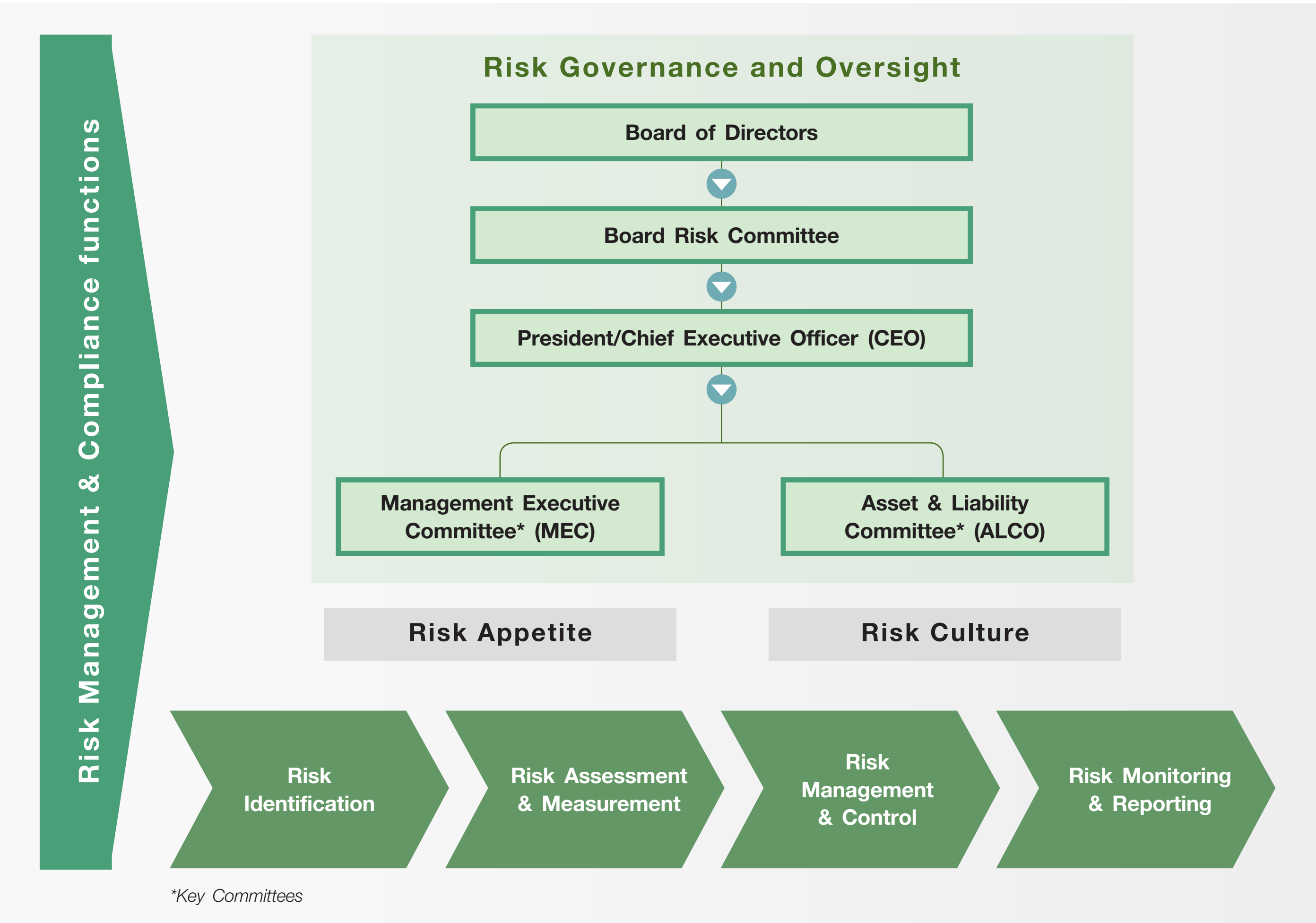
RISK MANAGEMENT

Risk management is an essential component of the Group's business, operations, and decision-making process. The risk management and compliance function participates in the early stages of the risk-taking process to ensure that the Group operates in a sound business environment while achieving optimal returns by providing independent inputs, including credit evaluations, assessments of new products, and quantification of capital requirements as well as relevant operational, legal, and regulatory requirements. These inputs enable the evaluation of risk-reward scenarios by the business units, thereby mitigating potential risks and enabling for the consideration and appropriate pricing of residual risk in relation to the expected return.

RISK MANAGEMENT OVERVIEW

The Group's risk management approach is supported by a sound and robust Enterprise Risk Management Framework ("Framework"), which is continuously enhanced to remain relevant and resilient against the background of a versatile risk landscape and evolving industry practices.

Key components of the Enterprise Risk Management Framework are represented in the diagram below:



RISK MANAGEMENT GOVERNANCE

In line with the Framework, three lines of defence in managing risks are adopted within the Group. The following table summarises the responsibility and accountability of the various parties involved in the risk management of the Group.

1 FIRST LINE OF DEFENCE:
Business and Support Functions

- primarily responsible to identify, mitigate and manage risks within their respective lines of business.
- ensure day-to-day activities are carried out within the established risk and compliance policies, procedures, and limits.

2 SECOND LINE OF DEFENCE:
Risk Management & Compliance Division (RMD)

- independently assess risk exposures and coordinate risk management on an enterprise-wide basis.
- ensure that risk management and compliance policies are implemented accordingly.
- ensure compliance with the applicable laws and regulations.

3 THIRD LINE OF DEFENCE:
Internal Audit Division (IAD)

- independently review the adequacy and effectiveness of risk management processes, system of internal controls and conformity with risk and compliance policies.

Cagamas Berhad's Chief Risk and Compliance Officer, Raja Shahriman Raja Harun Al Rashid (seated, first from left), speaking at the 9th IERP Global Conference 2023 organised by the Institute of Enterprise Risk Practitioners.

RISK MANAGEMENT *(continued)*

Management recognises and manages the following key risks that may prevent the Group from achieving its objectives as part of its enterprise risk management:

Strategic Risk

Risk of not achieving the Group's corporate strategy objectives and goals. This may be caused by internal factors such as deficiencies in performance planning, execution and monitoring, as well as external factors such as changes in the market environment.

Strategic risk management is addressed by the Board's involvement in the setting of the Group's strategic goals. The Board is regularly updated on matters affecting corporate strategy implementation and corporate direction.

Credit Risk

Potential financial loss arising from the failure of a borrower or counterparty to fulfil its financial or contractual obligations. Credit risk within the Group arises from Purchase With Recourse (PWR) and Purchase Without Recourse (PWOR) business, mortgage guarantee programmes, investments including Capital Management Solution (CMS), Skim Saraan Bercagar (SSB) and treasury hedging activities.

The primary objective of credit risk management is to proactively manage credit risk and limits to ensure that all exposures to credit risks are kept within parameters approved by the Board. Investment activities are guided by internal credit policies and guidelines that are approved by the Board. Generally, all credit approval process has been carried out in line with the internal credit risk management policy.

Market Risk

Defined as the potential loss arising from adverse movements of market prices and rates. Within the Group, market risk exposure is limited to interest/profit rate risk and foreign exchange risk as the Group does not engage in any equity or commodity trading activities.

The Group manages market risk by imposing threshold limits and entering into derivative hedging contracts. The limits are set based on the Group's risk appetite and risk-return considerations. These limits are regularly reviewed and monitored. The Group has an Asset Liability Management System which provides tools such as duration gap analysis, interest/profit sensitivity analysis and income simulations under different scenarios to assist in managing and monitoring the interest/profit rate risk.

The Group also uses derivative instruments such as interest rate swaps, profit rate swaps, cross currency swaps and Islamic cross currency swaps to manage and hedge its market risk exposure against fluctuations in interest/profit rates and foreign currency exchange rates.

Liquidity Risk

Liquidity risk arises when the Group does not have sufficient funds to meet its financial obligations as and when they fall due.

The Group manages liquidity risk by adhering to a match-funding principle whereby all asset purchases are funded by bonds/sukuk of closely matched size, duration, and are self-sufficient in terms of cash flow. A forward-looking liquidity mechanism is in place to promote efficient and effective cash flow management while avoiding excessive concentrations of funding.

The Group plans its cash flow and monitors closely every business transaction to ensure that available funds are sufficient to always meet business requirements. Reserve liquidity, which comprises marketable debt securities, is also set aside to meet any unexpected shortfall in cash flow or adverse economic conditions in the financial markets.

Operational Risk

Defined as the potential loss resulting from inadequate or failed internal processes, people, and systems, or from external events. Each business or support unit undertakes self-assessment of its own risk and control environment to identify, assess and manage its operational risks. The Group maintains robust internal controls, systems, and procedures, regularly reviewed by internal and external auditors for thorough oversight.

Technology Risk

Technology Risk management involves structured and consistent risk assessment pertaining to technology and cyber security risks. The Group has embedded sound governance and effective management of technology risk, which encompasses strong information technology (IT) security, reliability, resiliency and recoverability to ensure the availability, accuracy, accessibility, and agility of systems and data.

Business Disruption Risk

The Group has a robust Business Continuity Management (BCM) programme to minimise the impact and likelihood of any unexpected disruptions to its business operations through the implementation of its BCM framework and policy, business continuity plans, and regular BCM exercises. The Group has instituted diverse enterprise-wide recovery strategies to expedite business and technology recovery and resumption during catastrophic events.

Regulatory Compliance Risk

Regulatory compliance risk is the failure to observe relevant laws and regulations resulting in adverse consequences that leads to fines, penalties, and reputational damage to Group's business.

There are policies in place that outline overarching principles and guidelines to manage regulatory compliance risk within the Group. This includes the first line, which manages compliance risks inherent in business activities, to ensure the Group remains compliant. The Compliance Department (CD) keeps abreast of industry regulatory developments that impact the Group and provides recommendations for necessary controls to be in place.

Periodic regulatory compliance reviews are independently carried out by CD, on adequacy of controls and the level of adherence to laws and regulatory requirements.

Any incidences of non-compliance, deficiencies, corrective measures, and information is reported to the Board through the Board Risk Committee (BRC), to facilitate a holistic and overall view of all compliance matters across the Group.

RISK MANAGEMENT *(continued)*

Reputational Risk

Reputational risk stems from the perceived or real adverse effects on shareholders, investors, counterparties, customers, market analysts, regulators, employees, and other pertinent stakeholders. Such impacts can potentially hinder the Group's capacity to uphold current or establish new business relationships, maintain credibility, and sustain stakeholders' trust and confidence.

The Group has established a Reputational Risk Framework, delineating a structured process, tools, and controls to proficiently navigate and mitigate reputational risks across its operations. This framework operates through a three-stage approach, comprising risk assessment, early detection, and escalation, and continuous risk monitoring and control. These stages play a pivotal role in safeguarding the Group's reputation and image.

Shariah Non-Compliance Risk

Shariah non-compliance risk refers to the risk of legal or regulatory sanctions, financial loss, or non-financial implications, including reputational damage that the Group may suffer arising from the failure to comply with the rulings of the Shariah Advisory Council of Bank Negara Malaysia (BNM) and/or Securities Commission of Malaysia (SC) (collectively referred to as "SACs"), standards on Shariah matters issued by BNM or SC, including the advice of the Shariah Advisors that is consistent with the rulings of the SACs.

The Group consults and obtains endorsements/clearance from an independent Shariah advisor for all its Islamic products, transactions, and operations to ensure compliance with relevant Shariah requirements. Where applicable, the Group will obtain approval of the SACs through the counterparty or intermediary that falls under the purview of BNM, and/or through the principal adviser of the sukuk programme for submission of its Islamic financial products to SC.

CD conducts periodic Shariah compliance reviews, which are endorsed by the Shariah Advisor. Additionally, the Internal Audit Division conducts an annual audit to verify that the Islamic operations conducted by the business units are in compliance with the decisions endorsed by the Shariah Advisor. Any incidences of Shariah non-compliance will be reported to the Shariah Advisor, the relevant Board Committee, and the Board.

2023 KEY RISK MANAGEMENT & COMPLIANCE HIGHLIGHTS

01 Completed reviews in August 2023 on the Group's Enterprise Risk Management (ERM) maturity assessment, Internal Capital Adequacy Assessment Process (ICAAP), and Credit Risk Management (CRM) with no significant gaps.

02 Continuous independent risk assessment on strategic business initiatives and proposals for management and the Board's well-informed decision making.

03 Cybersecurity threat scanning is analysed and reported to the management on the latest developments and emerging cyber threats locally and globally, i.e., incidences, lessons learned, and attack vectors.

04 Conducted a BNM Cyber Resilience Maturity Assessment self-assessment of Cagamas' IT security and governance readiness and controls. Overall, the IT security controls and governance meet BNM's cyber resilience requirements.

05 Continuously monitoring and adapting to the latest guidelines and regulations from relevant authorities that impact the Cagamas Group of Companies, ensuring ongoing compliance assessments to proactively manage emerging regulatory risks.

06 Setup a centralised repository for Cagamas Compliance Resources, encompassing essential laws, regulations, pertinent compliance policies, updates, and legal articles. This initiative aims to improve communication and serve as a valuable internal reference point.

07 Market and liquidity risk management is further enhanced with more frequent and up-to-date reports disseminated to senior management.

08 Established an independent credit risk assessment for SSB applications for better control and governance of the credit-granting process.

09 Establishment of the Product Development and Review Committee (PDRC) as a platform to deliberate business proposals, risk profiles, and mitigations prior to recommendation to the MEC.

10 Enhancement of the ERM framework to include improvements to risk assessment methodologies and integration of climate risk.