EXIMBANK

RISK MANAGEMENT

Content:

Risk management objectives and policies

The strategies and processes to manage risks (Article 15 (1) from National bank regulation related to disclosure of information on the financial activity of the licensed banks from the Republic of Moldova, No 52 of March 20, 2014 and Article 435 1 (a) of the Capital Requirements Regulation No 575/2013 (hereafter CRR))

The risk management process of the Bank comprises the adequate mechanisms of corporate governance, the clear lines of accountability at the organizational level (chain-of-command) and a well-defined and effective internal control system. The objective of the risk management strategy is to achieve a comprehensive/complete overview of risks, given the risk profile of the Bank, foster a culture of risk awareness and enhance the transparent and accurate representation of the risk level of the Bank's portfolios.

The Bank's risk-acceptance strategy has been summarized in the Risk Appetite Framework implemented to ensure that the accepted risk remains within the framework of the risk acceptable for the Bank and its goals adopted by the ISP Group and the Bank's management and governance bodies. The Risk Appetite Framework is the result of the organizational process that comprises the Bank's risk profile analysis, setting the risk acceptance limits in line with the Bank's corporate strategies and annual plans. By adopting the limits that quantify the risk the Bank has set; the minimum capital adequacy level, the minimum liquidity level and the leverage ratio.

The most important principles of the Bank's risk-acceptance strategy are the following:

- the proactive participation of the Bank's management bodies and senior management in setting the risk appetite framework in accordance with the strategic targets of the Bank;
- the appropriate evaluation of business opportunities and the prevention of excessive risk-taking;
- when defining the risk-acceptance policy it is necessary that the business/corporate strategy and the planned annual results are aligned with the desired risk profile;
- the assessment of the overall risk profile regarding risk appetite is an on-going and continuous process;
- the general business orientation of the Bank is to provide standard banking services (savings, lending, payment services) for the key customer segments (large enterprises, small and medium-sized enterprises, households);
- to mantain an adequate level of capital commensurate with the level of risk;
- to minimize the market risk.

The processes of monitoring and managing the Bank's comprehensive risk profile comprises the analysis of the forms and scope of the risk; of the definition of risk appetite, the monitoring of the entire risk profile and the measures taken in case the approved limits are breached.

The structure and organization of the relevant risk management function including information regarding its authority and statute, or other appropriate arrangements (Article 15 (1) from National bank regulation related to disclosure of information on the financial activity of the licensed banks from the Republic of Moldova, No 52 of March 20, 2014 and Article 435 1 (b) of the CRR)

Eximbank, in line with the regulatory requirements and the Intesa Sanpaolo guidelines established an independent risk management function, which is in terms of hierarchy and organization separated from the business areas. The risk management function is organizationally placed under the member of the Management Board responsible for the risk area (Chief Risk Officer, i.e. CRO).

The Chief Risk Officer, in coordination with the Parent Group, proposes a framework for determining risk appetite, coordinates and verifies the implementation of the risk management policy, ensures the management of the risk profile of the Bank and reports to the management bodies of the Bank.

The role of the Risk Management Department is to identify, measure, report and control the Bank's exposure to risk. For this purpose, the Risk Management Department proposes to the Bank's Management Board strategies and risk management policies, issues guidelines for the Bank's organizational units regarding acceptable risk limits, and makes sure that the risk-taking practice is compliant with the regulations and guidelines issued by the supervisory authorities. In accordance with the rules and guidelines issued by the parent Bank, the Risk Management Department implements the methodologies to evaluate risk and to define limits. Furthermore, this function is in charge of the definition and implementation of reports to the Bank’s management and governance bodies and to the Parent Bank on exposures to risk that comply with the limits in place. The responsibilities of the Risk Management Department include the following areas:

- risk management policies and processes including proposals for risk management systems;
- methodologies, systems and procedures for measuring risk;
- an assessment of the Bank's internal capital requirements; definition of the Bank`s risk profile and the limits for the quantitative determination of the risk appetite;
- the control of exposure to specific types of risk and operating limits, as well as reporting to the Bank’s management and governance bodies.

Overall internal control framework

The internal control system comprises the adequate and efficient framework of the processes and procedures settled for the proper evaluation and monitoring of risks. It ensures the timely identification of exposure to risk arising from internal and external factors to which the Bank is exposed carrying out its business. The internal control system covers all significant risks connected with the Bank’s operations and involves the examination of the administrative and accounting procedures. It also covers the examination of the Bank's compliance with the laws in force; the standards, codes and internal acts, as well as of information security.

Being a part of internal control system, second level of controls, risk management controls cover the procedures, processes and methodologies for risk measurement and controls over those procedures and risk limits established for particular risk categories. The key process for managing risk is carried out through the management of the capital (ICAAP), of which the risk appetite framework is an essential part (both started since 2019). Internal control activities in the area of limits include the verification of the compliance of business transactions with the established limits and the approval and confirmation of the business transactions which exceed these limits.

The scope and nature of risk reporting and measurement systems (Article 435 1 (c) of the CRR) and the policies for hedging and mitigating risk, and the strategies and processes for monitoring the continuing effectiveness of hedges and mitigants (Article 435 1 (d) of the CRR)

At Eximbank, the risk management policies and practice are in the process of implementation for all relevant risks, defining the following:

- the principles of risk management;
- the organizational roles for risk management and coordination with the parent Bank;
- the indicators used for risk measurement and assessment;
- the operating limit systems and control procedures; the action taken in the event of exceeded limits, and reporting on exposures to risk to the Bank’s management and governance bodies.

The principles and framework of this policy are in compliance with the requirements and criteria prescribed by the regulation and by the parent Bank's requirements. Risk measuring and timely reporting are carried out by utilizing the daily data stored in the Bank's data base. This data base of Bank`s transactions is the base for calculating and monitoring the risk indicators. Stress test scenarios and simulations are coherently performed on those data as well.

Credit and counterparty risk

The Bank implemented a credit risk policy to create a suitable organizational environment for credit risk management, for underwriting the process to approve credit exposures and for monitoring the fulfilment of its contractual obligations.

In line with its commitment to prudential management on credit exposure, the Bank ensures an adequate segregation of duties, during the credit approval process, minimizes the errors of participants in the credit process, centralizes the management of credit exposure and controls. Such an approach requires the participation of different organizational units in the credit process. These units refer to the member of the Bank's Management Board in charge of the risk area:

- Credit Underwriting Department
- Credit Portfolio Analysis and Administration Office
- Proactive credit exposure management function
- Credit Management (Recovery and Workout) Department

The authority to approve the credit exposure is given at several decision-making levels in relation to the amount of issuing, the riskiness of the borrower and the type of credit transaction.

For measuring credit risk, the Bank has developed internal credit risk models for the calculation of the Probability of Default including the so called Satellite Model (namely, the forward looking Moldovan macroeconomic parameters embedded in the Life Time Probability of Default). The next step is the development of the LGD model. At the same time the Bank is working on the development of the Scorecards for retail and corporate clients.

To support the processes of classification and the management of non-performing loans, as well as for evaluating impairments and provisions, the Bank is implementing a dedicated IT System (Finevare).

The duties of the CRO Division within the framework of credit risk management comprise monitoring the credit portfolio, the credit risk valuation on a portfolio basis (with the purpose of risk pricing, provisioning) and the definition of the collateral's eligibility. To control the Bank's credit portfolio and monitor the portfolio composition and trends, the competent units shall prepare the following reports:

1) Monthly credit risk report delivered to competent Bank departments of the commercial, financial and risk area. The report contains information by relevant business segments about exposure, provision coverage, non performing exposure share, credit concentration, payment delinquency and other pertinent infomration.
2) Quarterly reports for the Management Board and the Audit Committee (a consultative body of the Bank's Supervisory Board) featuring in-depth information regarding the Bank's credit portfolio.
3) Quarterly reports for the Risk Committee containing in-depth information regarding the Bank's credit portfolio and other reports necessary to manage and control risk.

The most important instruments to mitigate credit risk and provide additional credit protection in case of deterioration of a borrower's financial situation, include unfunded credit protection (suretyship, primarily government guarantees and credit insurance) and funded credit protection (real estate property, deposit, security, means of transport, equipment, inventories). The process of monitoring the collateral comprises the periodic determination of fair values, the verification of the ratio between the amount of exposure and the value of the collateral, and other collateral eligibility requirements.

Concentration Risk

The Bank concentrates its efforts to be in line with the requirements established by National Bank of Moldova. Taking into consideration not only credit risk, but also concentration risk, in particulally large exposure, in case the Bank is facing a business opportunity for large exposure, the preassesment of impact of credit risk is evaluated by Risk Management Department and communicated to competent bodies for the final decision on the credit proposal.

Market risk

Market risk is the risk of losses in positions arising from movements in market prices. These include several aspects of banking activity as equity risk, currency risk and interest rate risk.

The policy of the Bank regarding market risk is low tolerance in accepting transactions with embedded financial risk.

The Risk Management Department, in collaboration with the parent Bank proposes and implements the internal policy. For the purpose of managing market risk, the Bank has set limits for the proper monitoring of the financial risk position (e.g. limits for currency risk). The Risk Management Department reports on a quaterly basis to the Audit and Risk Committees, the consultative bodes of the Supervisory Board of the Bank in detail on all positions which are exposed to market risk and limit utilization.

The measure of risk, which is used for monitoring and control of market risk is value-at-risk of the financial instruments portfolio (bond portfolio in the banking book, currency positions and equity positions). Currency risk of individual currencies is limited with the nominal position limits.

Interest rate risk of the banking book transactions

The practice about the management of interest-rate risk in the banking book determines the main guidelines, organizational roles, the methodology for measuring and the limits of the acceptable risk. The Bank has a moderate interest rate risk profile, this type of risk is mainly associated with credit activity and with the management of the bond portfolio for liquidity purposes.

The Treasury & ALM Department has an important role in managing interest rate risk through the asset-liability management policy and financial position management within the set of limits in order to set bounds to interest rate risk.

In addition to the measure of the Bank's exposure to interest-rate risk, which is subject to monitoring the limits, the Risk Management Department also evaluates the sensitivity of the net interest income to a parallel change in the interest rates of 100 and 200 base points in one year period and the sensitivity of the Bank`s economic value on non-parallel changes of the yield curve. When measuring the interest rate risk, the Bank uses the models which adjust cash flows sensitive to interest rate changes, to the characteristics of individual instruments.

The Risk Management Department with the support from the parent Bank proposes the policy and limits for controlling maximum exposure and prepares the report on positions in relation to the set limits. The limits are determined on the total interest rate gap measured with a sensitivity of the present value of future cash flows to an interest rate parallel shift of 100/200 basis points.

Liquidity risk

The liquidity risk management practice defined the organizational roles, the methodology for measuring risk, the limits of acceptable risk and the liquidity contingency plan.

The fundamental principles applied by the Bank are:

- to determine the operational structures which manage liquidity within the framework of the set limits, and supervisory structures which are independent from it;
- a prudential approach when assessing the expected cash flows for all on-balance sheet and off-balance sheet items, particularly those without contractual maturity (or whose maturity is insignificant);
- continuous availability of adequate liquidity reserves in accordance with the maximum level of tolerance when accepting risk;
- determining the influence of various scenarios, including stress scenarios (adverse scenarios) on cash flows and the quantitative and qualitative adequacy of the liquidity reserves.

The Treasury & ALM Department plans and proposes the medium-/long-term financing of the Bank in accordance with the liquidity targets of the Bank. The Treasury & ALM Department plans and manages the short-term liquidity position, engages in achieving a favourable structure of the liquidity portfolio and effective management of financial assets. The Risk Management Department proposes methods and processes for managing liquidity risks, periodically carries out stress tests and monitors the liquidity position through analytical measures of risk. The periodic reporting to the management bodies of the Bank is performed.

Reporting on the liquidity position comprises the following measures of risks:

- the liquidity coverage ratio and the net stable funding ratio calculated in accordance with the supervisory and parent Bank regulations;
- the stress ratio LCR (liquidity coverage ratio) for the period of 3 months for which the minimum ratio is determined;
- the liquidity ratio for the periods of 30 and 180 days.

Operational risk

The Risk Management Department is in charge of the centralized operational risk management activities. The above-mentioned department is, in cooperation with the parent Bank, responsible for the identification, preparation and monitoring of the methodological and organizational framework for controlling the Bank's exposure to operational risk. The Risk Management Department is also responsible for the verification of the effective mitigation of deficiencies and for reporting to the management bodies of the Bank. For the purpose of assessing operational risk, the Bank's organizational units are responsible for collecting and recording loss events, scenario analysis, as well as for the business environment and the evaluation of the internal control factors.

The loss events collection provides significant information on the exposure. It also contributes to building knowledge and understanding of the exposure to operational risk, on the one hand, and assessing the effectiveness or potential weaknesses of the internal control system, on the other hand.

The Bank mitigates exposures arising from operational risk by:

- protecting access to the IT systems and information,
- putting in place internal controls.