MARKET RISK

Strategic Risk

LEGAL AND REGULATORY RISK

MONEY LAUNDERING/ TERRORIST FINANCING RISK

RISK MANAGEMENT

PRE-RBS MARKET ENGAGEMENT
29 MARCH 2022
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Presentation outline

SECURITIES AND EXCHANGE COMMISSION
Protecting Investors in the Capital Markets

- Introduction
- Draft Risk Management Guidelines
- Risk Management Framework
- Inherent Risks
- Q & As

Objectives of the draft Risk Management Guidelines

RMGs aim to provide the minimum standards for risk management for capital markets operators

RMGs are not an exhaustive guide to risk management and hence onus is on Senior Management and the Board to determine the most appropriate framework for management of Risk

RMGs shall apply to all Capital Markets Operators taking into their size and nature of business operations.

Principles based approach: Apply-or-explain

A principles-based approach provides CMOs with the flexibility to adopt systems and procedures that suit their individual circumstances.

CMO must provide factual explanations which must be backed by documentary evidence.

Less reliance on senior management/ Board representations as to the existence or effective operation of the CMO's Quality of Risk Management.

Risk Management Framework

INHERENT RISK
[Seven (7) Categories of inherent risk prescribed in the SEC RBS Policy]

Risk Management Function

Chief Risk Officer

Risk Management Process

Basic elements of a Risk Management System

RISK MANAGEMENT PROCESS

(4) Risk monitoring

CMOs should establish Management Information Systems (MIS) that accurately identify and measure risks at the inception of transactions and activities. Information and communication are vital for monitoring significant changes in risk profiles.

(3) Risk control

the CMO should put in place controls to manage/ mitigate key inherent risks to prevent or minimize the adverse consequences.

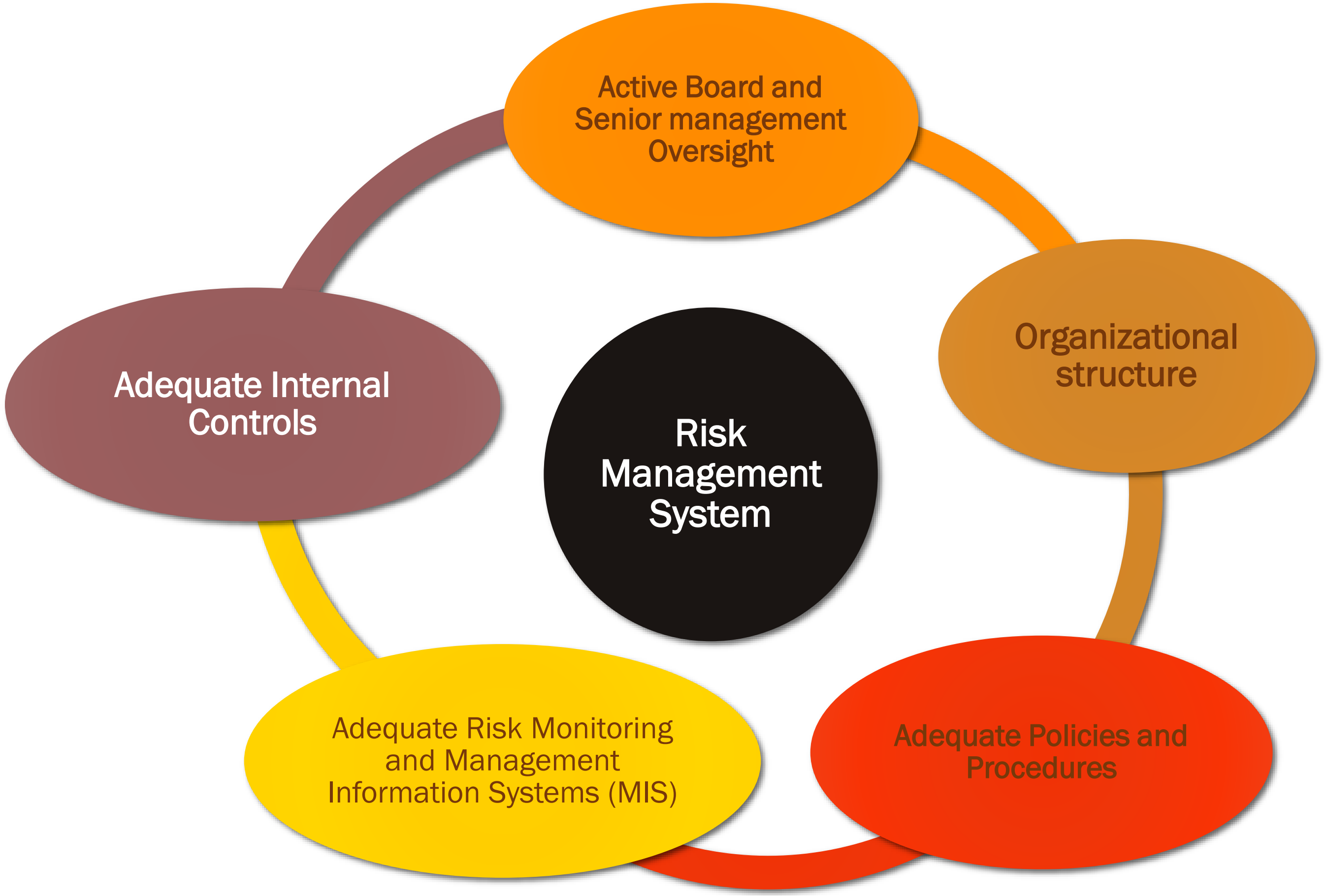
(1) Risk identfication

Risk identification should be a continuous process and risk CMOs are encouraged to identify and have a thorough understanding of their key business activities and processes and assess how these give rise to inherent risks. Risk identification should also take into account the characteristics of the CMOs product and services, delivery channels, customers, etc. CMOs are expected to focus on significant activities when undertaking risk identification exercises.

(2) Risk measurement

Once the risks associated with a particular activity have been identified, the next step is to measure the significance of each risk. Each risk should be viewed in terms of its three dimensions: size, duration and probability of adverse occurrences. Accurate and timely measurement of risk is essential to effective risk management systems. CMOs are expected to focus on key risks within the significant activities of the CMO. The CMO is also expected to monitor other risks.

Basic elements of a Risk Management system



QUESTIONS?

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SEC RISK MANAGEMENT GUIDELINES
Presentation to Capital Market Operators

INHERENT RISKS

RBS RISK MATRIX

SIGNIFICANT ACTIVITIES	MATERIALITY	INHERENT RISKS							QUALITY OF RISK MANAGEMENT						NET RISK	DIRECTION OF NET R
		Conduct	Credit	Market	Operational	Legal and regulatory	Strategic	Money Laundering/ Terrorist Financing	Operational management	Risk Management	Compliance	Internal Audit	Senior management	Board of Directors		
Activity 1																
Activity 2																
Activity 3																
Overall rating																
Overall Net Risk																

INSTITUTIONAL LEVEL SUPPORT	
Component	Rating
Earnings	
Capital	
Liquidity	

Composite Risk Rating	
Rating	
Direction	
Time frame	

- Conduct Risk
- Operational Risk
- Credit Risk
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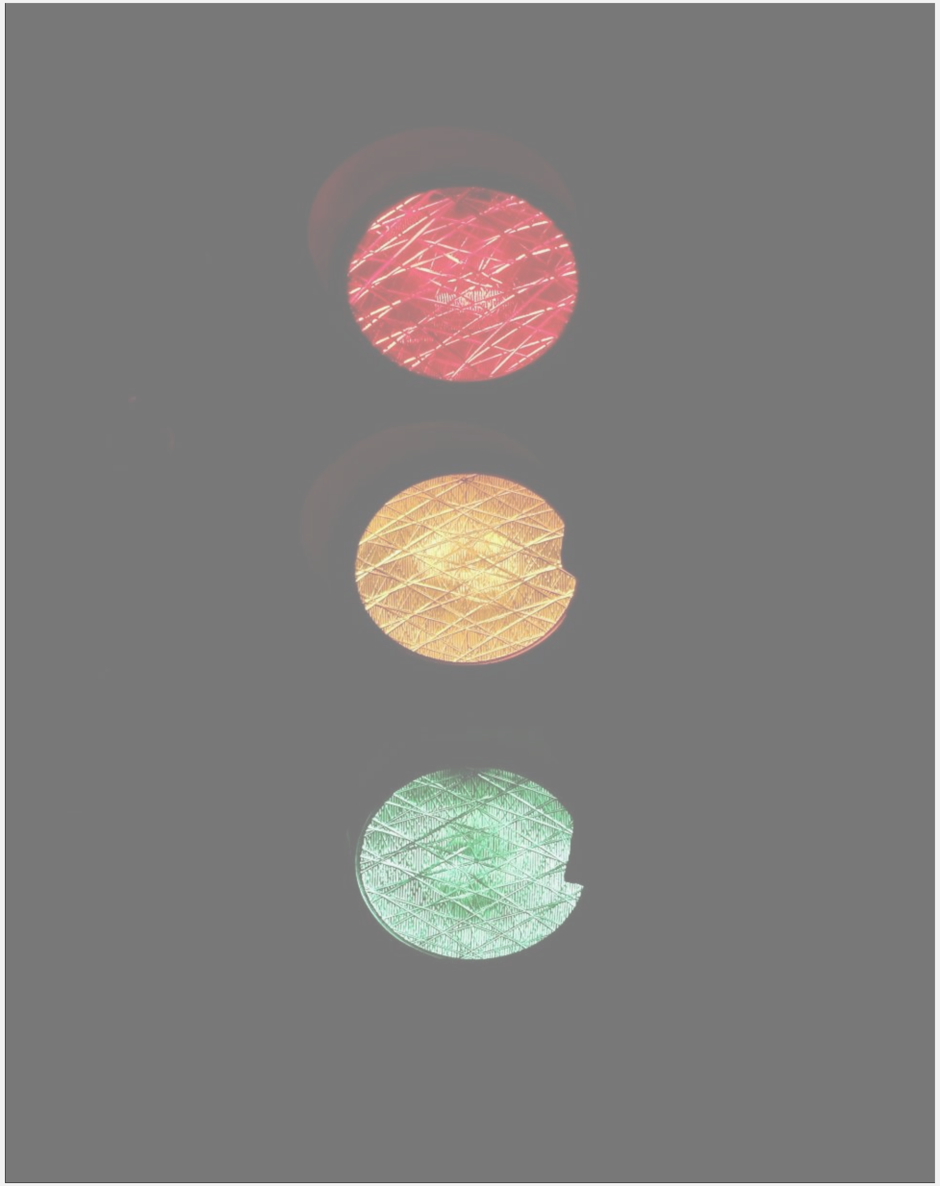


CONDUCT RISK

Conduct risk is the risk that the conduct of a CMO and/ or their employees will result in poor outcomes for investors and/or other stakeholders. Conduct risk may also arise from market abuses/malpractices in Financial Market Infrastructures e.g. Exchanges, CSDs etc.

CONDUCT RISK DRIVERS

1. **CMO's Target market:** e.g., customer mix, degree of customization of product e.g., mass market vs High Net Worth

2. **Product design:** complex products give risk to higher conduct risk as customers are less likely to appreciate the complexity of the product being offered

3. **Delivery channel:** where sales are outsourced to third parties such as agents/ distributors/ aggregators, the CMO has less supervisory control over the conduct of third parties;

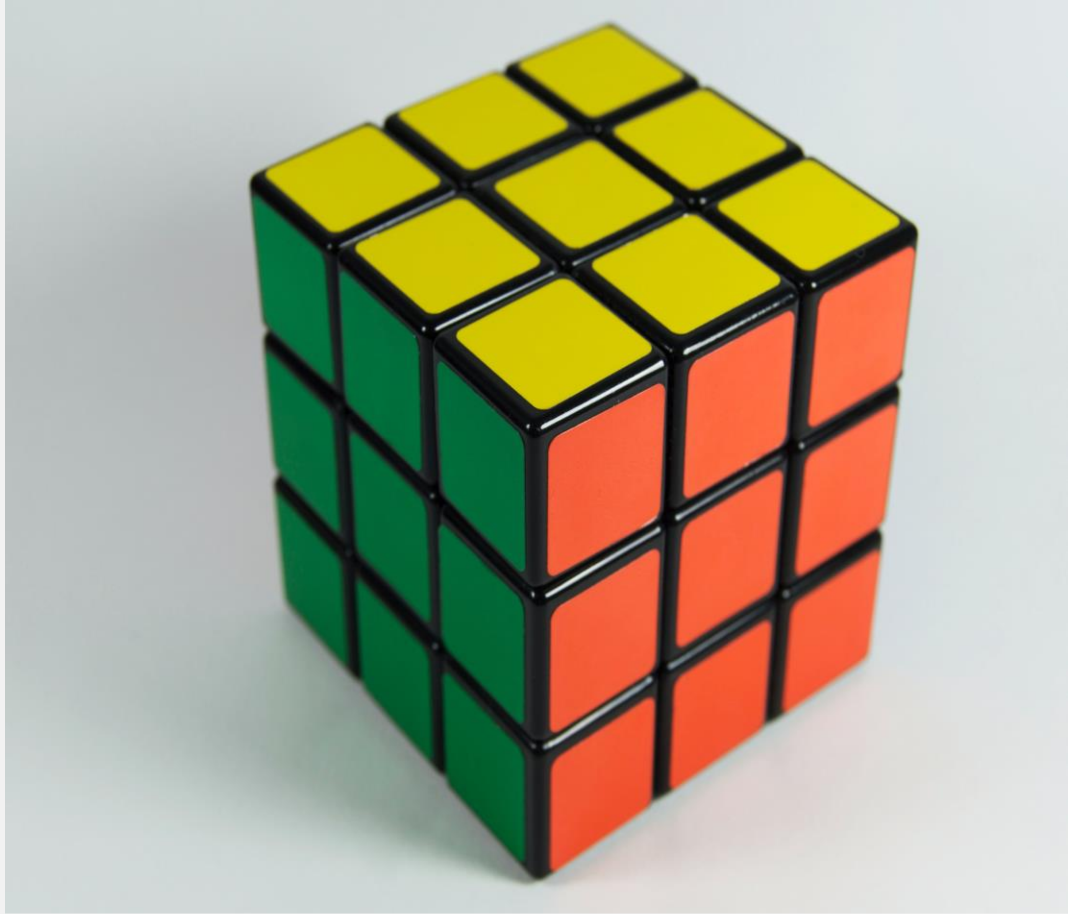
4. **Economic and Market trends:** This is a driver for all inherent risks as a downside in the economy emphasizes the risks faced by the CMO

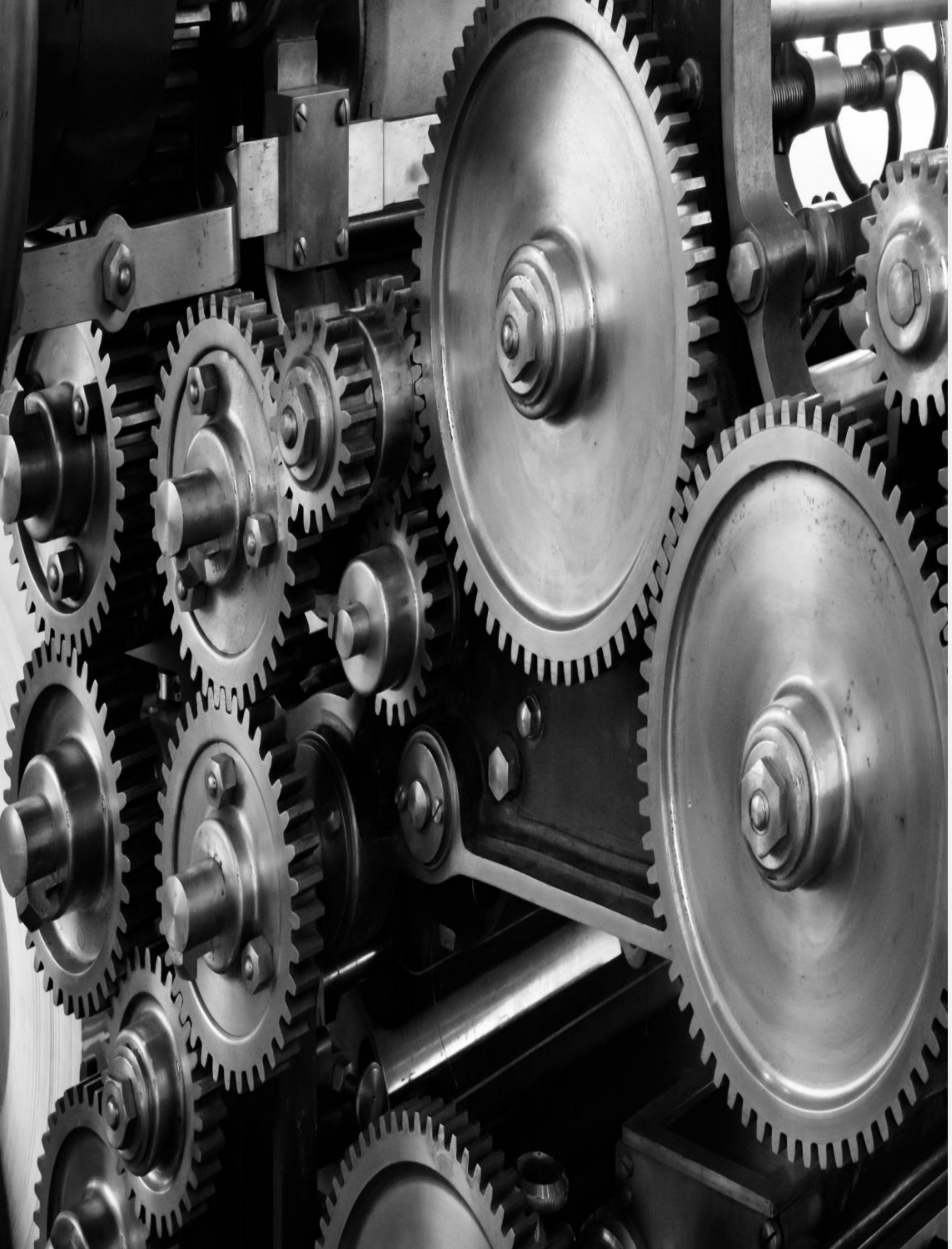
CONDUCT RISK EXAMPLES

Type of Conduct Abuse	Examples of market conduct offences
Selling	• Cold Calling and aggressive practices; • Failure to provide disclosure • Misrepresentations; misleading, incomplete information • Discounting disclosure (verbal lulling or over-riding of written or require ed verbal disclosure)
Trading	• Market manipulation; • Trading ahead; front-running a customer with a proprietary trade • Misallocation • Manipulation of prices (pump and dump schemes, spoofing and layering • Insider trading
Advising	• Conflict of interest • Mis-valuation, or different valuations for the customer and the seller • Unsuitable recommendation for financial/credit circumstances and/or financial objectives of customer
Treatment of customer assets	Mishandling (e.g., failure to segregate customer and proprietary assets) Theft

POSSIBLE MITIGANTS OF CONDUCT RISK

- Management of conflicts of interest.
- Free and fair communications to existing and potential clients.
- Disclosure of fees and charges.
- Client agreements.
- Ensuring confidentiality of customer information.
- Suitability of financial products.





OPERATIONAL RISK

Operational risk arises from potential problems and/or loss due to inadequate or failed internal processes, people and systems, or from external events (The Basel Committee on Banking Supervision).

OPERATIONAL RISK DRIVERS

1. **People:** People play a critical role in any CMO’s operations and are at the core of most of the organization’s processes.

2. **Internal Processes**: Weak, ineffective, and inefficient processes increase the likelihood of operational risk crystallizing.

3. **Systems:** In an increasingly digitized world, the significant role of systems within the operational process has never been more important.

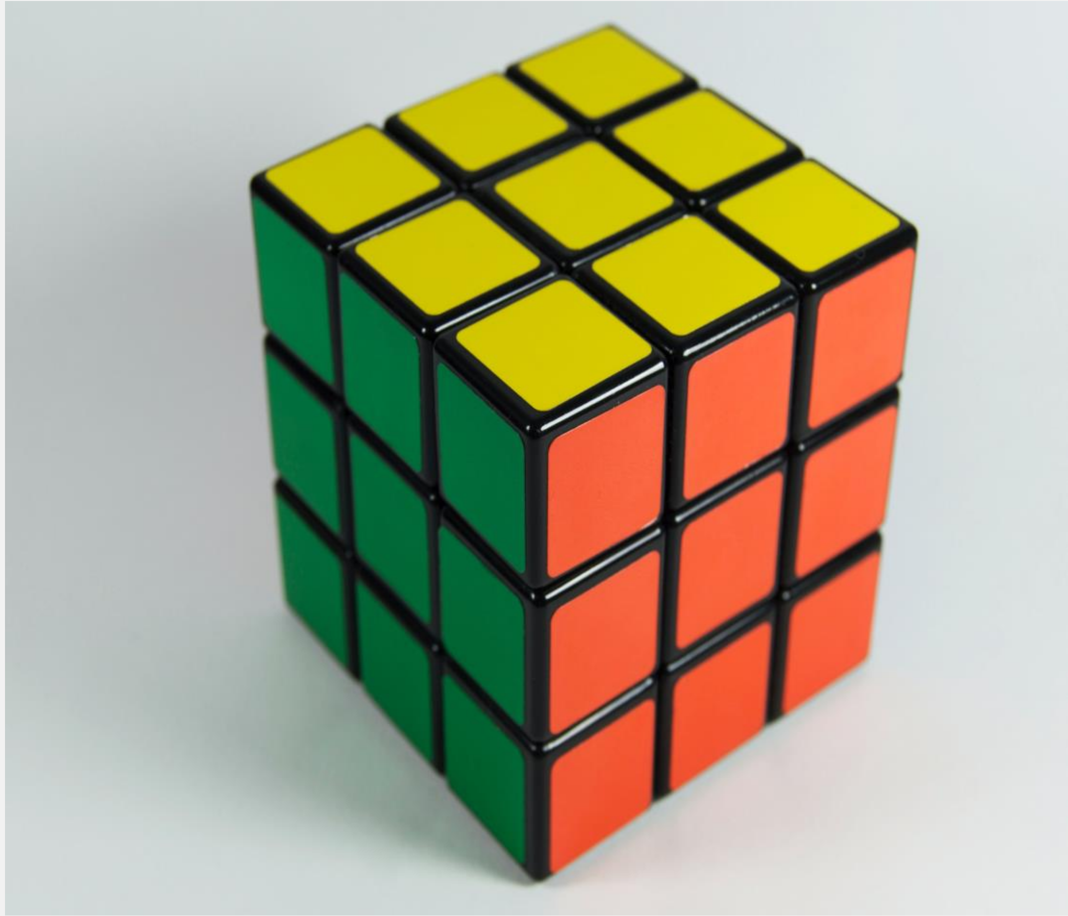
4. **External Events:** Despite these being outside the control of CMOs, their effects could still negatively impact the CMO’s operations.

OPERATIONAL RISK EXAMPLES

Sources of operational	Examples of operational risk
People	• Fraud • Loss or lack of key personnel • Unauthorized activity • Inadequate training and supervision • Inadequate staffing levels
Internal Processes	• Errors in valuation or pricing models and processes • Payment or settlement failures • Inadequate or insufficient documentation and record keeping • Internal or external reporting • Project management failures
Systems	• Failures during the development and systems implementation process • Failures of the system itself • Inadequate resources
External Events	• External crime • Outsourcing and insourcing risk • Natural and other disasters

POSSIBLE MITIGANTS OF OPERATIONAL RISK

- Existence of documented procedures and controls.
- Systems such as accounting systems, brokerage systems, asset management systems, custody systems, credit rating systems as appropriate.
- Automation of most tasks to minimize risks arising from human failure or error.
- Implementing a robust business continuity plan including a disaster recovery plan.



CREDIT RISK

Credit risk is the risk that arises from a counterparty's potential inability or unwillingness to fully meet its on and / or off-balance sheet contractual obligations.

CREDIT RISK DRIVERS

1. **Credit exposure:** Related to the amount of loss the CMO may be exposed to in the event that a counterparty or counterparties default.

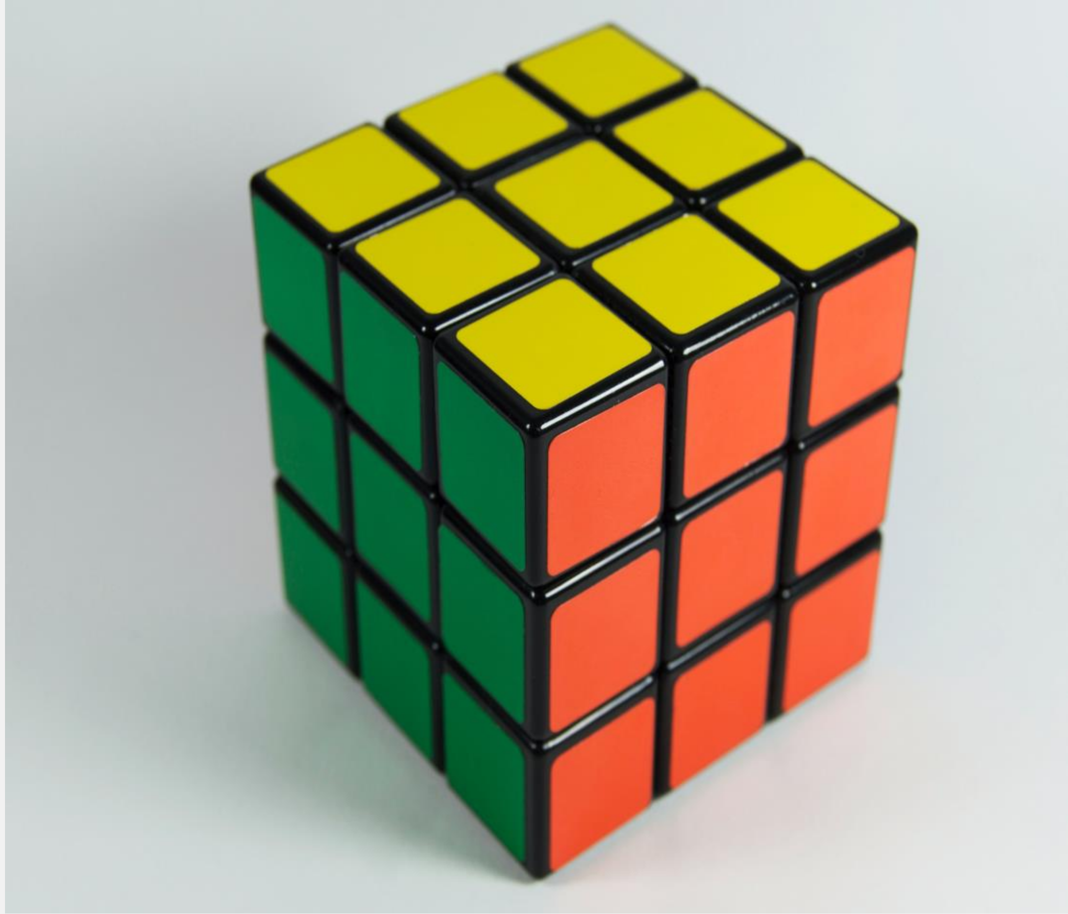
2. **Creditor Concentration**: Extent to which CMO's credit transactions are diversified i.e. concentration risk management .

3. **Internal Processes and Procedures:** Effectiveness of credit assessment/appraisals, due diligence processes etc.

4. **Economic and Market trends:** This is a driver for all inherent risks as a downside in the economy emphasizes the risks faced by the CMO

POSSIBLE MITIGANTS OF CREDIT RISK

- Sound and well-defined policies, procedures and limits are vital in the management of credit risk.
- Employing risk management safety measures for example insurance, collateral etc.
- Adherence to internal and regulatory requirements relating to investment limits.



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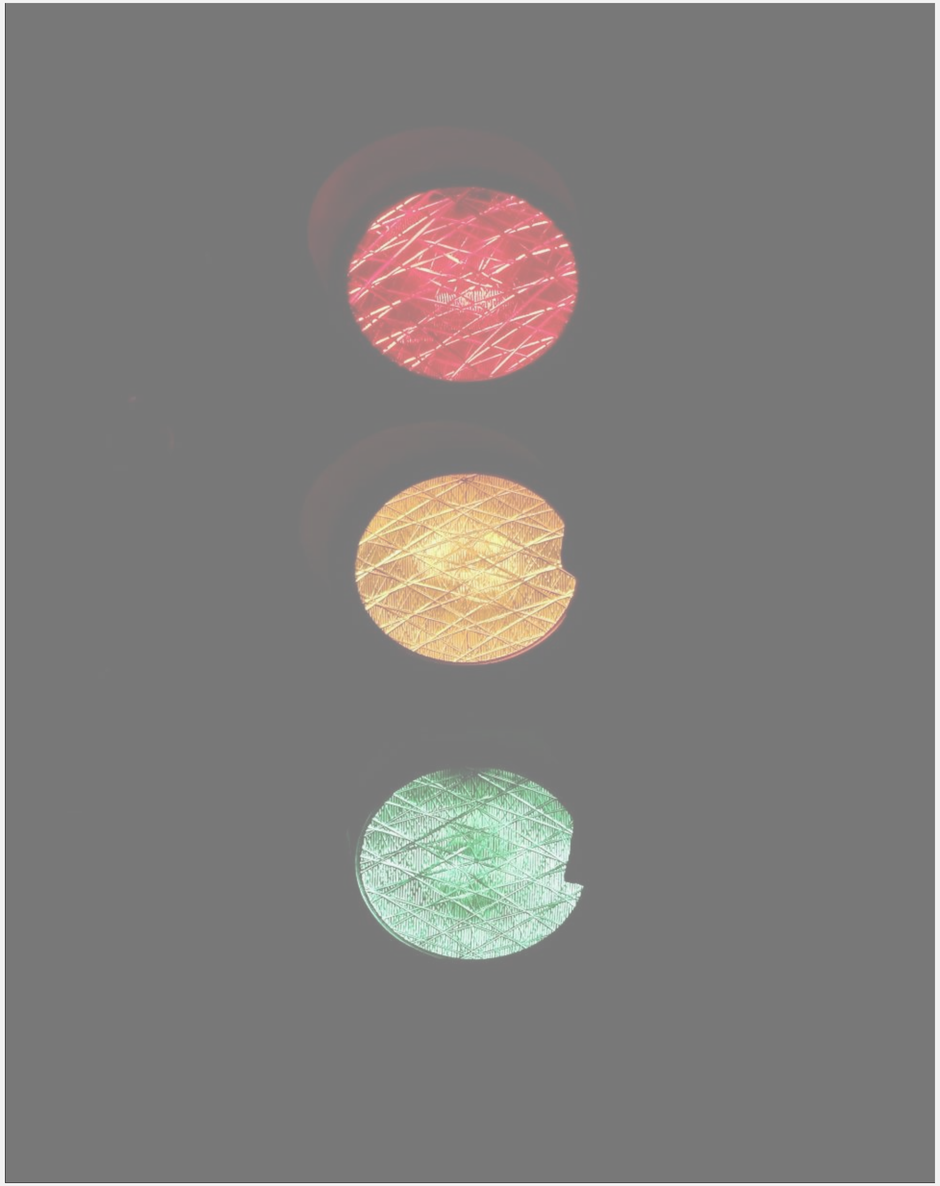

INHERENT RISK (continued...)

MARKET RISK

Strategic Risk

LEGAL AND REGULATORY RISK

MONEY LAUNDERING/ TERRORIST FINANCING RISK

MARKET RISK

Market risk arises from potential changes in market rates, prices or liquidity in various markets such as for interest rates, credit, foreign exchange, equities, and commodities.

WHEN DOES IT ARISE

Exposure to this risk results from trading, investment, and other business activities which create on and off-balance sheet positions.

KEY CONTROLS

- Clearly defined market risk limits
- Clear lines of authority and responsibilities for managing market risk exposure.
- Identification, assessment, monitoring, control and mitigation of market risk.
- Adequate systems and standards for measuring market risk;
- Standards for valuing positions and measuring performance;
- Comprehensive market risk reporting and review process.
- Effective internal controls.

Legal & Regulatory Risk

- **Regulatory compliance risk arises from potential non-conformance with laws & regulations, practices & standards.**
- **Failure to comply with contractual obligations**
- **Normally assessed on the impact of "onerous" provisions in laws and regulations, contracts.**

KEY DRIVERS:

- Emerging regulations and best practices which are "**ONEROUS**" e.g Capital adequacy, Tax payments
- Nature of business contracts e.g Restrictive loan covenants may impose strict default provisions

CONTROLS

- **Gap analyses:** Robust and periodic legal review process and gap analysis of CMO policies, documentation and level of regulatory compliance.
- Policy on **stakeholder engagement** on applicability of relevant legislation.
- **Planning and tracking statutory & contractual obligations** when they become due and assign staff to attend to them to mitigate the potential risk of neglect and/or failure to comply within the stipulated timeframe specified by the law. For example, have a compliance standard procedure document with specific dates and responsible personnel.

Strategic Risk

Strategic risk arises from a CMO's potential inability to implement appropriate business plans and strategies, make decisions, allocate resources, or adapt to changes in its business environment.

CMOs will be expected to develop, document and implement strategic plans/ Business plans

Key risks/ drivers of strategic risk include:

- Shifts in consumer demand and preferences;
- Legal and regulatory changes;
- Competitive pressure – new entrants, copy-cat tactics, counterfeit products;
- Mergers/ Demergers/ integration;
- Technological changes;
- Stakeholder pressure, shareholder revolts.

MONEY LAUNDERING/ TERRORIST FINANCING RISK

ML/ TF Risk is the risk that the CMOs activities result in its being used by criminals as a conduit to conduct money laundering and financing of terrorism.

KEY DRIVERS

- **Higher-Risk Products, Services and Transactions**
  - **Significant electronic payments, electronic/ online banking**
- **Higher-Risk Customers**
  - **Higher portion on cash intensive, large portion of foreign based clients, exposure to unregulated businesses, PEPs**
- **Higher-Risk Countries or geographic locations**
  - **Clients/ transactional exposures to juridictions identified by FATF or other bodies as having ML/ TF deficiencies**
  - **Extensive use of international financial centres/ tax havens**
  - **Jurisdictions with high criminality – Drugs/ Financial crimes**

KEY CONTROLS

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