering for risk categories not captured by risk specific policies. All the other components of the RMF shall be developed consistently with the principles set out in the IRMF.

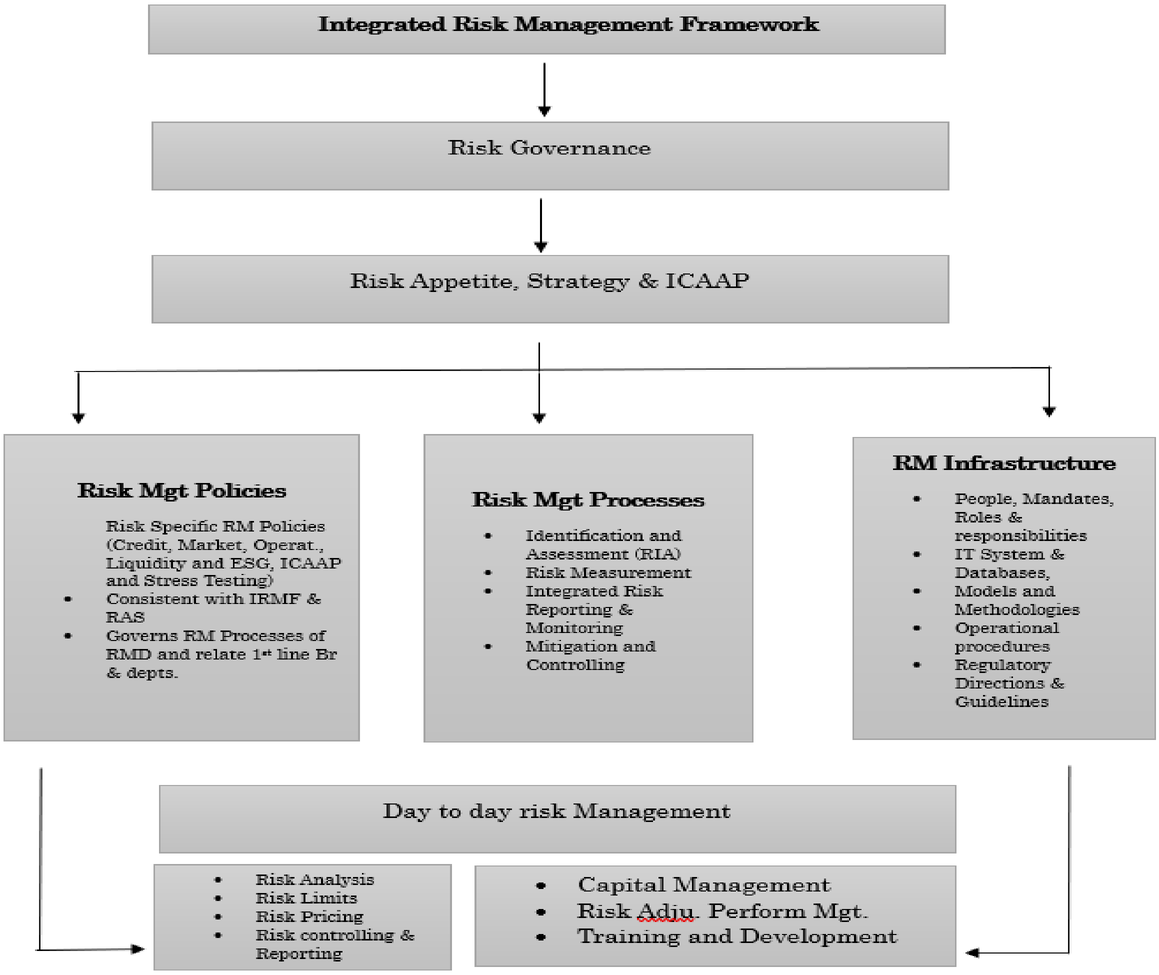

Figure 1Components of the Risk Management Framework

(ii) **Risk Governance**
Main roles and responsibilities, including levels of authority and reporting lines of all key stakeholders involved in Risk Management. The governance elements of the RMF are documented under IRMF (see next section)

(iii) **Risk Appetite, Risk Strategy and ICAAP**
Defines the risk strategy of that the Company in terms of risks the Company wishes to assume, clear boundaries for each material risk type, integration of risk planning with business planning through ICAAP. Detailed description of governance, processes, methodologies pertaining to RAS and ICAAP shall be documented in dedicated policies.

(iv) **Specific Risk Management Policies and Processes**
Defined for Credit, Market, Liquidity, Operational risk, and ESG risk following principles set out in the IRMF. All these policies are standalone documents that govern specific segments of the RMF.

(v) **Risk Management Infrastructure**
Consists of all the resources deployed by the Company to carry out the provisions set out in the risk management policies and procedures, including without limitation People, Systems, Data Base Models and Methodologies.

(vi) **Day to day Risk Management Activities** are the risk policies and procedures in action carried out by all relevant stakeholders.

Risk Management Policies that Supplement the IRM Policy

1. Credit Policy
2. Credit Risk Management Policy
3. Operational Risk Management Policy
4. Assets & Liability Management Policy
5. ICAAP Framework Policy
6. Stress Testing Framework Policy
7. Compliance Policy
8. Anti-Money Laundering Policy
9. Information Security Management policy
10. Whistler Blowing Policy

2.2 Definition of Key Risk

1. Credit Risk

Credit risk is the potential for lender to lose money when they provide funds to a borrower. It reflects the risk of losses due to one or more counterparties failing to meet all or part of their obligations towards the Company in accordance with the agreed terms. Credit risk makes up the largest part of the Company's risk exposures. Credit risk exists throughout the Company's activities, both on and off-balance sheet and arises from the Company's dealings with Corporate, SME entities, Cooperative, Individuals, other Company's, financial institutions or countries. Company assesses their credit risk at the portfolio level as well as at the exposure / counterparty level. Credit risk includes the Default risk, Concentration risk (Name, business sectors, product or geographical regions), Counterparty risk.

1.1. Credit Concentration Risk

The concentration risk denotes the risk arising from uneven distribution of counterparties (Name concentration), business sectors (Sectorial concentration), product or geographical regions (geographical concentration), which is capable of generating losses large enough to affect the solvency. Accordingly, Concentration Risk in the credit portfolios comes into being through a skewed distribution of lending to individual borrowers, industry / service sector, and geographical regions.

1.2. Default Risk

Default risk is the probability that a borrower will fail to make full and timely payments of principal and interest according to the terms of a debt security. Lenders and investors are exposed to default risk in virtually all forms of credit extensions. When borrowers pose a higher default risk, lenders typically require them to pay a higher interest rate.

2. Market Risk

Market risk refers to the potential for Company to experience losses due to factors that affect the overall performance of financial markets. These risks are inherent to investing and are largely unpredictable, as they stem from changes in economic conditions, political events, and market sentiment. It is that Company can only meet its cash and collateral obligation by suffering losses and risk of uncertainty in the future value of a portfolio, either an investment portfolio or a trading portfolio, due to changes in values of the market risk factors such as equity prices, market interest rates, foreign currency, Commodity price (Gold), Country situation.

2.1. Interest Rate Risk in Company Book (IRRCB)

Interest Rate Risk in Company Book (IRRCB) refers to the risk of loss in earnings or economic value of the Company's advance book as a consequence of movement in interest rates. Since the Company Book is not marked to market similar to the Trading Book, the economic value of such assets and liabilities is generally not ascertained on a regular basis and thus, can be a significant source of risk due to changes in market interest rates. Interest Rate Risk (IRR) arises due to the difference in re-pricing of Rate Sensitive Assets (RSA) and Rate Sensitive Liabilities (RSL), which will have an impact on the future income and expenses produced by relevant gap positions and an impact on Company's Net Interest Income (NII) compared to the level of NII expected from current interest rate levels

3. Liquidity Risk

Liquidity risk is the risk that the Company will not be able to efficiently meet both expected and unexpected current and future cash flows and collateral needs without affecting either daily operations or the financial condition of the Company. The primary aspect in funding liquidity risk is the risk that the Company is unable to meet its financial obligations as they fall due. These obligations include the repayment of deposits on demand or at their contractual maturity, the repayment of borrowings and loan capital as they mature the payment of operating expenses and taxation, the payment of dividends to shareholders and the ability to fund new and existing loan commitments. Another aspect is market, or asset liquidity risk which is the risk that the Company cannot easily liquidate a position without significantly affecting the market price because of inadequate market depth or market disruption. It's basically covered liquidity of Market, Funding, Asst specific, Time horizon, Event & Regulatory arears.

3.1. Settlement Risk

Possibility that one or more parties will fail to deliver on the terms of a contract at the agreed-upon time. It is a type of counterparty risk associated with default risk and timing differences between parties. Settlement risk is also known as delivery risk or Herstatt risk. In essence, it refers to the risk that a party involved in a financial transaction may default or fail to deliver after funds have been transferred to them. Settlement risk is most commonly assessed in forex markets and can also lead to liquidity risk for broader markets.

4. Operational Risk

Operational risk refers to the potential for loss resulting from inadequate or failed internal processes, people, systems, or external events. Operational risk encompasses a wide range of internal shortcomings and external disruptions that can impact a financial institution's profitability or solvency. Its include Process risk (Inadequate process, Compliance failure, Business Continuity Plan – BCP), People risk (Human error, Fraud, Skill gap), Technology risk (IT System issues, Syber security, Outdated technology), External event risk (Natural disaster, Business disruptions, Third party venders risk), Legal & Compliance risk (Regulatory changes, Errors in models, Unethical / illegal conducts)

4.1. Information Technology (System) Risk

Management of IT risks is an important component of the Company's operational risk management framework, and it comprises IT governance, a continuous technology risk management process, implementation of sound practices in respect of IT controls and ensuring quality of the computer systems. In addition to following IT Risk covered in Information Security Management System Manual (ISMS) designed according to the Baseline

Security Standard for Information Security Management. Over the years, Information Technology (IT) has become the backbone of the strategic business model of the Company. ICT is considered to be the critical success factor of the Company in effectively and efficiently delivering services to its customers. Consequently, risk management plays a critical role in protecting the Company's IT infrastructure and resources from potential vulnerabilities. The importance of identifying any potential risks on an ongoing basis as the technology and operating environment changes need to be reiterated. IT related risks are Access risk, Availability risk, Cyber and Information risk, Emerging Technology risk, Infrastructure risk, Integrity risk, Investment or Expense risk.

4.2. Internal Process Risk

Internal process risk in a Company refers to the potential risks associated with the Company's internal operations, systems, and processes. These risks can arise from deficiencies or weaknesses in the bank's processes, which may lead to operational failures, financial losses, regulatory issues, or reputational damage.

4.3. People Risk

People risk in a bank refers to the potential risks associated with the Company's employees, including their actions, behaviors, competence, and overall effectiveness in carrying out their roles within the organization.

4.4. External Event Risk

External event risk in a bank refers to the potential risks arising from events or circumstances outside the bank's control that can impact its operations, financial performance, or reputation. These events are typically unforeseen or unexpected and may include natural disasters, geopolitical events, economic downturns, regulatory changes, and other external factors. Natural Disasters, Geopolitical Events, Pandemics and Health Crises.

4.5. Business Continuity Risk (BCR)

Business continuity risk refers to threats or risks that disrupt the functioning of a business. These threats can be internal, such as system failures or human error, or external, like natural disasters or cyberattacks that impact a business's operations

5. **Regulatory Compliance Risk**

Company refers to the potential consequences they may face due to non-compliance with laws and regulations. It encompasses the risks arising from failing to adhere to established legal requirements. One specific subset of regulatory risk is compliance risk, which focuses precisely on the risk associated with violating existing laws or regulations.

6. Environment, Social, Governance (ESG) Risk

The ESG Risk to the LCBF stems from stakeholder expectations of the LCBF (material concerns identified through stakeholder engagement) in terms of compliance with minimum

Environmental, Social and Governance standards stipulated by the LCBF's policies, regulators, funding agencies and any other stakeholder. The Climate and Nature related risks, Responsible finance, Health & Safety standards, Employment Practices, Customer Protection Principles (CPP) would result in a multitude of aspects from Credit Risk, Operational Risk, Reputational Risk, and Market Risk.

7. Reputational Risk

Reputational Risk refers to the potential adverse effects, which can arise from the LCBF's reputation being tarnished due to factors such as unethical practices, regulatory actions, customer dissatisfaction and complaints, negative/adverse publicity etc.

8. Strategic Risk

Strategic Risk refers to the strategic decisions / plans / objectives which may go wrong due to actions or inactions by the parties to strategic decision making and implementation process, adversely affecting the shareholder wealth of the Company. e.g. incorrect decisions, inadequate information for decision making, delayed remedial actions etc.

9. Residual Risk

refers to the amount of risk or danger associated with an action or event that remains after natural or inherent risks have been reduced by risk controls1. In other words, it represents the risks that persist even after efforts to identify, eliminate, or mitigate them have been exhausted. Organizations assess residual risks to determine whether their planned risk treatment is sufficient or if additional measures are needed. If the level of residual risk exceeds an acceptable threshold, further risk mitigation strategies are considered3. Let me know if you need more information.

3 Risk Governance

3.1 Risk Governance Principles

The following principles underlie the risk governance structure of the Company as part of the Integrated Risk Management Framework (IRMF)

- ### Independent of control functions

  The risk management and control functions shall be independent from any other units or functions which have operational or business-related responsibilities. Independence shall be maintained throughout the entire internal control system, from Board independence through to the separation of front / middle / back-office functions based on the 3 lines of defense structure. The following are key elements to aiming at preserving independence of the risk function

- **The Board Integrated Risk Management Committee (BIRMC)**

The composition of the Board of Directors (BoD) shall consist in majority of independent / non-executive director. The **BIRMC** shall be formed mainly by independent or non-executive directors. The Chairman of the BIRMC shall be independent.

- **The Chief Risk Officer (CRO)** - Shall have a direct and functional reporting line to the BIRMC apart from the administrative reporting to the CEO.

- **The Risk Management function** shall not have responsibility for revenue generating business or risk-taking activities. Notwithstanding the independence requirement, Risk Management shall keep close enough to business/ risk taking activities in order to gain sufficient information on risk exposures, business strategies and ensure compliance with risk appetite, policies and limits.

- **Risk Management** shall use its own independent information sources (data, documents, records etc), shall have unrestricted access to this information and should form views, opinions and recommendations in an independent and unbiased way.

- 3 Lines of defense

All material risks as defined in the IRMF shall be based on the principle of three lines of defense**:**

- **1 st line of Defense :**
  Branches / Business Units shall be the primary risk owners and risk takers being responsible to manage risk exposures on a day-to-day basis through controls embedded at business process level or specialized back-office functions Including branches, Regional Office, Credit Dept., Finance & Treasury Dept., IT Dept., Branch Operations Dept. and other relevant support service sections. In addition to this Board Credit Committee (BCC) will act highest level of 1st line defense of credit.

- **2nd Line of Defense** :
  The Risk Management Division as an independent function headed by the CRO. The CRO has direct access to the BIRMC without impediment and reporting functionally to the BIRMC and administratively to the CEO. Compliance is the other independent function headed by the Chief Compliance Officer (CCO) / Head of Compliance and with similar reporting line of CRO. One of the key roles of the Risk Management Division under the 2nd line of defense is to ensure that the 1st line adequately applies and complies with risk and control policies and standards and to provide independent oversight of the risk profile of the LCBF. On the other hand, the function of the Compliance is to ensure that the 1st line is conducting the respective operations in accordance with industry laws and regulations, internal policies and best practices. Executive Integrated Risk Management Committee (EIRMC) will coordinate with

all above sections on 2nd line defense of risk under the leadership of CEO / ED. BIRMC is the highest level authority of 2nd line defense of risk management of the Company.

- **3rd line of Defense :**
  Specific to Risk Management, the Internal Audit Department is responsible to assess compliance and adherence to Risk Management Policies and Procedures on an ongoing basis and provide an independent assurance of the robustness of the Risk Management framework, processes and methodologies. Board Audit Committee will monitor this mechanism through Internal Audit Dept.

- Segregations of duties

The Risk Governance model caters for segregation of duties between

- Risk origination and risk underwriting /approval - This takes the form of segregation between business lines and review/approval functions (i.e. segregation between risk origination and the 1st line of defense).
- The Maker and Checker principle of Company's transactions - Any operation of the Company shall include, without exception a ' four eye principles ' whereby it takes at least one Checker for any transaction to be affected in the Company's books or systems.
- Top level oversight and Company's operations - Boards of Directors, various BoD or management committees need to be sufficiently independent from the supervised areas or activities of the LCBF to be able to exert effective supervision and oversight.

- Proportionality

The Risk Governance structure, as all the other elements of the IRMF shall consider the principle of proportionality by which it is acknowledged that the Company operates under a business environment of medium to low complexity and hence it is in the position to adequately manage risks by applying simpler yet robust governance models.

3.2 Risk Governance Layout

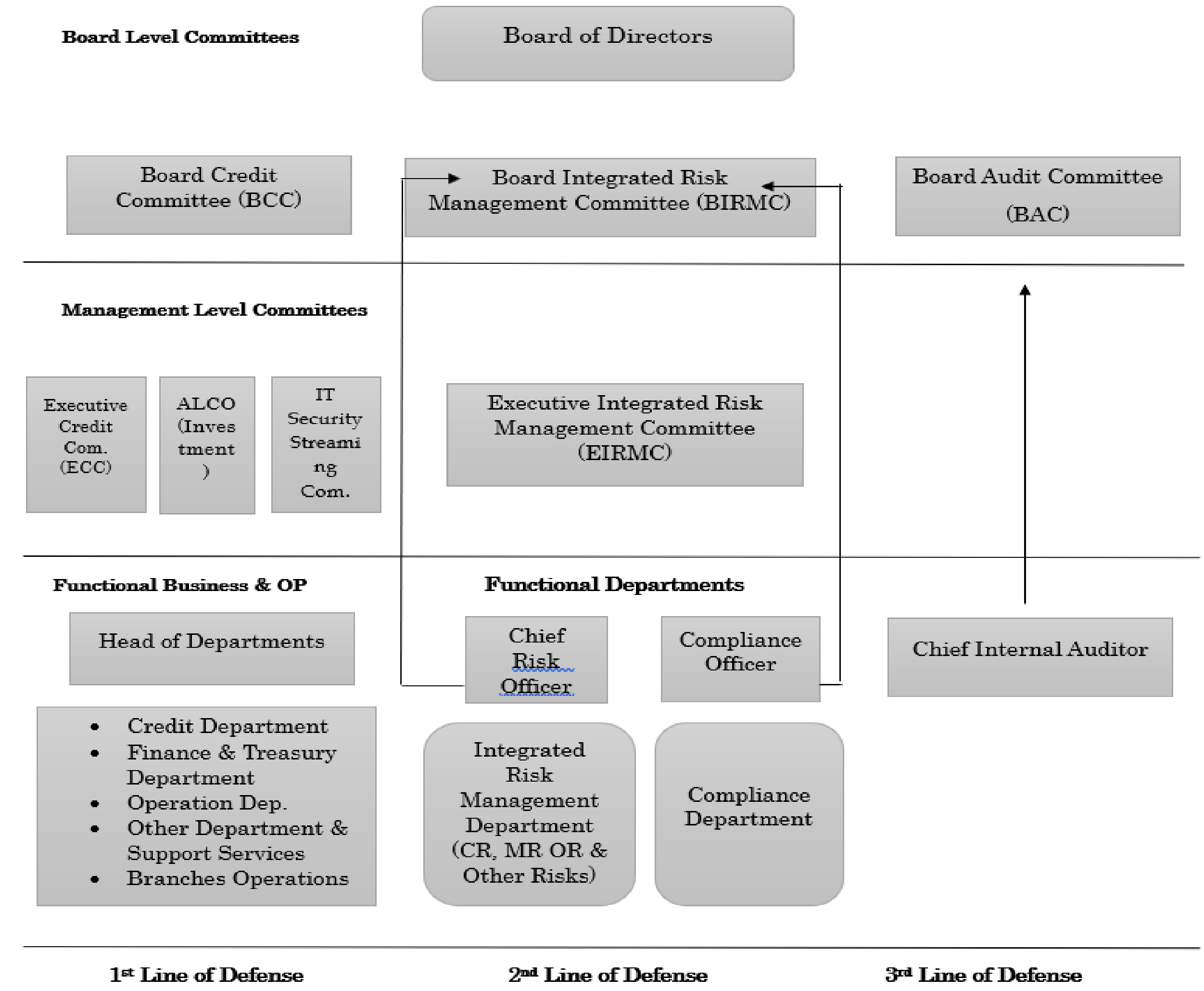

Figure 2 Risk Governance Layout

3.3 General Roles and Guidelines

3.3.1 Board of Directors

The BoD shall exercise the necessary level of control and oversight having a "duty of care" and "duty of loyalty" to the Company, its depositors and shareholders.

The ultimate responsibility for sound risk management in the Company rests with the BoD. The BoD sets the risk management strategies and policies and holds the main responsibility in overseeing risk taking activities and their compliance with the Risk Management Framework. In order to fulfill its oversight role effectively, the BoD delegates risk management responsibilities to a dedicated committee, the Board Integrated Risk Management Committee (BIRMC). BoD comprise with executive directors, non-executive directors and independent directors appointed by annual general meeting (AGM) under the approval of CBSL.

3.3.2 Board Committees (Relevant to Risk Management)

3.3.2.1 Board Integrated Risk Management Committee (BIRMC)

The Board delegates some of its responsibilities related to Risk Management to the Board Integrated Risk Management Committee (BIRMC) to increase efficiency and allow deeper focus on risk management. The BIRMC shall consist of at least 3 members of directors. It shall be formed in majority of non-executive or independent members and chaired by an independent director. Members shall have the relevant experience in risk management issues and practices. The BIRMC may include also non-Board members (such as independent consultants, staff members, or other cases decided by the BIRMC) in a consultative capacity only (non-voting members) in order to provide additional information and input to the Committee. Its main role shall be to advise and assist the Board of Directors on all its duties related to risk management. It is part of the 2^{nd} line defense of the Company and therefore should be independent from other all committees. This committee is report to BoD of the Company on a quarterly basis.

3.3.2.2 Board Credit Committee

The BCC is a committee of the Board of Directors, typically composed of senior, non-executive directors. The BCC shall consist of at least 3 members of directors, it shall be formed in majority of non-executive or independent members and chaired by an Independent Director. They provide high-level oversight and strategic direction for the Company's credit risk management practices. It vets all lending policies and products and advises the Board on lending matters. It is part of the '1st line of defense' and therefore should be independent from BIRMC. This committee is report to BoD of the Company on a monthly basis.

3.3.2.3 Board Audit Committee (BAC)

The Board Audit Committee is the main reporting and oversight body for the Internal Audit function of the Company. The BAC shall consist of at least 3 members of directors, it shall be formed in majority of non-executive or independent members and chaired by senior independent director. BAC ensures that Internal Audit performs its reviews an efficient, thorough and independent manner with regards to Risk Management the role of the BAC is to review the audit plan / scope and the audit findings on a yearly basis. Important findings shall be then discussed with Board of Directors. It is part of the '3^{rd} line of defense' and therefore should be independent from BIRMC and other committees. This committee is report to BoD of the Company on a monthly basis.

3.3.3 Executive Committees (Relevant to risk management)

3.3.3.1 Executive Integrated Risk Management Committee (EIRMC)

EIRMC consists of executive members of the management team under the CEO and secretariat by CRO including the, Compliance head, Finance head, Treasury head, IT head, Operations head, HR head and business heads, with the main role of coordinating management efforts to implement the Risk Mgt Framework. The EIRMC shall include representatives of both the 1st and 2nd line units responsible for material risks, including management of the lending divisions / lines, Treasury, Finance, Operations, as well as Risk Management representatives. Its overlook 2nd line Defense of overall risk of the Company. This committee is directly report to BIRMC on a quarterly basis.

3.3.3.2 Asset and Liabilities Management Committee (ALCO)

The Asset and Liabilities Management Committee (ALCO) is an executive level committee under the CEO and secretariat by Finance & Treasury head. Membership shall consist of senior management relevant to the mandate of ALCO such as business lines representatives, Risk & Compliance, etc. The mandate of ALCO shall focus on balance sheet management, business growth, profitability management, budgeting and business planning etc, while at the same time keeping the Company within the risk appetite formulated for ALM risks (Liquidity , Market, IRRBB, ICAAP and FX risk). Its overlook 1st line Defense of Market and Liquidity risk of the Company. This committee is directly report to BIRMC on a monthly basis.

3.3.3.3 Executive Credit Committees (ECC)

Executive Credit Committees shall review credit applications and approve loans within their approval authority and limits. Committee under the CEO and secretariat by Credit head. They should review and monitor credit portfolios and propose amendments to lending policies if and when needed. Composition of Credit Committees shall be CEO, Chief Credit Officer, Head of Credit Assessment (Credit origination), Head of Credit Control (Credit Administration, Control & Supervision) and Business, Treasury, Finance, Operations, as well as Risk Management representatives. Its overlook 1st line Defense of Credit Risk of the Company. This committee is directly report to the BCC on a monthly basis.

3.3.3.4 Internal Audit Department (IAD)

The current stress environment requires a rapid response throughout the organization, including the board, executive management, business and operations, and risk management. **The Chief Internal Auditor (CIA) / Head of Audit** Shall have a direct and functional reporting line to the BAC apart from the administrative reporting to the CEO. As the third line of defense, Internal Audit also plays a critical role in helping the Board Audit Committee (BAC) and executive management evaluate the Company’s processes for managing and monitoring risk, and testing the Company’s resiliency and controls. Chief Internal Auditor (CIA) in particular can provide the board with an independent perspective that can be pivotal in times of stress. Its overlook 3rd line Defense of overall Risk of the Company. This committee is directly report to BAC on a monthly basis.

3.3.4 The Risk Management Function

3.3.4.1 Risk Management Department & CRO

The Risk Management Department (RMD) is an independent risk management function headed by a Chief Risk Officer (CRO) whose appointment is to be approved by the BIRMC. The CRO has the primary responsibility for overseeing the development and implementation of the Company's risk management function. The CRO should not have responsibilities of any other operational department. The CRO shall be endowed with sufficient authority, stature, independence, resources and access to the Board, in order to fulfil role as the head of the Risk Management Division. Any 'double hatting' or involvement in operational activities / revenue generating functions must be avoided

The CRO is responsible for supporting the Board and BIRMC efforts to exercise its risk oversight by ensuring effective implementation of the Risk Management Framework, including the LCBF's risk management governance, RAS, ICAAP, risk limits, main risk management processes etc.

3.3.4.2 Integrated Risk Management (IRM)

IRM roles is to ensure consistency of all component of the Risk Mgt Framework in line with the principles set out in the Integrated Risk Management Framework (IRMF). It has to also ensure all material risks (including all material Pillar 2 risks in BASAL) are being managed within the RMD and consistent /coherent Integrated Risk Reporting (IRR) is submitted to senior management and BoD. The IRM function fosters communication, coordination and

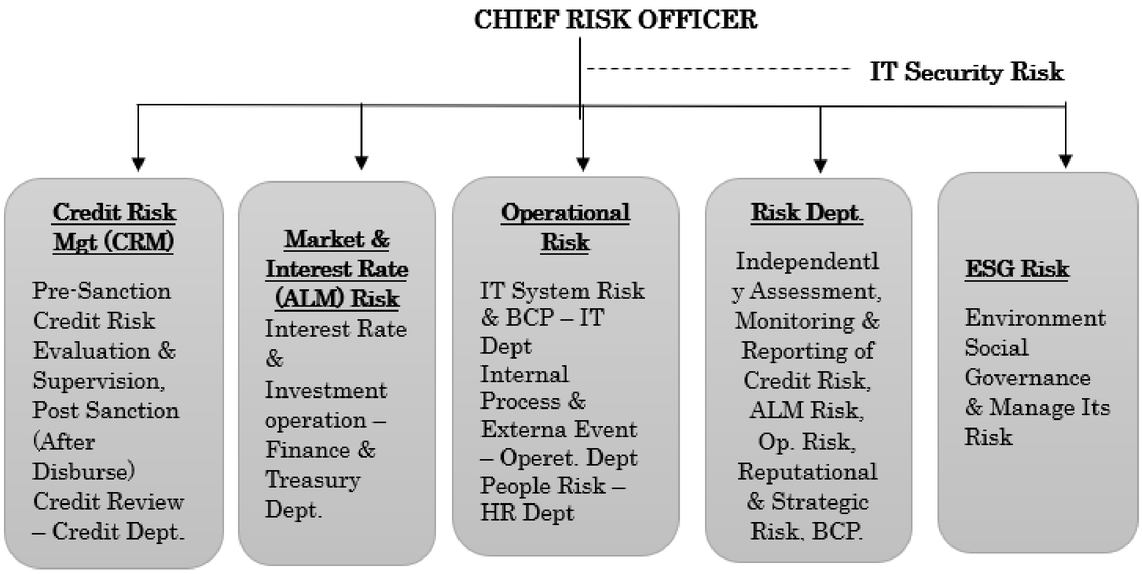

Figure 3 Functional Units within Risk Management

collaboration between various functions in risk management in order to recommend consistent risk strategies and policies, design risk governance structure, as well as ensuring a consistent approach to risk management and successful implementation of risk projects at risk division level.

3.3.4.3 Credit Risk Management (CRM)

The primary responsibility of CRM is to ensure that ’s credit risk exposures are within the risk appetite & tolerance levels of the Company. While the branches and credit department originate and accept credit risk exposures, Credit Risk Management unit (Pre-Sanction Credit Risk Evaluation) in the IRMD will be responsible for the following

- Conduct pre-sanction review to verify adherence to the credit risk and credit policies, prescribed lending processes
- Contribute in drafting lending and credit risk policies and procedures
- Be accountable for risk assessment methodologies and tools
- Generate and publish portfolio reports to reflect the risk position on the Company versus risk appetite.

3.3.4.4 Liquidity, Interest Rate and Market Risk Management (ALRM)

ALM and Market risks are managed by ALCO, mainly through Treasury and Finance departments (1st line of defense) and monitored by the TMO (2nd line of defense). The role of the 2nd line functions (i.e. the Market Risk Unit /RMD) with regards to these risks is to review and propose (before the final Board approval) all methodologies, assumptions, policies with regards to ALM & Market risks. Furthermore, it shall independently monitor, report and review exposures including generation of market risk reports.

3.3.4.5 Operational Risk Management

The primary responsibility of managing operational risks rests with 1st line operational functions such as Central Operations, the Branch Network, IT, HR, Legal, Finance etc. The Operational Risk Department / RMD shall be responsible for reviewing and assessing risks, as well as formulating recommendations and requests to 1st line function on mitigating all forms of operational risk, including without limitation, IT & IT security risk, Fraud risk, HR risk and Transaction Processing risk.

3.3.4.6 ESG Risk Management

The primary responsibility of managing ESG risks rests with 1 st line operational functions such as the Branch Network, Credit Department, Central Operations, Administration, etc. The Sustainable Banking function with IRMD shall be responsible for reviewing and assessing risks, as well as formulating recommendations and requests to 1st line function on mitigating all forms of ESG risks, including without limitation, Environmental and Social Risk Management and Social Performance Management.

3.3.4.7 Internal Audit

The general role of **Internal Audit** is to ensure that the Risk Management has been implemented as prescribed by the RMF and is functioning effectively. Internal audit should review the overall appropriateness and adequacy of the Framework as well as review compliance with Board approved policies and procedures with regards to risk management.

4 Risk Appetite Statement, Risk Strategy and ICAAP

4.1 Risk Appetite Statement (RAS)

4.1.1 RAS Principles

A Risk Appetite Statement (RAS) shall be developed to provide a common framework for the Board to set the boundaries of current and projected risk profile of the Company, by correlating RAS parameters and other risk metrics with strategic decisions and business planning. The Risk Appetite Statement (RAS) shall be designed based on the following key principles:

1. The Company's strategic objectives are articulated by the Board of Directors through the annual business planning. The RAS shall define the boundaries for risk, in full concordance with the Company's business targets.
2. The Company adopts a top-down approach for setting the Risk Appetite, whereby the Board through BIRMC sets / approves the Risk Appetite at the strategic level based on the recommendations of the EIRMC and the Risk Management Department.
3. The Risk Management Department will prepare a comprehensive document articulating the RAS Policy, defining the main principles, governance and processes as well as RAS measures and thresholds / limits.
4. Once the RAS is discussed and approved by the BoD and the relevant committees as discussed above, it is promptly communicated across the Company's departments.
5. RAS processes shall form an integral part of the broader risk planning and budgeting ie. ICAAP. There should be full alignment and consistency between ICAAP results and RAS.
6. RAS shall be defined comprehensively across all material sources of risk identified, covering as a minimum the following:

a) Credit Risk & Concentration risk

b) Liquidity Risk

c) Market Risk &Interest Rate Risk (IRRBB)

d) Operational Risk

e) Reputation Risk

f) Strategic Risk

g) Enterprise-wide Risk

4.1.2 Guidelines for the Risk Appetite Statement (RAS) process

The RAS processes entail three distinct stages:

a) **RAS Setting** consists of setting out appropriate RAS indicators and calibrating those as part of ICAAP. Proposed RAS levels shall be based on current levels in the LCBF, benchmark local or international data, regulatory requirements, as well as available capital and liquidity given business targets.

b) **RAS Review and Approval** Following the initial proposal and ICAAP feedback, the RAS indicators are submitted for review and approval as part of the ICAAP report as follows

c) **RAS Monitoring and Reporting** through the regular /quarterly Risk Mgt Reporting Processes (RMRP), including corrective actions if and when required. RAS shall be fundamentally reviewed at least once a year (ie RAS Setting) as part of the ICAAP or

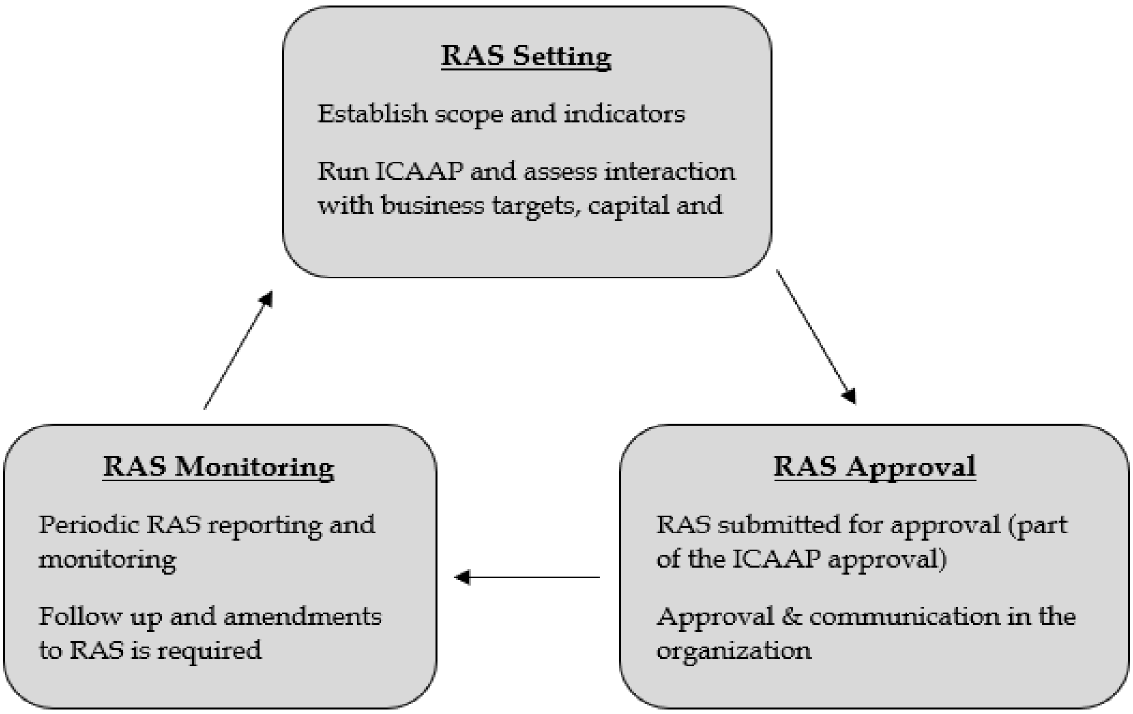

Figure 4 Summary of the RAS process

more often should business conditions fundamentally change (i .e. Shift in macroeconomic conditions, important revisions of business plans and budgets, depletion of capital buffers or liquidity etc.)

Following, Format will be used after the board approval

Risk Type	Risk Sub Type	Definition	Risk Appetite Criteria	Industry Appetite	Regulat - ory Limit	31st Mar. 2024 LCBF	LCBF Risk Appet ite Range	Remarks
Credit Risk	Exposure Risk	Annual increase rate	Portfolio Growth	4.50%		27.00 %		
	Defaul risk	% Of Advance portfolio	Non Performing Loans Ratio - Gross	14.70%		23.35 %		
	Defaul risk	% Of Advance portfolio	Non Performing Loans Ratio - Net	9.40%		15.00 %		
	Defaul risk	% of Total NPA	NPA/ Imparment Ceverege Ratio	7.00%		7.00%		
	Security risk	% Of Advance portfolio	Exposure to secured loans and advances	95.00%		99.63 %		
	Security risk	% Of capital fund	Maximum exposure to aggregate unsecured financing	4.00%	5.00%	0.67%		
	Borrower risk	% Of Total Capital Fund	Maximum exposure to single borrower - secured - Individual	5.00%	15.00%	10.12 %		
	Borrower risk	% Of Total Capital Fund	Maximum exposure to single borrower - secured - group	10.00%	20.00%	14.13 %		
	Borrower risk	% Of Total Capital Fund	Maximum exposure to single borrower - unsecured - Individual			0.04%		

	Related party lending	% Of capital fund	Maximum exposure to related party			9.00%		
	Connected party lending	% Of capital fund	Maximum exposure to connected party					
	Concentration	% of Total Gross Loan portfolio	Maximum exposure to Personal Loan			3.80%		
	Concentration	% of Total Gross Loan portfolio	Maximum loan exposure to Sector			24.62 %		Finance Sector
	Concentration	% of Total Gross Loan portfolio	Maximum loan exposure to Industry					
	Concentration	% f Total Gross Loan portfolio	Maximum loan exposure to Region			49.01 %		Southern Region
	% f Total Gross Loan portfolio	Maximum loan exposure to Region	Maximum loan exposure to District			34.68 %		Galle District
	Concentration	% of Total Gross Loan portfolio	Maximum loan exposure to 3rd Party guarantee Loan			14.43 %		
	Security risk	% Of Immoveble Property FSV	LTV Ratio on Property Mortgage (On Forced Sale Value) - Maximum Limit			51.00 %		
	Security risk	% Of Gold market value	- 01 Month - Maximum Limit			80.73 %		
	Security risk	% Of Gold market value	- 03 Month - Maximum Limit			74.60 %		

	Security risk	% Of Gold market value	- 06 Month - Maximum Limit			71.03 %		
	Security risk	% Of Vehicle Market value	LTV - Motor Vehicle - Maximum Limit (As per the CBSL Direc)			67.00 %		
Liquidity risk	Liquidity risk		Statutory liquidly asset ratio	21.00%	20.00%	18.39 %		
	Liquidity risk	% Of total assets	Liquidity assets ratio	14.80%		0.01%		
			Fixed Deposit	26.30%		36.75 %		
			Savings	10.00%		6.29%		
			Government Securities	5.00%		3.61%		
			Unsecured Borrowing	5.00%		0.00%		
	Liquidity risk	Total loan portfolio as % of deposit	Advance to deposit			172.77 %		
	Liquidity risk	% of high quality liquidity assets	Liquidity Coverage Ratio					
	Liquidity risk	% On Savings of total deposit	Savings to total deposit			14.00 %		
	Liquidity risk	% of deposit reneval	Deposit renewal ratio	75.00%				
	Liquidity risk	Capital fund to deposit	Maximum amount of deposit (As % of capital fund)	40.00%		40.00 %		
	Liquidity risk	Deposit composition (FD)	Fixed deposit	80.00%		85.00 %		

	Liquidity risk	Deposit composition (Savings)	Savings	20.00%		15.00 %		
	Liquidity risk		% of Advance to Stable Funds	>100.00%		165.00 %		
	Liquidity risk		External Borrowing Limit			0.00		
	Deposit Concentration	Large deposit exposure (Top 25)	As % of Capitol fund			25.00 %		
	Deposit Concentration	Sector wise deposit	As % of Deposit base			30.00 %		
	Funding risk	Short term deposit	As % of Deposit base			30.00 %		

4.2 ICAAP

The ICAAP is a process to estimate and project capital requirements through a comprehensive risk assessment methodology, in conjunction with the business and strategic plans of the Company.

4.2.1 ICAAP Principles

a) The ICAAP shall be comprehensive. It shall identify, assess all material risks. It shall assign a specific capital measure across the entire risk scope (i.e. Enterprise-wide Risk, Credit Risk & Concentration risk, Market Risk, Operational Risk, Liquidity Risk, IRRBB, Reputation Risk Strategic Risk and ESG Risks)
b) The ICAAP should be embedded in the Company's business and strategic planning processes. The Company shall blend the existing financial planning processes with the risk / capital planning dimension to obtain a consistent view of the potential scenarios related to achieving the business objectives.
c) ICAAP's design and related metho do loggias are determined according to the principle of proportionality (i.e. the level of sophistication of the methods and processes deployed under ICAAP are developed in relation to the nature, size and complexity of the Company's operations).
d) The overall responsibility for the ICAAP is assigned to the Company's BoD, which must ensure that the Company's risk-bearing capacity is secured.
e) The ICAAP shall be designed to ensure sufficient capital in a variety of market

conditions (particularly unexpected adverse conditions), with Stress Testing being a key feature of the Company's ICAAP framework.

f) The ICAAP should be fully documented, i.e. the methodologies, assumptions, procedures and policies should be formally documented in an ICAAP Framework Policy
g) ICAAP should be forward looking and cover a horizon of at least three years. The direct consequence of this requirement is that the business plan has to cover the same three-year horizon.

4.2.2 Guidelines for the ICAAP Framework Policy

The ICAAP Framework Policy shall achieve the following objectives:

- Reiterate the process for the high-level Risk Identification and Assessment (RIA)
- Define the ICAAP process, including clear assignment of roles and responsibilities for facilitating the ICAAP (i.e. ICAAP Governance)
- Facilitate integration of ICAAP processes the wider strategic management process including, without limitation, the Multiyear Business Plan and the Budget.
- Describe accepted methodologies for internal capital and liquidity assessment, as well as forecasting assumptions
- Describe interaction and integration of RAS as a sub-process of ICAAP
- Set out the standards for ICAAP reporting and documentation

4.2.3 Guidelines for the ICAAP process

a) **ICAAP Planning** shall cover at least the following process steps

1) Establish Scope of ICAAP by running a high-level risk assessment
2) Perform calculation of current values of RAS & ICAAP indicators
3) Projecting business targets based on the strategic objectives defined by the Board, part of the Multiyear Business Plan
4) Calculate projected RAS and ICAAP risk indicators. Projections shall be done under a baseline scenario and under stress scenarios.
5) Review results in terms of capital and Liquidity availability as well as RAS compliance
6) Draft ICAAP Report describing the ICAAP scope, process and results.

b) **ICAAP Review and Approval**

Following ICAAP Planning, ICAAP shall be Reviewed and Endorsed by ALCO, EIRMC and BIRMC and approved by the BoD. Following approval, the assignment business and risk targets (including allocation of capital) shall be communicated to the relevant business lines.

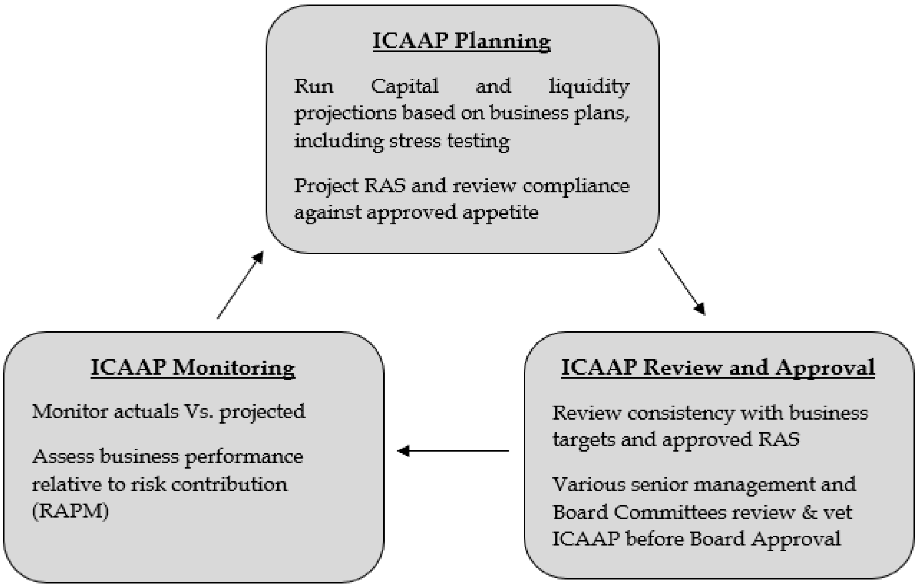

Figure 5 Summary of the ICAAP process

c) **ICAAP Monitoring and Reporting**

Regular (at least quarterly review by ALCO, EIRMC and BIRMC of the Company's financial performance and risk profile against the RAS and ICAAP benchmarks.

ICAAP Policy Manual would define the specific tasks and responsibilities along with the timelines of activities including all regulatory requirements.

5 The Risk Management Processes (RMP)

Risk management process covers the steps to be taken by the Company in the process of identifying, assessing, mitigating and treating the risks to which the Company is exposed to. It consists of the following conceptual steps.

5.1 Risk Identification and Assessment (RIA)

The purpose of the risk identification is to generate a comprehensive list of risk that may impact the Company's risk profile and may impede the achievement of the Company's overall strategic and business objectives. This process shall capture all significant risks and identify potential threats at the earliest opportunity. It includes review of portfolios, risk indicators, business processes, risk reports etc.

RIA & Risk type scoping involves the following dimensions

The following risks should be covered by RIA as a minimum

Type of Risk	Definition	Exposure dimension	Methods
Credit Risk / Borrower Risk	Credit risk is the risk of a client or commercial partner's non- performance of payment obligations deriving from a loan, a deferred payment agreement or some other credit-type relationship with the LCBF. Credit risk applies to both the lending book and to non- lending operations such as treasury or investment operations.	Portfolio or segment (as defined in the standard Portfolio reporting)	Review of i. Portfolio sizes (balances) ii. Credit performance metrics (NPL ratios, PaR indicators, write offs and provisions charges etc.)
Credit Risk / Credit Concentration risk	Refers to the potential defaults which may be driven by a common underlying cause and may threaten the viability of the Company through correlated portfolio defaults. There are two main types of concentration risks: I. Concentration of exposures to individual customers and customer groups (Single name risk – large exposure). Concentration shall be assessed both in terms of direct as well as indirect exposure (e.g. guarantees) ii. Concentration of risks arising from a group of exposures that share a common underlying risk driver, including: a. economic sector concentration (e.g. Agriculture, Construction, Transport etc.) b. repayment reliance on certain group's financial viability other than the borrower c. regional/ geographic concentration d. collateral type concentration e. product based concentration	Portfolio or segment (as defined in the standard portfolio reporting), OR Individual exposure (borrower or connected borrowers)	Review of % holdings in the total portfolio following the dimension highlighted in the definition (specific counterparties, industries, collateral sectors or regions etc.)

Credit Risk /Asset and Collateral Risk	Refers to the risk of material falls in the market value of certain asset classes due to systemic / macroeconomic factors or regional /idiosyncratic shocks.	Overall Company	Collateral exposure by collateral type as a percentage of total portfolio (or multiple of equity)
Market Risk	Refers to the uncertainty and potential losses related to the future value of market instruments due to changes in values of the market risk factors such as interest rates, foreign exchange rates, equity prices or commodity prices	Net Open Position OR Trading Book Value	Size of FX positions /operations or trading positions as a percentage of total capital or total assets
Operational Risk	Is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This includes legal risk but excludes strategic and reputational risks. The OR sub types identified under this Framework are: a) Fraud risk - (internal and external fraud) b) HR risk - (under staffing, lack of training, health and safety, etc.) c) IT risk - (system disruption, IT security, systems errors) d) Process and Product risk - (ineffective or lack of process controls, product / process design flows) e) Compliance risk - (non- compliance with CBSL and internal regulation) f) Business Continuity risk – (refers to threats or risks that disrupt the functioning of a business. These threats may include untoward incidents or disasters that negatively impact an organization. Several types of business continuity risks can cause significant harm to organizations.)	Business lines, product categories, branches, Overall Company.	Number and magnitude of losses and incidents of operational risk incidents (whether monetary or non-monetary) by business lines, product categories or branches

Liquidity Risk	Is the risk that the Company will not be able to efficiently meet both expected and unexpected current and future cash flows needs without affecting either daily operations or the financial condition of the Company.	Overall Company	% level of liquid assets ratio (liquid assets over total liabilities) Liquidity Coverage Ratio (LCR) Net Stable Funding Ratio (NSFR)
IRRBB	Interest rate risk in advance book (IRRBB) refers more generally to the current or prospective risk to both LCBF's capital and earnings arising from adverse movements in interest rates, which affect the Company's LCBF book exposures.	Overall Company	Sensitivity of Net Interest Income (NII)to market rate movements as a % of capital or P&L
Strategic and Business Risk	Means the risk to earnings and capital arising from changes in the business environment and from adverse business decisions	Overall Company	Operational income volatility assessment
Reputational Risk	Refers to the potential adverse effects, which can arise from the LCBF's reputation being tarnished due to factors such as unethical practices, regulatory actions, customer dissatisfaction and complaints, negative/adverse publicity etc.	Overall Company	Number and severity of incidents with large reputational impact for the Company (Social media, press releases)
Business Continuity Risk	Risk refers to threats or risks that disrupt the functioning of a business. These threats may include untoward incidents or disasters that negatively impact an organization. Several types of business continuity risks can cause significant harm to organizations.	Overall Company	Number and severity of business disruptions by critical system or location.

ESG Risk	Environmental, Social and Governance related risks relating to LCBF's core activities (lending and deposits), LCBF's operations and its broader ecosystem including the supply chain	Overall Company	Review of client/project level ESG risks and portfolio level exposure (High risk clients and high risk industries – eg : fossil fuel based industries). Risk relating to improper disposal of waste by the Company (eg: e-Waste disposed improperly). Risk of human rights / labour rights infringements in supply chain.

5.2 Risk Measurement

Risk Measurement is a critical component of the risk management process and consists of assessing the potential negative financial and non-financial impact a risk may have on the LCBF's financial position, market standing and relationship with key stakeholders.

5.2.1 Principles of Risk Measurement

The principles defined below shall be followed whenever specific methodologies are defined:

- <u>Quantitative Assessment Limitations -</u> Risk Measurement shall be done in a quantitative (i.e. data driven) way whenever possible and reasonable. Modelling should be only one part of the measurement efforts and should always be tempered by expert judgment.

- <u>Clear and transparent methodologies -</u> Risk measurement methodologies shall be defined in a clear and transparent way so that senior management and the Board members understand the underlying assumptions and limitations and qualify decisions based on this metrics accordingly

- <u>Non-arbitrary methodologies -</u> Methodologies should not follow purely judgmental assumptions but should be backed by objective (i.e. data driven) evidence whenever practical.

- Data Quality - Data based on which risk estimates are developed shall be consistent, complete and should reflect a full economic cycle (i.e. covering also recessionary episodes). In case historical data is incomplete or of substandard quality, this requires relevant caveats when reported to senior management and the Board.

- Principle of proportionality - Measurement methodologies have to be developed in correlation with the size and complexity of the Company's positions.

- Responsibility - The ultimate responsibility for comprehensive and accurate risk measurement including the adequate model risk management which sets standards for model development, validation, deployment and maintenance lies with the BoD through the BIRMC. The BIRMC mandates the CRO and the Risk Management Function (RMF) of the Company to assess and propose the most accurate and relevant measurement options for each type of risk covered by this IRMF.

- Consistent usage - Metrics and analytics used to measure risks shall be used consistency by the Company. For instance, measures used for defining ICAAP targets shall be used to define limits and to run portfolio reports.

- Aligned with CBSL guidelines and good international practices - As a minimum, the Company has to develop methodologies that are fully aligned with the regulatory guidelines issued from time to time by CBSL and shall continuously consult international practices with regards to risk measurement methodologies.

5.2.2 Risk Specific Assessment and Measurement Guidelines

Type of Risk	Guidelines
Credit Risk	Credit Risk Management Officer is responsible for (notwithstanding specific provisions of the Credit Policy or the Credit Risk Policy) 1. Assessing through an independent credit risk review the risks embedded in a. Products or programs - Check product / program parameters with regards to lending conditions, amounts, risk underwriting criteria etc. Provide the Board or the approving committee with an independent review of the product proposition. b. A specific exposure - According to credit approval authority as defined in the Credit Policy. 2. Developing, managing and implementing Credit Risk Measurement Methodologies (CRMM) in the Company across all material portfolios CRMM consists of two types of approaches i. Backward looking credit portfolio analytics consisting of a range of portfolio reports (see **Error ! Reference source not found**) ii. Forward looking models such as rating or scoring models aiming at providing a default estimate at contract level, collectively known as credit risk models. At a minimum, the CRMM: Shall have two separate dimensions, whenever possible, to reflect i) Risk of borrower default ii) Recovery-specific risks Shall have the following features: o Be based on a clear default definition and a minimum set of default rate analytics (vintage, regression analysis or flow rates) o Produce pools or customers with similar default behaviors (i.e. a credit grading system). The grades shall provide a statistically significant discrimination between default behaviors across grades. o Have a minimum number of five grades for non-defaulted obligors, and one for defaulted obligors. o Used throughout the lending cycle, from origination to monitoring and provisioning. Recovery and write-off rates should be modelled separately using client, product and collateral attributes as a starting point for its grading system. Credit Risk Management (CRM) is responsible for developing, administering and implementing internal rating systems in the Company across all material portfolios. The internal rating system shall provide a robust classification of credit risk by type of client and type of transaction. The Company must collect and store data on key borrower and facility characteristics to provide effective data support to its internal credit risk measurement.

	At a minimum, the Risk Rating systems: • Shall have two separate dimensions, whenever possible, to reflect (i) Risk of borrower default (ii) Transaction-specific factors • Must have a meaningful distribution of exposures across grades with no excessive concentrations, on both its borrower-rating and its facility-rating scales. • The obligor rating shall incorporate both quantitative (financial ratios) and qualitative standards (industry, payment history, credit reports, mgt, purpose of the loan, quality of financial information, facility characteristics etc.) • Must have a minimum of five grades for non-defaulted obligors, and one for defaulted obligors. The Company will have a Master Rating Scale, to which all the score cards' / rating models' output will be aligned with. • Must have specific rating definitions, processes and criteria for assigning exposures to grades within a rating system. The rating definitions and criteria must be both plausible and intuitive and must result in a meaningful differentiation of risk • Shall be used throughout the lending cycle, from origination to monitoring and provisioning. Rating grades shall be assigned Probability of Default (PD), in the case of obligor risk rating models, and Loss Given Default (LGD) in the case of facility rating models in case historical credit data is available in sufficient quality and quantity.
Credit Concentration risk	Credit concentration risk shall be measured across two dimensions. Single name – large exposure concentration and industry / region / product concentration. The following measures should be used to measure concentration: 1. Single obligor / Group concentration (direct) - % of total direct exposure into total capital 2. Single obligor / Group concentration (indirect) - % of total indirect exposure into total capital 3. Economic sector / product / collateral type concentration - % of total direct exposure into total lending book
Credit Risk / Asset and Collateral Risk	Scenario analysis exploring impact on provisions and NPL levels. Wherever possible the magnitude of the shock should be benchmarked against past local experience in that asset class. If local market experience is unavailable, the following broad benchmarks can be used (against book values): - 30% drop in residential real estate valuation - 50% drop in Commercial Real Estate valuation - 50% drop in private vehicle price - 70% in commercial vehicles and equipment

Market Risk (applicable to TB & FX positions)	The preferred measurement approach for market risk is Value at Risk- VaR VaR is defined as the highest loss estimate the Company may experience on a specific position or portfolio over a certain period of time and within a specified confidence level. All the recognized VaR methodologies can be deployed by the Company but as a minimum two methodologies shall be applied at the same time - Historical VaR simulation by which the largest (within a specified confidence level) portfolio impact is estimated based on past volatility of the underlying risk factors. - Parametric VaR by which a specific variance and covariances are estimated for all the underlying risk factors and a normal distribution assumption is taken to arrive at the VaR estimate. The VaR estimates shall - Be accurately estimated on at least one year of market data and thoroughly back tested - Recognize empirical correlations within broad risk categories as well as across these categories (e.g. interest rates, exchange rates, equity prices, including related options volatilities in each risk factor category).
Liquidity Risk	The foundation for all liquidity risk measurements shall be the cash flow gap analysis and the liquidity ratios of Liquid Assets Ratio (LAR), Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR). 1. Cash Flow gap analysis shall take the form of o Static Liquidity Analysis based on a business 'run-off' scenario using various Cash Flow allocation rules (regulatory and internal cash flow allocation rules based on client behavioral elements, particularly relevant to deposits). o Dynamic Liquidity Analysis based on projected balance sheet changes and accounting for client behavioral elements (to accommodate future business growth and balance sheet transformations). 2. Similar assessment is required for LAR, LCR and NSFR using a static analysis (computed on current balances) and a dynamic analysis based on projected business. Ratio analysis shall enable the Company to: a. Comply with regulatory/CBSL requirements b. Project cash flow gaps and needs in order to avoid liquidity shortages going forward c. Plan liquidity and develop funding strategies part of ICAAP

Interest Rate Risk in Baking Book (IRRBB) – Advance book	Two perspectives are used by the Company when measuring IRRBB: - Earning perspective impact due to mismatches in re-pricing of Rate Sensitive Assets (RSA) and Rate Sensitive Liabilities (RSL), which will have an impact on the Company's Net Interest Income (NII) over a defined short to mid- term horizon (usually one year) - Economic value perspective The sensitivity of a Company's Economic Value of Equity (EVE) to fluctuations in interest rates particularly, is an important consideration of shareholders, management, and supervisors. In order to capture the entire exposure to IRRBB, the Company shall - Estimate magnitude of shifts in the yield curve reflecting the specific conditions and vulnerabilities of the economy - Apply a multitude of scenarios, including: Parallel shift (up and down) of the yield curve. Twists of the yield curve such as flattening and steepening of the curve Increased volatility in short term rates - Capture behavioral repricing patterns such as prepayments, or limit drawdowns that might magnify exposure and losses

Operational Risks	Measurement of OR shall be done through the following methodologies (applied jointly) - Risk occurrence and severity estimation through Risk and Control Self-Assessment (RCSA) performed regularly (at least annually) or whenever a new product, system or a process is newly introduced, or any material amendments are made to existing ones. - Operational loss incidents by event type, unit or branch, type of product as well as any operational losses experienced. More specifically, on the five sub-types identified a) <u>Fraud risk</u> - number and magnitude of fraud cases, total financial losses as a result of fraud incidents b) <u>HR risk</u> - staff turnover rates, number of vacant positions (mid management and executive level), number of health and safety incidents c) <u>IT risk</u> - number of IT security breaches, number and severity of system downtime d) <u>Process & Product risk</u> - number of product and process flows detected e) Compliance risk - number of regulatory compliance incidents, number of material internal policy breach For the key risks identified under RCSA, the Company would develop indicators which can assist the Company in monitoring its key risks (Key Risk Indicators). These indicators should be quantitative in nature and periodically reported to senior management and Board.

Strategic and Business Risk	Strategic and business risk shall be assessed through a careful consideration of business implications for all considered strategic decisions (i.e. scenario analysis). A more quantitative assessment in terms of earnings volatility or a questionnaire / scorecard approach could also be deployed.
Reputational Risk	Reputational risk shall be assessed by means of a scorecard approach, a risk review approach (part of RCSA) and / or estimates based on past reputational incidents.
Business Continuity Risk	Statistics with regards to the number of material weaknesses identified during Business Continuity Plan (BCP) testing and the number and description of unplanned system or operational outages per quarter
ESG Risk	The ESG Risk to the Company stems from stakeholder expectations of the Company (material concerns identified through stakeholder engagement) in terms of compliance with minimum ESG standards stipulated by the Company's policies, regulators, funding agencies and any other stakeholder. Breaches of these would result in a multitude of aspects from Credit Risk, Operational Risk, Reputational Risk, and Market Risk. The Company would initially set minimum environmental and social standards for its lending practices through the Exclusion and Negative list and screen borrowers against these lists. Other ESG related factors such as Health & Safety standards, Employment Practices, Customer Protection Principles (CPP) will be monitored with the defined KRIs. Over the medium to long-term, LCBF will need to assess the climate and nature related risks of its portfolio (eg: physical and transition risks faced by clients) and work to proactively manage this risk through risk-informed sustainable finance strategy. The ESG risk management approach is more fully defined and expressed in LCBF's Integrated Sustainability Policy Framework and associated sub-policies, position statements and procedures

5.3 Risk Reporting and Monitoring

5.3.1 Principles of Risk Reporting

The processes of risk reporting and monitoring shall comply with the following principles

- Integrated reported - Risk reporting to senior management and Board shall be done in an integrated and consistent manner. In order to ensure consistency, an Integrated Risk Report is compiled and validated by the IRMD based on specific risk reporting prepared by each relevant risk department.
- Accuracy - Risk reporting shall be validated to ensure completeness and accuracy. Validation of risk reports shall be independently carried out by IRMD and each Risk Unit as well as Internal Audit as part of its annual risk audit plan. Also, risk data should be reconciled with Company's sources, including accounting data where appropriate, to ensure that the risk data is accurate
- Access and Infrastructure - The Company's risk personnel should have sufficient access to risk data to ensure they can appropriately aggregate, validate and reconcile the data to risk reports. To this end, an appropriate reporting platform shall be made available to risk personnel (e.g. business intelligence systems)

- Timeliness - The Company should be able to generate aggregate and up-to-date risk data in a timely manner in order to allow recipients of the reports take timely decisions based on these reports.
- Distribution - Risk management reports should be distributed to the relevant parties, including without limitation Board members and relevant members of the management team, while ensuring confidentiality is maintained.
- Deviations - Any deviations to Policies, Risk Limits to be escalated to EIRMC and BIRMC on a timely manner with remedial action plans.

5.3.2 Risk Specific Reporting Guidelines

5.3.2.1 Monthly Reporting to Senior Management / EIRMC and BIRMC

No	Item	Report by	Received by	Reporting Frequency
1	Overview of the balance sheet and profitability, including compositing and growth of specific items	Finance Dept	EIRMC	Quarterly
2	Track levels and trends of key balance sheet ratios, including benchmarking against the industry	Finance Dept	EIRMC	Quarterly
3	Enterprise-wide RAS indicators level and trends vs. target levels	Risk Dept	EIRMC / BIRMC	Quarterly
4	ICAAP Pillar I and Pillar II risk assessments	Finance/Risk Dept	EIRMC / BIRMC	Quarterly
5	Capital adequacy and RWA breakdown	Finance/Risk Dept	EIRMC / BIRMC	Quarterly

6	Outcome of the main key risk elements analysis along with respective stress test outcome	Risk Dept	BIRMC	Quarterly
7	Stress Testing Results	Finance / Risk Dept	EIRMC/ BIRMC	Quarterly
	Enterprise-Wide Risk Reporting covers overarching risk indicators, not attributable a specific risk type.			
	Credit Risk & Concentration Risk			
1	Credit Risk RAS indicators, other credit risk KRI's and credit risk limits level and trends vs. target levels	Credit Dept	EIRMC / BIRMC	Monthly / Quarterly
2	Total portfolio and growth analysis by the following relevant dimensions:			
	- Product Wise loan portfolio (Loans, Lease, Cash Margin)	Credit Dept	EIRMC	Monthly
	- Securerd / Colleterel Asset Type wise loan portfolio (Land, Deposit, Golod, etc)	Credit Dept	EIRMC	Monthly
	- Branch Wise loan portfolio	Credit Dept	EIRMC	Monthly
	- Customer exposure wise advance (Top 25)	Credit Dept	EIRMC	Monthly
3	NPL/PaR (0/1-30/31- 60/61-90/ 91 & above DPD) portfolio analysis for total portfolio and broken down by the dimensions above.	Recovery Dept	EIRMC / BIRMC	Monthly / Quarterly
4	Provisioning coverage analysis for total portfolio and broken down by the dimensions above.	Risk Dept	EIRMC / BIRMC	Monthly / Quarterly
5	Vintage analysis for total portfolio by vintages and broken down by the dimensions above (where transactions samples are sufficiently large for a meaningful statistical estimation).	Recovery Dept	EIRMC / BIRMC	Monthly / Quarterly
6	Flow rate analysis (across aging buckets) for the overall portfolio as well as by segments (product, branch or region)	Recovery Dept	EIRMC	Quarterly
7	Recovery rate analysis (current rates) broken down by all relevant dimensions	Recovery Dept	EIRMC	Quarterly
8	Write off rates analysis broken down by all relevant dimensions (if material)	Recovery Dept	EIRMC	Quarterly
	8 Please see Appendix 2: KRI Matrix for further detail-**			
9	Concentration analysis by economic sector (CBSL), region or single borrower / group.	Credit Dept	EIRMC	Quarterly
10	Credit risk stress testing results including stressed NPL levels, impact in provision levels and charges, w/offs and capitalization levels.	Finance/Risk Dept	EIRMC / BIRMC	Quarterly
11	Related & Connected party lending (direct exposure), Single Obligor Concentration and Geographic concentration	Credit Dept	EIRMC / BIRMC	Monthly / Quarterly

	Market Risk (applicable to Treasury Bill / Bond (TB) and Forex Exchange (FX) positions)			
1	Market Risk exposure vs. RAS targets levels and other limits (Liquid Asset Ratio, Liquidity Coverage Ratio, Net Stable Funding Ratio, Loan to Deposits and Savings Ac funding ratio,	Finance Dept	EIRMC / BIRMC	Monthly / Quarterly
2	FX open position vs. applicable limits and historical Profit & Loss	Finance Dept	EIRMC	Monthly
3	Trading Book composition and performance (positions and P&L breakdown) (if material)	Finance Dept	EIRMC	Monthly
4	Market risk stress scenario analysis and results (if material)	Finance/Risk Dept	EIRMC / BIRMC	Quarterly
	Liquidity Risk			
1	Exposure vs. RAS target levels, other relevant KRIs and other limits (e.g. Liquid Asset Ratio)	Finance Dept	EIRMC / BIRMC	Monthly / Quarterly
2	Funding position of the LCBF vs. the funding plan	Finance Dept	EIRMC / BIRMC	Monthly / Quarterly
3	Cash flow mismatch analysis as well as trend analysis in cash flow coverage ratios	Finance Dept	EIRMC / BIRMC	Monthly / Quarterly
4	Stress scenarios / testing results and impact in terms of RAS ratios	Finance/Risk Dept	EIRMC / BIRMC	Quarterly
	Interest Rate Risk of Banking Book (IRRBB)			
1	Exposure vs. RAS target levels, other relevant KRIs and other limits	Risk Dept	EIRMC / BIRMC	Monthly / Quarterly
2	Repricing mismatch analysis	Finance Dept	EIRMC/ BIRMC	Monthly / Quarterly
3	NII/EVE impact of yield curve shifts and twists scenarios	Finance Dept	EIRMC / BIRMC	Monthly / Quarterly
4	NII impact of interest rate shifts under mild and severe stress scenarios	Finance/Risk Dept	EIRMC / BIRMC	Quarterly
	Operational Risk			
1	Exposure vs. RAS target levels, other relevant KRIs and other limits OR Losses and incidents by various dimensions (business lines, products and risk type)	Operation Dept	EIRMC / BIRMC	Monthly / Quarterly
2	Risk and control heat map by various dimensions (business lines, products and risk type)	Risk Dept	EIRMC/ BIRMC	Monthly/ Quarterly
3	Risk level dynamics and trends by risk types	Risk Dept	EIRMC	Monthly
4	KRIs levels and trends – Department / Branch wise	Operation Dept	EIRMC / BIRMC	Monthly / Quarterly
	Reputational Risk			

1	Description of reputational incidents over the reporting month or quarter, including negative press coverage, client complaints and social media impact assessment, supervisory measures / fines	Compliance Dept	EIRMC / BIRMC	Monthly / Quarterly
	Business Continuity Risk			
1	Number and description of unplanned outages per month/ quarter	IT Dept	EIRMC / BIRMC	Monthly / Quarterly
	Eenvoinmetal & Social Governance (ESG) Risk			
1	Number of customers and projects in high risk, medium risk and low risk categories further to environmental and social due diligence (ESMS)	Risk Dept	BIRMC	Quarterly
2	Remaining exposure on LCBF's existing portfolio to exclusion list activities and degree of phase out during review period.	Risk Dept	BIRMC	Quarterly
3	Social Performance Management /Client Protection Monitoring Reports	Compliance Dept	BIRMC	Quarterly

5.3.2.2 *Escalation Process*

The IRM Department would escalate to EIRMC/ BIRMC and Board of Directors any material Risk incidents/ Losses or adverse trends in risk matrixes.

(i) Any material Risk incidents and Losses along with the root cause analysis and mitigation plans with timelines for closure.

(ii) KRI's within Amber Zone (refer section 5.2 above) and the trend of deterioration if any.

(iii) KRIs' within the Red Zone and the action plan for rectification

(iv) Any material deviations to agreed workarounds/ mitigation action plans (as defined in the RCSA process and/ or for operational risk incidents) with justifications and/ or extension of timelines for closure. The material deviations to mitigations and extensions for timelines for closure should be approved by the BIRMC.

6 Stress Testing

6.1 Principles

Stress testing is a critical component of the LCBF's risk management system. The main goal of Stress Testing is to quantify the impact of stressed yet plausible macroeconomic and LCBF specific shocks on the LCBF's financial position including its long-term viability.
The following principles shall apply to any stress testing framework of the LCBF:

1. Stress Testing Governance

Stress testing shall form an integral part of the overall risk governance and risk management culture of the LCBF. Authority over the LCBF's stress testing framework rests with the LCBF's Board of Directors and senior management. While the Board is ultimately responsible for ensuring that the LCBF has an effective stress testing framework, it is the role of Risk Management and the relevant risk committees to fulfill the following roles:

- Establish adequate stress testing policies (or sections within risk specific policies) and procedures, and ensure compliance with these policies and procedures
- Review and evaluate stress test results, discuss implications and take prompt remedial action where necessary.
- Finally, Risk Management, through the BIRMC, is also responsible for regularly reporting stress testing results to the Board.

2. Relevant Methodology

Stress test scenarios should be anchored in actual relevant historical corrections in the local market or, in case such history does not exist, using hypothetical scenarios based on the broader interactions experience.
Irrespective of the type of methodology deployed, stress testing should be:

- Forward Looking - it should reflect a potential a severe yet realistic future stress situation
- Tailored to the Company's portfolio vulnerabilities - should reflect specific portfolio vulnerabilities in the Company rather than being generic
- Meet regulatory requirements- should cover minimum regulatory directives

3. Actionable results

Stress test results should be clear, actionable, well supported, and inform the decision-making process at Board, BIRMC and ALCO levels in regular and timely manner. More importantly, stress test results should be directly linked to decision-making related to business strategies, including business planning and budgeting. Among the actions that could be taken the following shall be considered depending on level of impact severity:

- Holding additional risk buffers such as provisions, capital or liquid assets
- Reducing risk exposures (reducing growth levels, shifting portfolios towards lower risk products or segments, requiring additional collateral, reducing concentrations)
- Reduce budgetary or strategic targets or adjust target portfolio mix

- Amending contingency plans

4. Stress Testing Documentation

Stress Testing Framework shall be fully documented, part of each Risk Policy, and shall include frequency and procedure for identifying the principal risk factors, which affect the LCBF's portfolio and required to be stressed.

- Methodology for constructing stress tests, including simulation parameters
- Process of monitoring the stress loss limits.
- Necessary remedial/trigger actions to be taken, including contingency planning
- Delegation of authority to ensure timely execution of remedial/trigger action

5. Forward Looking

Stress testing methodologies shall be forward-looking and flexible. Flexibility is necessary in order to incorporate changes in the LCBF's activities, portfolio composition, operating environment, business strategy.

Although historical information should be utilized in stress testing, the LCBF' stress testing shall go beyond that and assess various scenarios of 'what could go wrong' within a certain macroeconomic context and given the specific features of the LCBF (using hypothetical scenarios, for example).

6. Frequency of analysis

The LCBF shall aim at preparing stress test results on a quarterly basis. Annually, for ICAAP purposes, the underlying macro scenarios shall be updated as part of ICAAP planning. In case of stress testing related to market conditions (i.e. market risk and IRRBB), stress testing shall be conducted at least monthly.

7. Scope of Risk Coverage

Stress testing shall focus on risk dimensions and portfolios which have the potential of a significant impact on the LCBF's financial condition. All material risk sources shall be subjected to stress testing provided reasonable/realistic methodologies are devised.

8. Relevance of scenarios

Most measures of risk, including the ones used in stress testing, contain a number of assumptions and limitations. In the absence of objective information, the subjective test scenarios should be reasonable and justifiable. In case none of this is possible, the LCBF should not run purely arbitrary stress scenarios that may distort the assessment of risks.

9. ICAAP Component

Stress testing is a key component of ICAAP. Capital and funding projections have to be assessed under adverse scenarios. Relevant and credible contingency plans have to be drawn up in case of capital or liquidity shortages.

10. Stress Test results

Stress test results should be clear, actionable, well supported, and inform the decision-making process at Board or Risk Management Committee levels in regular and timely manner. More importantly, stress test results should be directly linked to decision-making related to business strategies as well as ICAAP and management of the risk profile.

Benchmarking or other comparative analysis should be used to evaluate the stress testing results produced by different scenarios. The LCBF should determine which results should be given greater or lesser weight, analyze the combined impact of its tests across various risk categories, and then evaluate potential courses of action based on that analysis.

6.2 General Methodological Guidelines

1. Level of Severity

Stress testing shall be conducted across at least three levels of intensity according to CBSL guidelines corresponding to a recessionary contraction, a severe downturn and a very severe global market disruption. More specifically the stress scenarios shall be categorized into:

i. **Moderate Stress Scenario** shall reflect a typical recessionary episode. This is a once in 7-10 years scenario. It is an average severity recessionary episode within a business cycle confined to local market conditions.

ii. **Severe Stress Scenario shall reflect a severe but plausible recessionary scenario.** This is once in 30-50 years scenarios. This is a severe recessionary episode where local vulnerabilities blend with a regional and international financial crisis situation9.

2. Types of Stress Testing

A number of Stress Testing methodologies and approaches shall be deployed, as follows:

- ***Sensitivity analysis*****:** Seeks to identify how portfolios respond to the movement of a single risk parameter, while holding all others constant. The following can be considered NPL ratios, provisioning levels, drops in collateral valuations and reduction in recovery rates.

- ***Scenario analysis****:* Requires movement of multiple risk parameters simultaneously with the source of the stress event being well defined (the "scenario"). Scenario analysis can make use of hypothetical macroeconomic scenarios or major systemic shocks that occurred in the past.

3. Development of Scenarios

Scenario analysis is a process that should cover the following stages:

(i) Identification of specific macroeconomic vulnerabilities within the operational environment of the LCBF

(ii) Construction of a stress scenario

(iii) Conversion of the macroeconomic scenario into a form that is usable for a balance sheet and income statement analysis

(iv) Assess impact on liquidity and capitalization levels (where a link to liquidity and capital can be identified).
(v) Interpreting the results

6.3 Risk Specific Guidelines

Type of Risk	Guidelines
Credit Risk	The effects of a stress scenario on the lending books shall be assessed as a minimum with regards to (i) the increase in default probabilities and NPLs (ii) increase provisioning levels; (iii) slowdown in portfolio growth (iv) decrease in the value of collaterals and consequently decreases in recoveries A set of elasticities against market conditions shall be estimated and/or benchmarked against regional or international data.
Liquidity risk	Stressful liquidity conditions shall consider the following as a minimum: **1.** Abnormal client behavior (high deposit withdrawal rates or assumption of no deposit roll over, significant reductions of savings account deposits in line with 3-4 historical standard deviations) **2.** Tightening of market liquidity triggering a surge in refinancing rates. **3.** Tightening of market liquidity that generates drops in market prices of traded securities, drying up of wholesale funding and money markets. These conditions shall lead to a revised set of 'tighter' Cash Flow allocation rules and a set of predefined shocks in the client deposits, market prices etc.
IRRBB	Based on historical series of yield curves, a set of stressed shocks shall be defined with relation to the following scenarios such as parallel shift (up and down) of the yield curve of at least 300-400 bp in local currency and 200 bp in USD rates

Market Risk	Various market variables shall be analyzed in terms of significant historical or hypothetical shocks such as: - Widening of credit spreads for the Sri Lankan Government - Sharp drop in equity indexes - Steep and sudden devaluation of the local currency 10** - Increase in market volatility correlation levels
Operational Risk	Operational risk stress testing shall be rooted in historical data (Operational Losses or Op. Risk KRIs). If this is not attainable due to data quality and/or completeness, some sensible scenarios shall be developed instead around the main operational risk categories (e.g. system disruption, legal cases, internal fraud, natural disasters etc)
ESG Risk	Stress testing of the portfolio based on physical or transition risks relating climate change or nature loss. For example, possible financial impact to the LCBF due to new environmental laws (eg: bans on agrochemicals, bans on fossil fuel-based products such as plastics and polythene, etc) or due to prolonged drought causing physical losses for LCBF's agriculture client segment.

6.4 Contingency Planning

Contingency Plan (CP) addresses the Company's strategy for handling liquidity crises and capital shortfalls. The LCBF shall have a clear plan on managing risk exposure in case of crisis. The CP shall be based on the Company current liquidity and capital position, stress testing output and business plans.

The following roles are responsibilities are defined with regards to Contingency Plan

- Head of Finance / CFO along with CRO shall be responsible for drafting the CP
- CEO will have to provide approval for the activation of the CP
- ALCO shall be responsible for running the CP procedures and monitor implementation

The CP shall address the following administrative policies and procedures:

- Responsibilities of senior management during a liquidity, capital or a regulatory compliance crisis situation
- Crisis Committee part of ALCO - task force to handle the crisis : Names, addresses and telephone numbers of members of the crisis committee. Crisis Committee shall include at a minimum the CEO, CRO, Head of Finance, Head of Operations.
- Procedures shall be documented and that the chain of command and communication process shall be clearly defined.
- Definition of the trigger event (e.g. sovereign default, breach of regulatory

provisions, run on the Company's deposits, sharp and severe devaluation of the LKR etc.)

- Possible course of action depending on trigger event (e.g. sale of investments, halting lending activities, conversion of debt into equity, suspension of dividends, central LCBF refinancing, additional capital injection etc.)

Contingency Planning shall be regularly reviewed and updated at least on an annual basis to take into account both internal and external developments. The LCBF shall test the CP at least on an annual basis by conducting a 'dry run'.

6.5. Business Continuity Management (BCM)

BCM is a management processes and it is the implement strategies to address the risk of unexpected disruptions. It covers emergency response, risk management, planning, business continuity plan (BCP), training, testing, and improvements. The benefits of a BCP include supporting the organization's strategy, creating a strategic advantage compared to your competitors, demonstrating to stakeholders such as investors and customers that you are taking their needs seriously, and addressing operational vulnerabilities.

Strategic framework that enables organizations to rapidly restore their operations in the event of a disaster. Here are the key components and phases of BCM

Establishment Phase:

- Identify Risks: Assess potential disruptions (e.g., natural disasters, cyber Attacks).
- Prioritize Resources: Evaluate business activities and prioritize resources.
- Policy and Training: Develop policies, form a BCM team, and educate personnel.
- Recovery Time Objectives: Set recovery time objectives for restoring normal operations.

Implementation Phase:

- Recovery Strategies: Develop effective strategies for restoring operations.
- Infrastructure Setup: Establish necessary resources for recovery.
- Minimize Downtime: Ensure minimal downtime during incidents.

6.6. Business Continuity Plan (BCP)

- An integral part of BCM
- Focuses on resuming operations during an unplanned disruption until it returns to normal again
- The strategies and actions required by the organization
- More comprehensive than a disaster recovery plan
- It contains contingency plans for every aspect of business operations that may be affected,

• financial services • human resources • productions • inventory management

• Distributions • external suppliers and business partners etc.

Detail the roles and responsibilities of various key stakeholders and be shared with top management for their agreement and sign-off.

7 Risk Based Pricing and Performance Measurement

7.1 Risk Based Pricing

Minimum pricing shall be derived based on the cost of funds, operating expenses, credit losses and cost of capital. The Company will use this hurdle rate as a reference point and price its loans with appropriate mark up or mark down as the case may be.

- Cost of funds - is the average cost of funding sources for a specific transaction or exposure. The average is computed across all funding sources including capital, relevant to the currency and the tenor of the exposure. The Fund Transfer Pricing (FTR) rate is a relevant starting point in computing the Cost of Funds (CoF).

- Operating expenses - allocation of OPEX per product using a clearly defined methodology developed by the Head of Finance / CFO

- Cost of risk - shall be estimated based on credit models, if available. Till such models are developed net provisions expenses (i.e. net of recoveries) from the previous years shall be used as a reference.

- Cost of capital - accounting for
  - Target Weighted Average Cost of Capital (WACC), based on Return on Equity (RoE) target levels and Tier 2 capital costs
  - Average capital requirements (average RWs) per type of transaction.
  - Tax rate, because ROE is on net of tax basis.

7.2 Risk Based Performance Measurement and Target Setting

While the Company would strive towards Risk Adjusted Performance Measurement (RAPM) – Risk Adjusted Return On Capital (RAROC) which involves

a) adjusting profitability with expected credit losses,

b) comparing profitability with risk capital consumed RAROC,
Due to the current level of complexity would initially measure performance against portfolio level performance measurements such as, business targets, portfolio delinquency targets etc. irrespective of capital consumed / allocated.

8 Integrated Risk Management Framework (IRMF) Documentation

8.1 Guidelines for Framework Documentation

The IRMF sets out the guidelines and principles for the documentation of Risk Management policies and processes as follows

8.1.1. The risk policy structure of the Company is organized on three levels

i. IRMF defines the high-level principles and standards and describes the entire Risk Management Framework

ii. The RAS and ICAAP Framework Policies defines the risk planning process across all risk categories

iii. Specific Risk Policies where risk specific governance, processes and methodologies are documented. The specific risk policies shall be articulated in full alignment with the Integrated Risk Management Framework. Integrated Sustainability Policy Framework will capture separately the ESG risks in detail.

8.1.2. The Specific Risk Policies shall follow as standardized structure and should read consistently (see Policy Content Guidelines below)

8.1.3. Risk Polices have to document comprehensively the management of all material risks the Company is facing. In so doing, the RMF has to identify, measure and manage all material Pillar 2 risks (see RIA for a definition of types of risks under the scope of RMF), as well as all the forms Pillar 1 risks may take. For instance, in the case of credit risk policies should cover not only direct credit risk but also counterparty risk, indirect risk or guarantor risk and

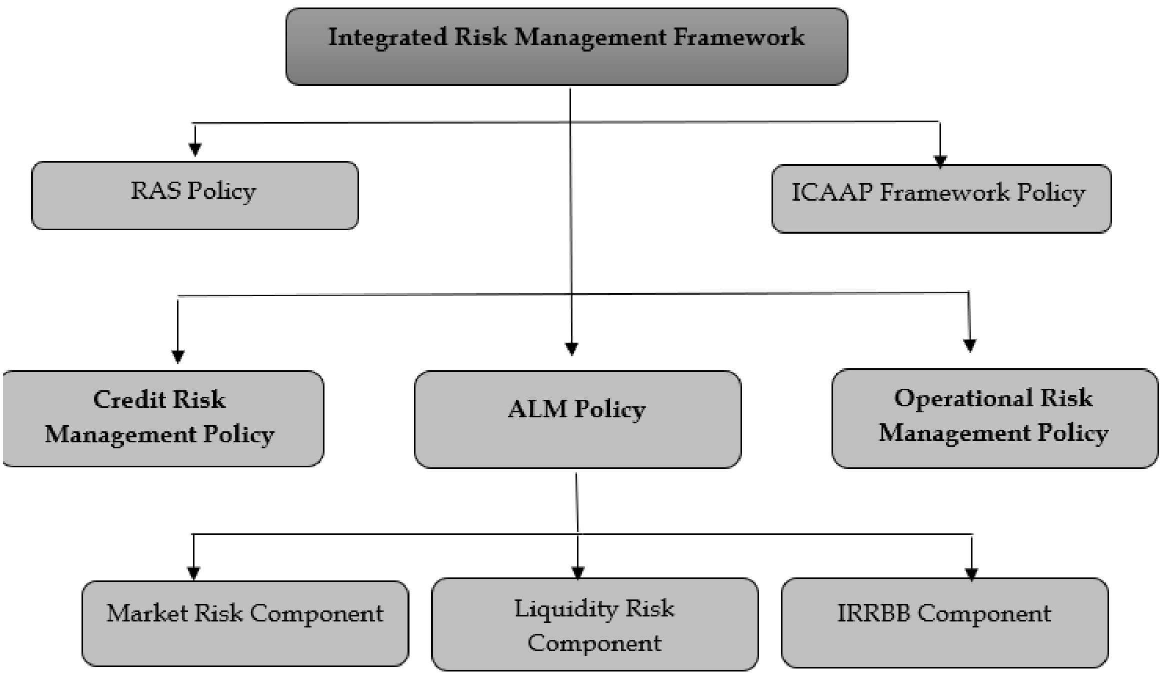

Figure 6 - Risk Management Framework Documentation Hierarchy

off-balance sheet risk.

8.1.4. All Risk Polices have to be reviewed by the EIRMC, vetted by BIRMC and approved by the Board. In the case of IRRBB, Liquidity and Market Risk, as well as the RAS and ICAAP Polices specific review and vetting by ALCO would also be required.

8.2 Risk Policies Content Guidelines

All risk specific policies shall follow a standard structure as follows:

8.2.1 Definitions and Background

- This section shall define in detail the risks covered, including specific forms a risk may take, and explain the general context of the Policy in relation to other components of the RMF.

8.2.2 Governance

- Diagram of the all units/functions involved in the management of that specific risk, including reporting lines.
- Describe for each stakeholder specific role in a detailed and granular manner. For the Committees the Policy shall refer to specific ToRs/Charters which should form specific documents or appendices to that policy.
- Specifically define the role of the RMD in detail, particularly when interactions with other divisions, departments or units are required. In the case of credit risk, The Policy shall be very specific with regards to its role in the credit cycle.

8.2.3 RAS and Risk Limits

- Restate the relevant RAS components and the affiliated threshold levels. The documentation of risk specific RAS elements shall be consistent with the RAS Policy.
- Define risk specific limits aligned with the RAS indicators. These are 'level 2' limits defined in subordination to the RAS limits and thresholds. These limits have to include as a minimum regulatory limits and potentially other/internal limits.
- The following limits indicative coverage standards shall apply (by risk type)

Type of Risk	Guidelines
Credit Risk (incl. Credit Concentration)	The following limits shall apply indicatively for credit risk part of Credit Risk Policy (i) Single obligor (including group of connected obligors) limit (ii) Product concentration limits (iii) Related party lending (including indirect exposure) (vi) Regional concentration limits (v) Industry segment concentration limits (vi) Collateral concentration limits (vii) Maximum PaR30 ratio limits (per portfolio or product by true and collection aging criteria) (viii) Maximum PaR90 ratio limits (per portfolio or product by true and collection aging criteria) (ix) Maximum default rate limits (per portfolio or product) (x) Minimum collateral coverage ratios (averages per relevant portfolio)
Market Risk	The following limits shall apply indicatively for market risk (i) Stop loss limits (ii) Trading Position limits as a % age of capital (iii) VaR limits as a % age to capital (total portfolio and by type of risk) (iv) FX Open position limits (v) Instrument specific limits (if relevant)

Liquidity Risk	The following limits shall apply indicatively for liquidity risk part of Liquidity Risk Policy (i) Liquid assets ratios (ii) Liquidity coverage ratios (internal and regulatory) (iii) Net Stable Funding Ratio (internal and regulatory) (iv) Loan to Deposits limits (v) Deposit concentration limits (vi) Minimum survival horizon
IRRBB	The following limits shall apply indicatively for IRRBB (i) Max EVE / NII impact as a % age of equity

Operational Risk	The following limits shall apply indicatively for OR (i) Number of high-risk areas identified through the periodic risk /control assessments (ii) Number and amount of Op. Risk incidents by business line or functional area (iii) Specific KRI thresholds
ESG Risk	The following limits shall apply indicatively for ESG risks: (i) Portfolio exposure limits on high-risk industries (eg: mining; chemical manufacturing, etc) (ii) Thresholds on exposure to high-risk clients/projects in terms of environmental and social risks. (iii) Growth rate targets and case load targets in relation to Social Performance Management.

8.2.4 Risk Identification, Assessment and Measurement

The following Policy documentation standards apply by risk type:

8.2.4.1 Credit Risk

The Policy shall detail credit risk identification and measurement for:

a) Pre-sanctioning review and underwriting

1. Review of product programs, credit manuals and lending procedures by assessing controls along the Company, underwriting and disbursement stages. The process description should be consistent with the process described in the Credit Policy.
2. Pre-approval Individual transactions appraisal /underwriting, by reiterating in brief the main
stages of the lending process (from Company to customer) alongside the role of Risk Management in reviewing specific transactions. The process description should be consistent with the process described in the Credit Policy.

b) Portfolio credit risk measures such as KRIs and broader risk metrics required for credit risk reporting (default rate analysis, recovery rates, migration rates etc.), by portfolio or products (Term loans, Housing loans, Gold loans, Leasing).

c) Credit models development, maintenance, testing and usage standards, including scoring and rating models, by portfolio or products (Term loans, Housing loans, Gold loans, Leasing). The Policy should detail model risk management elements such as minimum quality standards, approval and maintenance.

d) Provisioning standards and shall cover as a minimum
- Methodology based on CBSL and SLRFS process and rules as well as internal rules
- Units /functions responsible for calculation and review
- Role of Risk Management in provisioning calculation and review

d) Capital calculation methodologies shall be detailed in terms of Consolidated Basal Methodology Risk Weighted (CBM RW) methodologies or any other internal capital calculation methodologies, if the case.

f) The Policy shall also document **stress testing methodologies** and scenarios in accordance with the principles set out under the section Stress Testing section of this RM Framework.

8.2.4.2 Liquidity Risk

The methodology for identification and measurement of liquidity risk shall be detailed as follows:

a) Overview of the methodological approach (static vs. dynamic analysis, baseline vs. 'stressed' cash flows)
b) Methodological approach, including cash flow allocations, for static liquidity mismatch analysis
c) Methodological approach, including cash flow allocations, for dynamic liquidity mismatch analysis
d) (factoring in future business on both sides of the balance sheet, as budgeted).
e) Definition for all the liquidity risk ratios used for internal/external reporting, ICAAP etc. (e.g. liquid asset ratios)
f) Scenario analysis and stress testing (development of meaningful scenarios creating a liquidity shortfall such as cancellation of financing lines, unexpected increase in operating expenses, increase in borrowing costs, increased delinquencies etc.). Specific scenarios and factors to be discussed and agreed with the clients.
g) Cash management (this is of particular concern for MFIs having to optimize the cash allocations between branches in order to mitigate operational risks and in the same time provide sufficient liquidity for day-to-day management of the lending activities)

8.2.4.3 Interest Rate Risk in Banking Boob (IRRBB) Risk

The methodology for identification and measurement of IRRBB risk shall be detailed as follows

a) Overview of the methodological approach (repricing assumptions, behavioral elements, classification of all relevant rate sensitive assets and liabilities)

b) Definition of the IR movement scenarios (type of scenario, calibration methodology, current scenario definition)

c) Definition for all risk measures (Net Interest Income (NII) and Economic Value of Equity (EVE)) used for internal /external reporting, ICAAP etc.

8.2.4.4 Market Risk

The methodology for identification and measurement of IRRBB risk shall be detailed as follows:

a) Exposure definition (e.g. net open position)
b) Scenario analysis for FX and Investment risk
c) VaR methodologies, assumptions and statistical standards (confidence levels, holding period etc.)
d) Stress testing scenarios definition, as well as subsequent calibration methodology
e) Other risk measures used in market risk measurement (open position, exposure values etc)

8.2.4.5 Operational Risk

The OR measurement and identification methodologies shall be documented along the following standards:

a) RCSA process, stakeholders, templates and methodologies
b) Loss data collection standards (i.e. reporting items), responsibilities, processing and reporting
c) KRI definition, monitoring and reporting requirements

8.2.4.6 Environmental and Social Governance Risk (ESGR)

The ESG measurement and identification methodologies shall be documented along the following standards:

a) Integrated Sustainability Policy Framework and documentation relating to management systems (eg: Environmental and Social Risk Management System (ESMS) Policy and Procedure Manual)

b) Based on Sri Lanka LCBFs' Association's Sustainable LCBFing Initiative implementation guide standards including the relevant KPIs.

8.2.5. Reporting Requirements Documentation of the following reporting details per risk type

B. Type of reporting and content

C. Main responsible unit to produce the report

D. Frequency of report generation
E. Audience

8.2.6. Policy maintenance provisions
F. Responsibilities (i.e. Policy owner and co-owners)
G. Frequency of review

Appendix 1

Specific Risk Management Responsibilities by Key Stakeholder

STAKEHOLDER	RESPONSIBILITY
BOARD OF DIRECTORS	i. Approve the Risk Management Framework (RMF) including Risk Governance, Risk Management Policies, including Risk Limits, key processes such as ICAAP, risk reporting structure and contents, stress testing rules and processes ii. Set out the Company's business and risk /capital strategy once a year and oversee implementation of business and financial targets (see detailed responsibilities part of ICAAP process) iii. Establish appropriate Risk Governance and organization structure in line with the Risk Governance Principles set out herein, which is suitable for effective risk management iv. Establish a risk management culture, and support the Risk Management function and relevant committees instill the right level of awareness across the entire Company on the importance of the risk management function. v. Ensure that all material risks are covered by the Company's RMF and the methodologies for identification, measurement, mitigation and reporting are adequate. vi. Ensure that all relevant regulations are complied with and support to develop beyond minimum standards towards regional best practices vii. Ensure that the Company's Risk Management Framework is subjected to effective independent review by internal audit viii. Approve CRO and monitor CROs and IRMD performance through BIRMC
INTEGARTED RISK MANAGEMENT (BOARD LEVEL)	i. Annually review and recommend for Board's approval revisions to the Risk Management Framework and policies to improve effectiveness of risk management. More specifically the review shall cover the RAS, risk methodologies, including ICAAP process, risk limits, appropriateness of risk reporting

	etc. ii. Review risk profile at least quarterly through ongoing risk reports including also Stress Testing results iii. Review of risk management performance, including CRO effectiveness and follow up of remedial actions iv. Permanently communicate with EIRMC on RMF implementation / compliance issues, risk profile monitoring, raise risk related issues and follow up on remedial action. v. Review compliance of the LCBF with respect to RMF provisions
BOARD AUDIT COMMITTEE	i. Approving Audit manual for internal audit with regards to risk management ii. Reviewing and approving the audit scope and frequency for risk management audits iii. Review audit reports pertaining to risk management and ensure senior management is taking corrective actions in a timely manner to address control or process weaknesses iv. Review risk governance against principles and standards established by the BoD v. Assess performance of BIRMC in performing its oversight role with regards to risk management
ALCO	i. Monitor and discuss the status and results of implemented asset / liability management strategies and tactics. ii. Review the impact of major funding shifts and changes in overall investment and lending strategies. iii. Review Assts Liability Mgt., Liquidity, and Market risk profile monthly iv. Discuss and report on the impact of major funding shifts and changes in overall investment and lending strategies v. Review the current and prospective capital levels to determine sufficiency in relation to; expected growth, interest rate risk, price risk, and asset mix / quality vi. Ensuring a prudent liquidity, interest rate, foreign currency risk management (ALM risks). vii. Receive and review reports pertaining to ALM risks. viii. Cooperate with BIRMC in reviewing the internal ALM risk

	policies such as, interest rate risk, liquidity risk, exchange rate risk management and monitoring compliance with relevant limits ix. Reviewing the budget and business plan of the LCBF in terms of liquidity and capital needs implications. Review annually the funding and the capital plan accompanying the budget and / or the business plan. xi. Balance Sheet and Financial Performance optimization Directing and monitoring balance sheet composition (structure of the BS) and key KPIs: ROE, ROA, Cost of funds, CAR, etc xii. Product Pricing and FTP, including methodology and revision of actual FTP rates xiii. Business Planning and ICAAP a. Review budgets and projected business growth b. Assess current and prospective capital levels and capital adequacy c. Devise capital management and capital planning strategies as part of ICAAP xiv. Assess impact of macro environment on the performance of the Company and impact on its assets / liability portfolios and implement necessary tactical or strategic change xv. Approval of new products with reference to the ALM Policy and ALM risks xvi. Risk Monitoring and Management with regards to ALM risks by reviewing exposure levels against limits, reviewing stress testing results, analyzing relevant reports sent by RMD and Treasury etc.
EXECUTIVE RISK MANAGEMENT COMMITTEE	i. Monitors implementation of processes and methodologies pertaining to risk management, as described by the RMF ii. Ensures compliance with all relevant risk regulations and internal policies iii. Provides advice and feedback on recommendations formulated by Risk Management for the Board and / or BIRMC's approval. iv. Reviews the risk profile of the Company at least monthly across all risk major categories v. Provides coordination among the executive team for RMF

	implementation, corrective actions, strengthening internal controls and implementation of Companywide risk management projects such as Basel 2. vi. Reviews the risk profile of the Company at least monthly across all risk categories as follows vii. Review reports prepared by the Credit Risk on portfolio quality, including, reports on NPL ratios, collateralization, provisioning coverage, concentrations along geographical and industry segments, creditworthiness of borrower through size and leverage analysis, vintage analysis for retail portfolios viii. Review reports prepared by for ALM risks, including liquidity, interest rate and market risk ix. Review operational risk reports and recommendations formulated by the Operational Risk department including a summary of the RCSA results and follow up action, material operational risk incidents, summary of KRIs. x. Reports on other relevant risks xi. Provides coordination among the executive team for corrective actions proposed by Risk Management including, without limitation, strengthening internal controls, hedging, amendments to lending policies or LCBF wide risk management projects. xii. Monitors implementation of processes and methodologies pertaining to risk management initiatives xiii. Ensures compliance with all relevant risk regulations and internal policies xiv. Follows up on recommendations formulated by BRC regarding risk management issues and remedial actions. xv. Suggest Credit Policy amendments when and if necessary xvi. Ensure loans originated by the LCBF within its authority are within the approved lending rules, including Credit Policies.

CREDIT COMMITTEES	i. Approve specific transaction within its approval authority ii. Suggest Credit Policy amendments to Credit Dept. iii. Ensure loans originated by the LCBF are within the approved lending rules, including Credit Policies and Credit Risk Management policies. iv. Monitor credit quality of lending portfolio, including delinquency status, remedial action for non-performing Policy in line with the risk strategy in relation to credit/lending activities. v. Ensure compliance with LCBF's Laws and Regulations, Statutory requirements and internal limits/ controls for prudent management of the lending activities vi. Review the credit/lending portfolio periodically in particular the credit portfolio composition, concentration and diversification
RISK MANAGEMENT DIVISION (RMD)	The roles and responsibilities of the RMD are laid out on two levels: i) 'core' roles and responsibilities valid across various risk categories and ii) risk specific roles and responsibilities (to be detailed in risk specific policies) 'Core' roles and responsibilities of the RMD are: i. Identify, measure, monitor, control and report on all material risk exposures as defined in the RMF. ii. Develop risk policies, procedure manuals, models and methodologies for measuring all material risk, including stress testing scenarios and methodologies iii. Development adequate data and systems to support all required risk analytics iv. Monitor on a constant basis adherence to various limit structures and risk thresholds, compliance with the Risk Appetite Statement and report to the EIRMC and BIRMC. v. Conduct risk review on new products regarding their operational and financial implications for the LCBF and alignment to risk management framework vi. Assist the Board and the BIRMC in instilling an appropriate risk culture throughout the LCBF. vii. Assess risk and ALM implications on any business plan or budget to ensure sustainable balance sheet growth viii. Provides interpretation and implementation of risk-related regulations and leading practices, and disseminates to business units ix. Regularly (at least monthly) report to the BIRMC and the EIRMC the risk profile of the LCBF, the compliance with various

	limits/RAS, as well as strategic initiatives taken by the RMD. x. Run stress testing across all material risks, communicate results and suggest mitigation action through the regular reporting to EIRMC and BIRMC
INTEGRATED RISK MANAGEMENT (IRM)	i. Review of all risk related policies before approval to check compliance with the principles set out in eth IRMF ii. Perform comprehensive risk assessment beyond those managed by specific RM Units. iii. Assist the CRO to annually propose the Risk Appetite Statement to be approved by the Board. iv. Cooperate with Finance in developing the annual ICAAP as the RMD representative in the process. v. Ensure reporting covers all material risks to allow BIRMC, EIRMC, the CRO and any other relevant stakeholder to monitor the risk profile of the LCBF against RAS and other limits. vi. IRM will be to consolidate all risk specific reports and present the entire reporting package to the recipient on behalf of the CRO.
CRO	i. Coordinate all activities of the RMD ii. Liaise with BIRMC and take part in ALCO, EIRMC and Credit Committees representing risk management iii. Prepare quarterly Board, and monthly senior management updates on risk management matters (i.e. risk reporting) iv. Review new products, business strategies and budgets from a risk management perspective v. Coordinate with CFO in preparing the business projections in conjunction with the RAS exercise vi. Prepare the RAS and submit for approval vii. Work with the Head of Credit Risk Management in proposing amendments to Credit Manual, Polices, Procedures and Products to relevant approval authorities (Credit Committees, BoD) viii. Daily review NPLs by segment and branch and distribute workload across recovery officers

CREDIT RISK MANAGEMENT	i. Vets any propositions or updates of lending policies & products and related circulars or procedures before they are submitted for Board approval. Formulates recommendations in case lending policies & products are considered inappropriate ii. Ensures strict adherence to lending policies through sample reviews of retail and micro portfolios and all large transactions above a certain threshold. iii. Ensures that credit governance structure is sound with particular emphasis on: a. Credit approval authority, composition, independence and seniority are commensurate to the underlying credit risk of transactions b. Segregation of duties between loan origination vs. risk underwriting and approval, as well as segregation between loan origination vs. workout and recovery c. Credit Approval function has the right resources and authority to provide pertinent credit review and a strong voice in the approval process iv. Prepare periodic reports on portfolio quality, including without limitation reports on NPL ratios, collateralization, provisioning coverage, concentrations along geographical and industry segments, creditworthiness of borrower through size and leverage analysis etc. v. Review all systems providing support for the lending process (core systems, LOS systems, collection system) to ensure integrity of the internal controls for credit risk vi. Develop robust and risk sensitive credit risk analytics such as scoring and rating systems including out of sample and out of time back testing of the statistical estimates vii. Run training programs for business users from Corporate & Cooperatives, SME and Retail LCBF's on the developed tools and methodologies
CREDIT RISK MANAGEMENT / CENTRAL CREDIT DEPT	i. Review individual transactions (underwriting) and products before approval as per the delegation of approval authority ii. Draft credit review notes and submit to the relevant approving authority iii. Create and maintain credit analysis templets, tools and models, including corporate / SME rating tools iv. Review accuracy of financial information, liaise with relationship managers on any unclear or incomplete client information v. Interrogate credit bureaus, public collateral registries, land registries any other source of public information relevant to the credit quality of the borrower (when applicable) vi. Prepare activity reports on number of accounts received,

	reviewed, approved and rejected vii. Formulates observations regarding general lending practices in the LCBF including Credit or Product Policy Amendments, Procedures, Lending Standards etc.
CREDIT RISK MANAGEMENT / PORTFOLIO REVIEW AND REPORTING	i. Design and regularly prepare portfolio reports including portfolio composition reports (by segment, product, geography etc.), portfolio quality reports, default analysis, vintage and flow rate analysis, credit performance analysis etc. ii. Compile credit risk section for senior management and risk committee reporting iii. Prepare compliance and regulatory credit reporting iv. Develop, validate and maintain credit risk tools and models (e.g. scorecards) v. Perform random checks
CREDIT RISK MANAGEMENT / LOAN ADMIN & CREDIT CONTROL	i. Reviewing disbursement conditions for each loan facility (lending agreement, collateral agreement, registration of collateral, other loan granting conditions stipulated in the Credit Policy and Product Programs) ii. Book specific loans in the core system post-approval iii. Safe-keep and archive lending files including legal documentation
CREDIT RISK MANAGEMENT / RECOVERY AND COLLECTION	i. Daily review of workout and recovery work plan ii. Run recovery and collection procedures (calls, letters, emails) as defined in dedicated manuals iii. Document recovery and collection efforts in a dedicated client file iv. Restructure non-performing facilities, negotiate with clients restructuring terms, liaise with legal counsels in drafting legal agreements v. Liaise with approved valuation agents on collateral value estimations

ALM RISK MANAGEMENT	i. Propose all methodologies, assumptions, policies with regards to ALM & Market risks, developed in consultation with the Treasury and Finance. ii. Independently review exposures and ensure that the risk exposure indicators are within the approved limits set by the Board iii. Generate market and ALM risk reports to be submitted to the EIRMC at least monthly, and to the BIRMC at least quarterly to allow accurate and timely review of risks. iv. Coordinate with IRMD on ICAAP implementation v. Review and propose (before the final Board approval) all methodologies, assumptions, policies with regards to ALM & Market risks. More specifically, relevant risk policy elements are a) Liquidity risk measures, cash flow forecasting and estimating net funding requirements including stress testing techniques b) Interest rate risk in the LCBF related risk measures, interest rate scenarios, stress testing assumptions c) Market risk measures, pertaining to trading book positions, and trading book definitions, including without limitation VaR models, stop loss limits, trading book investment criteria, scenario analysis and stress testing (if and when applicable) vi. Review and comment on risk aspects part of Annual Budgets, Business Plans and brief CRO on ALM implications of annual budgets and business plans vii. Draft funding and capital plans as part of Annual Budgets and Business Plans viii. Independently review ALM risk exposures and ensure that exposures stay within the approved limits and liabilities ix. Develop and maintain an FTP model x. Calculate reference/target pricing levels v xi. Prepare ALM reports with regards to ALM risks, capital, funding and interest rate pricing considerations
OPERATIONAL RISK	i i ii. Establish Operational Risk policy and any supporting policies and procedures. iii. Establish the methodology to conduct RCSA and prepare all necessary templates, scoring sheets, questionnaires and accessories for the same iv. Collect and maintain an operational loss events database ensuring timely, comprehensive and accurate capturing of Op. Loss Incidents.

	v. Assist branches and departments run the RCSA exercise and identify the top risk events. Ensure that all RCSAs are completed and updated at least annually. vi. Determine the framework for KRIs along with corresponding tolerance thresholds and set up the KRI monitoring system throughout, monitor the adherence to KRI thresholds and undertake / coordinate consequent action vii. Prepare reports on operational risk analysis, including without limitation: loss events reporting, RCSA results and agreed corrective action and progress reports, KRI monitoring reports, to CRO, EIRMC and BIRMC viii. Review new processes and products for embedded operation risks and provide recommendations to the BIRMC before approval. x. Coordinate with IRMD on ICAAP related operational risk measures to be used in RAS, ICAAP and by Finance for capital and liquidity projections.
ESG RISKS	i. Formulate and coordinate the implementation of Integrated Sustainability Policy Framework that includes Environmental and Social Risk Management System (ESMS), Social Performance Management (SPM), Sustainable and Inclusive Finance (SIF), Operational Footprint management, Operational Excellence and Resilience, Sustainability Culture and Brand and Integrated Strategy and Reporting.
INTERNAL AUDIT	i. Assess, through Audit reviews, that the RMF Policies and guidelines are complied with by all stakeholders involved ii. Provide audit reports to the BAC and management of any material compliance breaches in the risk management related processes iii. Communicate with RMD in relation to vulnerable process areas as indicated during the audit process, particularly with regards to Operational Risk. Indicate recurring operational loss events and weak control areas. iv. Review RCSA results periodically, cross-check findings with Internal Audit results and send feedback to Operational Risk Management. v. Identify potential threats from fraud risks, review anti-fraud guidelines and review all processes, policies and methodologies with respect to fraud vulnerability. vi. Provide inputs to the Loss Event Database once an incident is

	uncovered. vii. Perform from time-to-time checks on the quality of risk reporting in terms of completeness, accuracy and timeliness. viii. Maintain IA staff knowledgeable and updated with the latest prudential regulation, risk management methodologies and guidelines

Appendix 2: KRI Matrix

The materiality thresholds defined below are for illustrative purposes. During the annual budgeting process, the specific thresholds would be defined for that particular year.

(Following, Format will be used after the Board Approval)

Risk Type	**Risk Sub Type**	**Metric**	**Definition**	**Assessment Dimension**	**31.03.2024**	**Materiality Thresholds / Management Action - Trigger**			**RAS Indicator**
						High Risk	**Medium Risk**	**Low Risk**	
Credit Risk	Exposure Risk	Portfolio Growth	Annual increase rate	Overall Portfolio					RAS
	Default Risk	Stages wise portfolio	% of Portfolio (Gross) by branch, by geography by product, business line	Overall Portfolio					
	Default Risk	PaR90 ratio (NPA Ratio)	% of Portfolio (Gross) by branch, by geography by product, business line	Overall Portfolio					RAS
	Default Risk	PaR90 ratio (NPA Ratio)	% of Portfolio (Net) by branch, by geography by product, business line	Overall Portfolio					RAS

	Cost of Risk	Provisioning charge	annual figure as a% of operating profit	Product / Sector					
	Cost of Risk	Collateral coverage ratio	Forced Sale Value as a % of portfolio	Product / Sector					
	Cost of Risk	Provisioning coverage rate	Specific + General provision % in to total NPAs (90+)	Product / Sector					RAS
Credit Concentration Risk	Single Obligor Concentration on	Single obligor maximum exposure	% of total capital	Overall Portfolio					
	Related party lending (Direct exposure)	Total related party exposure (direct)	% of total capital	Overall Portfolio					RAS
	Related party lending (direct and indirect exposure	Total related party exposure (direct and indirect)	% of total capital	Overall Portfolio					
	Single Obligor Concentration	Top 25 largest accounts	% of total portfolio using	Overall Portfolio					RAS
	Product Concentration	Top product exposure	% of total portfolio	Overall Portfolio					
	Geographic Concentration	Top regional exposure	% of total portfolio	Overall Portfolio					
	Geographic Concentration	Township exposure	% of total portfolio	Overall Portfolio					RAS

	Industry concentration	Top industry / segment exposure	% of total portfolio	Overall Portfolio					
	Collateral Type Concentration	Top collateral type exposure	% in total collateral value (FSV)	Overall Portfolio					
	Price Sensitivity	Collateral value decrease	% decrease in collateral value (Stress Scenario	Overall Portfolio					
Liquidity Risk	Liquidity Risk	Liquid Asset Ratio	% of total liabilities	Entire Company					RAS
	Liquidity Risk	Liquidity Coverage Ratio	1-year cumulative CF gap as a % total liabilities	Entire Company					
	Liquidity Risk	Net Stable Funding Ratio		Entire Company					RAS
	Liquidity Risk	Loan to Deposit	Total loan portfolio as a % of deposit	Entire Company					RAS
	Liquidity Risk	Savings Account funding ratio	% of savings accounts to total deposit	Entire Company					RAS
IRRBB	IRRBB	Net Interest income sensitivity	% Drop of Net Interest in stress scenario	Entire Company					
Operational Risk	Fraud Risk	Fraud incidence	# of fraud cases in a quarter	Entire Company					RAS
	Fraud Risk	Fraud Severity	% of total fraud losses as a % of net profitability (quarterly)	Entire Company					

	HR Risk	Vacant positions	# of vacant position level (not filled or more than 03 months)	Entire Company					
	HR Risk	Staff Turnover Rates	% of resignation s over total staff (by branch and dept.)	Entire Company					
	HR Risk	Health and safety System	# of incidents per quarter	Entire Company					
	IT Risk	System disruption	# of incidents in critical system (more than 01 hr.) in a quarter	Entire Company					
	IT Risk	IT Security Breaches	# of incidents per quarter	Entire Company					RAS
	IT Risk	System Errors	# of incidents in critical systems in a quarter	Entire Company					
	Process and Product Risk	Breaches of process control	# of incidents per quarter	Entire Company					
	Process and Product Risk	Control design flows	# of design flows detected per year	Entire Company					
	Complian ce risk	Internal Policy Complian ce	# of material non compliance per quarter	Entire Company					
	Complian ce risk	Regulator y Complian ce	# of material regulatory compliance	Entire Company					

			cases per year						
	Compliance risk	SAR reports incidents	# of SAR reports from key correspondents per year	Entire Company					
	Business Continuity Risk	BCP Plan Flaws	# Material weaknesses identified during BCP testing	Entire Company					
	Business Continuity Risk	Disaster Recovery Flaws	# of system outages more than 01 day long	Entire Company					
Market and Investment Risk	FX Risk	FX NOP	FX Net Open position as a % of capital	Entire Company					RAS
	Trading book risk	Trading exposure	% of trading operations part of total assets	Entire Company					
Business and Strategic Risk	New Product Risk	Implementation on success rate	% Rate of new product profitable after 01 year	Entire Company					
	Income Variability	Operating Income Volatility	% of operating income drop (against trend)	Entire Company					
ESG Risk	Exposure Value	Total Balance	% of total portfolio in high, medium and low risk categories	Industry / Client / Project level					

	Exclusion Screening	Coverage	No of credit facility screened for exclusion activities expressed also as % of total advance	Overall portfolio					
	Environmental and Social Due Diligence (ESDD)	Coverage	No. of Advance facilities on which ESDD was conducted (including interviewing of client) expressed also as % total advance	Non Personal portfolio					
	Environmental and Social Due Diligence (ESDD)	Coverage	No. of Advance facilities for which field assessment on ESDD was conducted expressed also as % total advance	Non Personal portfolio					
	Environmental and Social Action Plans	Coverage	No. of Envier. And social action plans agreed upon with client expressed also as a % against total high	Non Personal portfolio					

			risk rated advance facilities for the year						
	Exposure to Exclude activities	Outstanding advance amount	Total value as well as % change YoY	Type of Excluded Activity/ Client/ Project Level (% of outstandig portfolio)					
	E&S Risks materialized	Incidents/ Accidents / Claims in own operation as well as that of clients	No. of Incidents and Accidents and amount in claims	Entire Company					
Reputational Risk	Social Media Risk	Negative Social Media Reviews	Social Medial Rankings (FB, Google ratings)	Entire Company					RAS
	Legal Risk	Legal Cases	# of prominent ongoing legal cases	Entire Company					
	Media Risk	Negative Press Reviews	# of negative press reviews (over 01 yr.)	Entire Company					
	Regulatory risk	Regulatory actions	Regulatory fines amounts or notice letter (over 01 yr.	Entire Company					RAS

RECOMMENDATION

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Chief Risk Officer CEO/Chief Executive Officer