MCB

Bank for Life

Key Elements of
Risk Management Policy

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- Risk is an inherent part of banking business activities. At MCB Bank Limited, a comprehensive Risk Management Framework around an approved risk appetite is in place. Mechanisms are defined for every identified risk to ensure that the Bank continuously evaluates the associated risk and ensures presence of operational mitigating controls.
- The risk management framework and governance structure at MCB helps to mitigate and counter any foreseeable risk in its various lines of business. Risk awareness forms an integral part of strategic and operational activities of risk management. Through its Global Risk Management Policy, Bank sets the best course of action under uncertainty by identifying, prioritizing, mitigating and monitoring risk issues, with the goal of enhancing shareholders' value. Bank's risk management structure is based on the following five guiding principles:
  - Optimizing risk/return in a controlled manner
  - Establishing clear responsibility and accountability
  - Establishing & maintaining independent and properly resourced risk management function.
  - Promoting an open risk culture
  - Adopting international best practices in risk management
- The Bank executes its risk strategy and undertakes controlled risk-taking activities within its risk management framework. The Board of Directors (BOD) at MCB actively drive the risk management framework. Under the valuable guidance of BOD, the Bank has a proactive approach in dealing with factors that influence the financial standing of the Bank, to generate recurrent earnings and to maximize shareholder's value by achieving an appropriate trade-off between risk and returns. An effective risk management framework along-with a robust risk governance structure, strong capital & liquidity coupled with a good quality of credit portfolio remains a cornerstone of the Bank's risk management goals.
- Empowerment and independence are the basic principles in risk management and it is implemented as a fundamental part of BOD's vision. Independence of areas that are responsible for measuring, analyzing, controlling and monitoring risk from the frontline risk takers (i.e. business soliciting groups) is ensured within the Bank.
- Risk takers and Risk controllers have independent reporting lines, yet work together to increase Bank's value via efficient utilization of capital. Through a four-eye principle for credit approval levels for corporate and retail banking, all exposure related requests are approved with the formal consent of at least two authorized individuals including one from the business side having credit approval authority and the other from risk management side having credit review authority.
- The BOD and its Risk Management & Portfolio Review Committee (RM&PRC) have ensured formulation and implementation of a comprehensive risk management framework. Under the BOD's guidance, the Bank has executed an effective risk strategy and continued to undertake controlled risk-taking activities within the risk management framework; combining core policies, procedures and process design with active portfolio management. The risk management framework requires strong integrated risk management practices in key strategic, capital and financial planning processes and day-to-day business processes across the organization, with a goal to ensure that risks are appropriately considered, evaluated and responded to in a timely manner.
- As a matter of principle, the Bank constantly endeavors to improve its risk management framework in light of the international best practices and regulatory guidelines. Accordingly, all policies and procedural documents that form part of the Bank's risk management framework are regularly reviewed to keep them aligned with changing market dynamics, regulatory environment and international standards.
- The RM&PRC guides the management on its risk-taking activities within the policy framework approved by the BOD. Regular meetings of RM&PRC are convened to oversee the risk exposures and their trends as a result of the various initiatives undertaken by the Bank. The committee reviews different aspects of the loan portfolio which, among others, includes asset growth, credit quality, credit concentration, lending business trend and cross sectional analysis. Review of various aspects of country risk, liquidity risk, market risk covering interest rate risk, foreign exchange risk, equity price risk and technology risk along with the stress-testing is also a regular feature. Operational risk assessments, key risk indicators and major findings of Risk & Control Self-Assessment (RCSA) pertaining to processes, people, systems, technology and reputation are also regularly reviewed by the committee. The committee also reviews in detail the Bank's capital levels under Internal Capital Adequacy Assessment Process (ICAAP) and Capital Adequacy Ratio.
- The Management Credit & Risk Committee (MC&RC) is the management platform for discussion and deliberation on key risk issues in the portfolio. Regular meetings of the committee are convened to oversee the risk exposures in the portfolio of the Bank.

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- Credit Risk Review ensures to minimize credit risk associated at account and portfolio level. Credit Risk Review manages to evaluate and approve loan requests, within required turnaround time, both for domestic and international operations. The Bank has implemented Loan Origination System (LOS) for end to end automation of credit approval process, facilitates effective management of internal policies and controls as well as regulatory requirements while also contributing towards its transition to a paperless environment under the Green Banking initiative.
- For risk categorized as sovereign/ government risk, the lending exposure is spread over multiple government owned or controlled organizations and departments which are engaged in a variety of tasks that range from different development related works to utility distribution and production. To manage adverse outcomes in terms of unfavorable scenarios, multiple control factors in the lending structure of the Bank provide additional comfort and support. Such controls range from quality of eligible collateral, pre-disbursement safety measures to post disbursement monitoring.
- In order to further enhance the credit risk analysis, the Bank has in place a probability of default based Internal Credit Risk Rating (ICRR) system which is based on statistical modeling and validation in line with Basel principles. The ICRR is currently focused on corporate-commercial customer category. Furthermore, scoring Models are also in place to calculate ICRR for Small Enterprises, Medium Enterprises, Agriculture Finance and Overseas exposures. An Internal Credit Risk Rating Model for facility risk rating has also been implemented which reflects expected loss rate of a credit facility.
- In addition to the credit risk, like all financial institutions, MCB is also exposed to Market Risk through its trading and other investment activities. A comprehensive control structure is in place to ensure that the Bank does not exceed its qualitative and quantitative tolerance for market risk. A number of metrics like VaR methodologies complemented by sensitivity measures, notional limits, stop loss triggers at portfolio level/asset class and stress testing are used to capture and report the multi-dimensional aspects of market risk.
- As an authorized derivatives dealer, the Bank is an active participant in the derivatives market. Overall limits in derivatives are approved by the BOD. Counter party limits structure for derivatives transactions is in place and exposures are monitored and reported on a continuous basis.
- Operational Risk is being managed professionally in accordance with the Global Risk Management Policy, Policy on Internal Controls, Operational Risk Management Framework and various regulatory instructions. Operational Risk Inventory database covering losses, control breaches and near miss events is being maintained using professionally developed software. Operational risk events and Key Risk Indicators (KRI's) are captured and management reports are generated. A process of Risk and Control Self-Assessment (RCSA) is in place to assess the operating effectiveness of controls and to implement remedial measures as needed. Updates on operational risk events are presented to the senior management and RM&PRC of the BOD on quarterly basis.
- The Bank has developed Information Technology Risk Assessment Framework which enables better management of technology risk with respect to the security managed by IT Risk team. The IT Risk Assessment Framework helps the management to identify and manage key security risks and its associated threats for the critical infrastructure/IT assets of the Bank which includes systems, applications and network devices. The Bank has an internal operational security risk awareness program which is aimed at building capacity and inculcating risk aware culture in the staff through workshops and on-job awareness.
- The Bank has remained a well-capitalized institution with a capital base well above the regulatory limits and capital requirements under Basel frameworks. The Bank continues with a policy of sufficient profit retention to increase its risk absorption capacity.
- The Bank's comprehensive liquidity management framework assists it to closely watch the liquidity position through monitoring of early warning indicators and stress testing in order to ensure effective and timely decision making. The liquidity risk management approach at the Bank involves intra-day liquidity management, managing funding sources and evaluation of structural imbalances in the statement of financial position. A large and stable customer deposits base, along with a strong capital base provides strength and support for maintenance of a strong liquidity position. The Bank also has a substantial portfolio of marketable securities that can be realized in the event of liquidity stress. Further, in line with SBP's directives, the Bank has fully implemented BASEL III required liquidity standards and maintains liquidity ratios within prescribed limits.
- Foreign exchange risk exposes the bank to changes in the value of exposure denominated in foreign currencies due to the exchange rate fluctuation and volatility. Limit structure to manage foreign exchange risk including gap limits in different tenors in major currencies are in place to control foreign exchange risk. Bank's net open position and Foreign Exchange Exposure Limits (FEEL) are monitored and reported on intra-day and day end basis. Foreign exchange risk parameters including VaR are generated and monitored on a daily basis. Stress testing of foreign exchange portfolio and its reporting to senior management and RM&PRC of the BOD is also a regular feature.