PMF FINANCE PLC

INTEGRATED RISK MANAGEMENT POLICY

Version 3.0

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Abbreviations

ALCO	: Assets and Liabilities Committee
BOD	: Board of Directors
BIRMC	: Board Integrated Risk Management Committee
CBSL	: Central Bank of Sri Lanka
CP	: Contingency Plan
CR	: Credit Risk
CRM	: Credit Risk Management
EIRMC	: Executive Integrated Risk Management Committee
EM	: Emerging Risk
ER	: Equity Risk
IRMF	: Integrated Risk Management Framework
IRMC	: Integrated Risk Management Committee
LR	: Liquidity Risk
MR	: Market Risk
OR	: Operational Risk
ORM	: Operational Risk Management
RAPM	: Risk Adjusted Performance Measurement RC: Regulatory Capital
RCSA	: Risk and Control Self-Assessment
RG	: Risk Governance
RMD	: Risk Management Department
RMF	: Risk Management Framework RMP: Risk Management Policies
PMF	: PMF Finance PLC

Contents

1. Introduction and Purpose

The Integrated Risk Management Framework (hereinafter referred to as the "Risk Management Policy Framework" or "IRM Framework") sets out the principles adopted by PMF Finance PLC (hereinafter referred to as "PMF"), to measure, monitor and manage its material risks, and also to ensure that adequate capital is held to meet the various risks to which PMF is exposed.

The IRM Framework aims at establishing the foundation rules for 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 including risk. identification, assessment/measurement and management/mitigation.
4. Guidelines for the formulation of the Risk Appetite Statement (RAS) and high-level Risk Identification & Assessment (RIA).
5. Setting out standards for documentation of specific risk policies.
6. Ensure that the company is aware of risks incurring from new and existing products, activities, processes, systems, technology, people and third parties
7. Defining guidelines for Integrated Risk Management Reporting.
8. Defining the underlying principles for comprehensive risk assessment and risk & capital budgeting.

2. Risk Management Principles

P1. Risk Management shall ensure the long-term viability of PMF. 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 defines the risk boundaries within which risks are underwritten by PMF. All risk control elements (limits, 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 PMF needs to have an Owner, Approver and an Independent Reviewer. Through the governance model (see next principle) PMF should aim at segregating the three roles ensuring independence.

P4. Risk management is to be embedded within the organization's strategic planning process, performance measurement system and day-to-day operations.

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 PMF, 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 a way to ensure long term viability of the business. Risk control elements shall be embedded in the incentive structure for PMF employees.

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

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.

3. The Risk Management Framework (RMF)

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

i. **Integrated Risk Management Framework** sets out the ground rules for the Risk Management Framework, including, without limitation, risk governance, RAS guidelines, definition of the risk management processes, as well as RM policy documentation and reporting guidelines. IRMF also caters 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.

ii. **Risk Governance** lays down the 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 and Strategy** defines the risk strategy of PMF in terms of risks PMF wishes to assume, clear boundaries for each material risk type, integration of risk planning with business planning through budgeting. Detailed description of governance, processes and methodologies pertaining to shall be documented in dedicated policies.

iv. **Risk Management Infrastructure** consists of all the resources deployed by PMF to carry out the provisions set out in the risk management policies and procedures, including without limitation, people, systems, technology, data, models and methodologies.

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

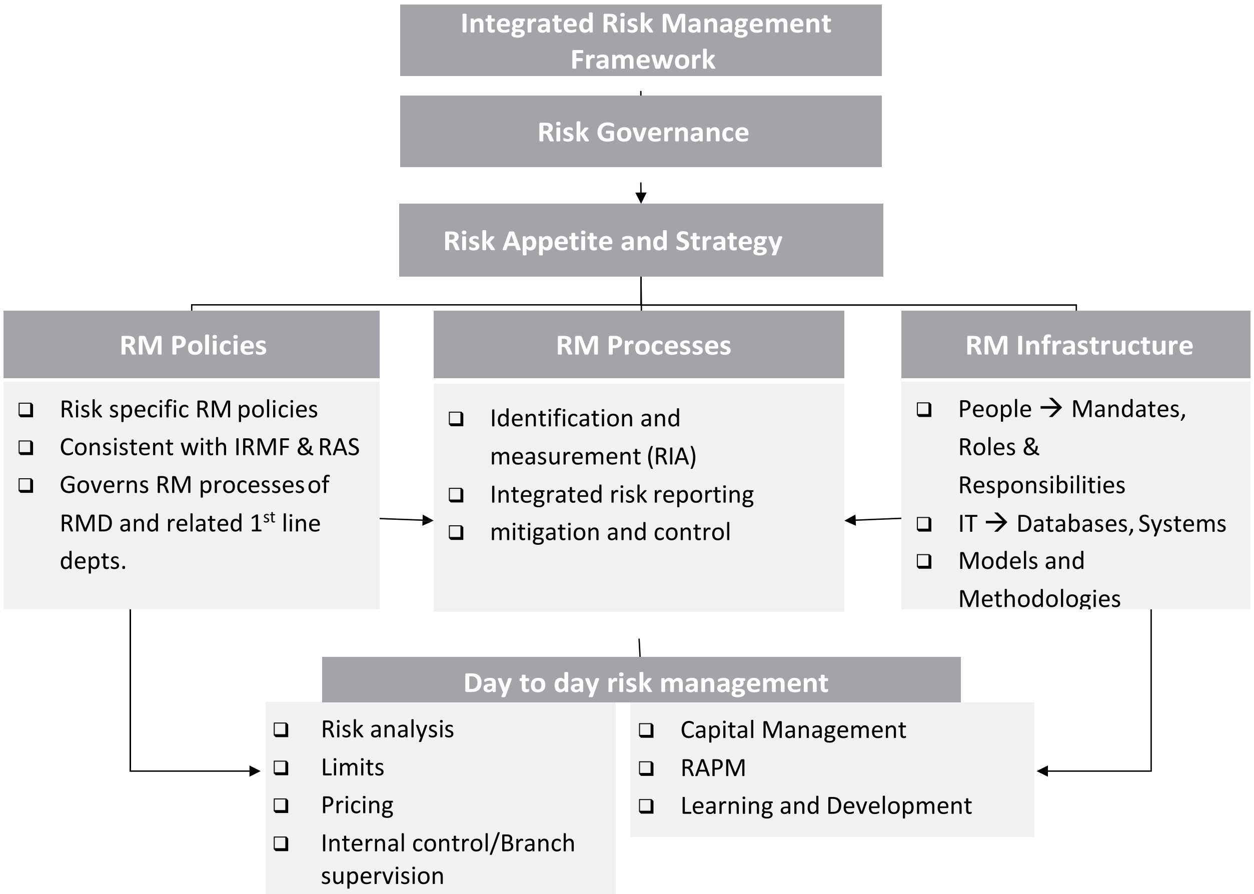


Figure 1- Components of the Risk Management Framework

4. Risk Governance

4.1 Risk Governance Principles

The following principles underlie the risk governance structure of PMF Finance PLC as part of the Integrated Risk Management Framework (IRMF):

1. **Independence 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:

   1.1. The composition of the Board of Directors (BOD) shall consist of Non-independent/independent/non-executive directors. The Board Integrated Risk Management Committee (BIRM) shall consist mainly of the Board of Directors of PMF. The Chairman of the BIRMC shall be a non-executive director.

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

   1.3. 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 the risk appetite, policies and limits.

1.4. 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 manner.

2. 3 Lines of Defense. All material risks as defined in the IRMF shall be based on the principle of three lines of defense**:**

2.1. 1st 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.

2.2. 2nd Line of Defense: Risk Management Division is 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. One of the key roles of 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 PMF.

2.3. 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.

3. **Segregations of duties.** The Risk Governance model caters for segregation of duties between:

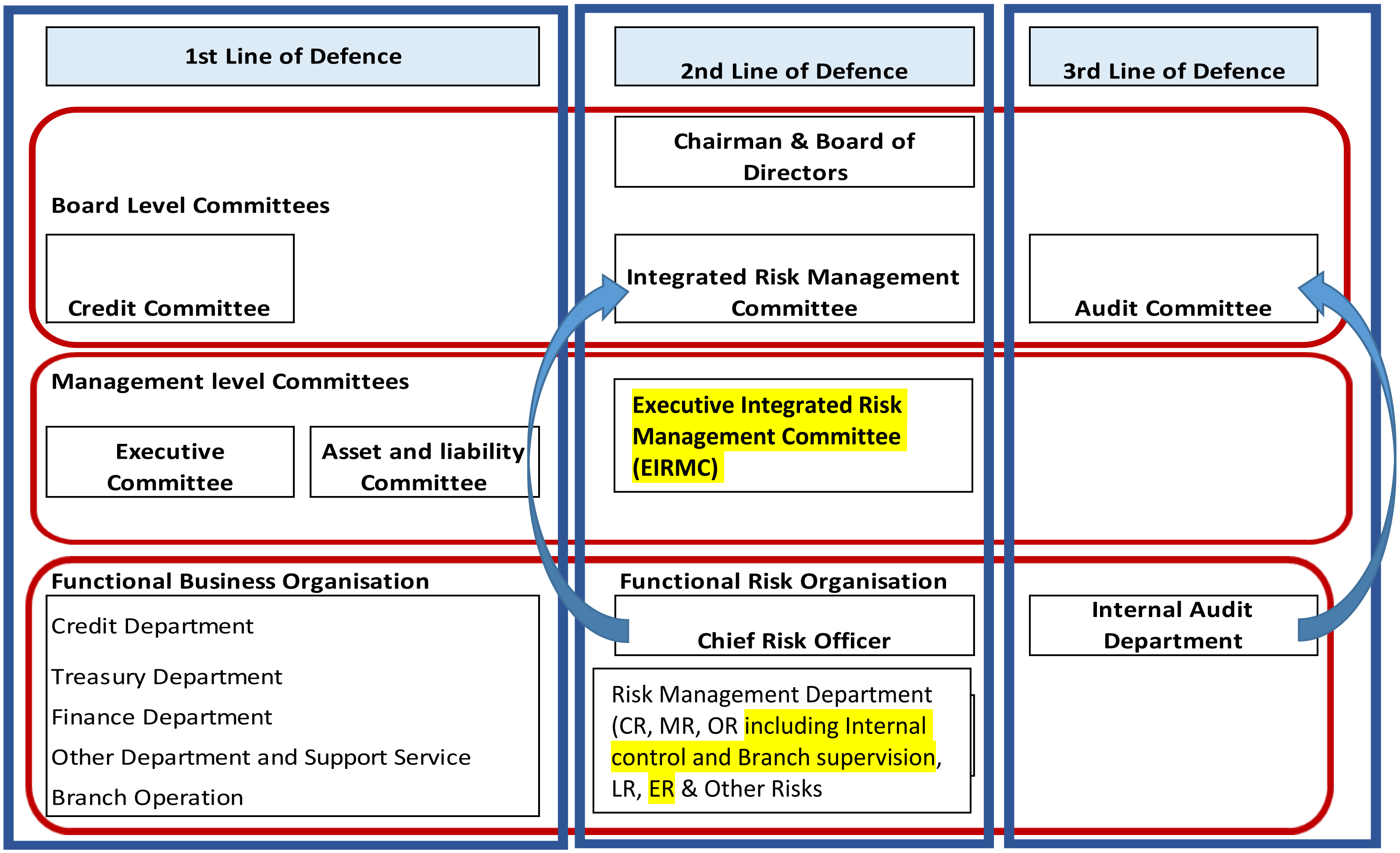
3.1. Risk origination and risk underwriting/approval- This takes the form of segregation between business lines and review/approval functions (i.e., segregation between risk origination and the 1st line of defense).

3.2. The Maker and Checker principle of PMF's transactions- Any operation of PMF shall include, without exception a 'four eye principles' whereby it takes at least one Checker for any transaction to be affected in the PMF's books or systems.

3.3. Top level oversight and PMF's operations- Boards of Directors, various BOD or management committees need to be sufficiently independent from the supervised areas or activities of PMF to be able to exert effective supervision and oversight.

4. **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 PMF operates under a business environment of medium to low complexity and hence it is in a position to adequately manage risks by applying simpler yet robust governance models.

4.2 Risk Governance Layout



The above Committees and organization structure is limited only to Risk and related areas

4.3 General Roles and Guidelines

4.3.1 Board of Directors

The BOD shall exercise the necessary level of control and oversight having a “duty of care” and “duty of loyalty” to PMF, its depositors and shareholders.
The ultimate responsibility for sound risk management in PMF 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. (Refer: Appendix 1 for Responsibilities)

4.3.2 Board Committees (relevant to risk management)

4.3.2.1 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 5 members. It shall be formed by two Non-Executive Directors, CEO, Head of Risk Management, Compliance Officer and chaired by a Non-Executive Director. (please refer IRMC Charter for the scope and the responsibility of the IRMC and Refer: Appendix 1 for Responsibilities).

4.3.2.2 Board Audit Committee (BAC)

The Board Audit Committee is the main reporting and oversight body for the Internal audit function of PMF. BAC ensures that Internal Audit performs its reviews in 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 the other members of the Board. (Refer: Appendix 1 for Responsibilities)

4.3.2.3 Board Credit Committee

The Board Credit Committee is the ultimate credit approval authority of PMF. 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. (Refer: Appendix 1 for Responsibilities)

4.3.3 Asset and Liabilities Management Committee (ALCO)

The Asset and Liabilities Management Committee (ALCO) is an executive level committee under auspices of the CEO. Membership shall consist of senior management relevant to the mandate of ALCO such as business lines, Risk Management, Finance 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 PMF within the risk appetite formulated for ALM risks (liquidity risk and Capital risk) and capital adequacy targets. (Refer: Appendix 1 for Responsibilities)

4.3.4 The Risk Management Function

4.3.4.1 Risk Management Division & 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 PMF'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 his role as the head of the Risk Management Division. Any 'double hatting' or involvement in operational activities/ revenue generating functions must be avoided. (Refer: Appendix 1 for Responsibilities)

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 PMF's risk management governance, RAS, risk limits, main risk management processes etc.

4.3.4.2 Integrated Risk Management (IRM)

IRM roles is to ensure consistency of all component of the RM Framework in line with the principles set out in the Integrated Risk Management Framework (IRMF). It has to also ensure all material risks are being managed within the RMD and consistent/coherent integrated risk reporting is submitted to senior management and BOD. The IRM function fosters communication, coordination and collaboration between various functions in risk management in order to recommend consistent risk strategies and policies, design the risk governance structure, as well as ensuring a consistent approach to risk management and successful implementation of risk projects at risk division level. (Refer: Appendix 1 for Responsibilities)

4.3.4.3 Credit Risk Management (CRM)

The primary responsibility of CRM is to ensure that PMF's credit risk exposures are within the risk appetite & tolerance levels of PMF.
While the branches and credit department originate and accept credit risk exposures, Credit Risk Management in the IRMD will be responsible for the following:

@ Verify adherence to the credit risk and credit policies, prescribed in lending processes and
@ Contribute in drafting credit procedures,
@ Be accountable for risk assessment methodologies and tools
@ Monitor Lease/loan portfolio quality through the Portfolio Review Mechanism, and
@ Generate and publish portfolio reports to reflect the risk position of PMF versus risk appetite.

(Refer: Appendix 1 for Responsibilities)

4.3.4.4 Liquidity, Interest Rate and Market Risk Management (ALM Risks)

ALM and Market risks are managed by ALCO, mainly through Treasury and Finance departments (1st line of defense) and monitored by the RMD (2nd line of defense). The role of the 2nd line functions (i.e., the RMD) with regard 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.

4.3.4.5 Operational Risk Management

Operational risk management is the process aimed to identify, measure, control, and respond to risk resulting from inadequate or failed internal processes, people and systems/technology or from external events. Effective ORM enables to assume risks deliberately within maximum tolerance levels, expand operations on cost effective basis, avoid financial losses and operational discontinuity, comply with prudential requirements, and achieve other targets that may meet corporate strategic objectives.

The primary responsibility of managing operational risks rests with 1st line operational functions such as Central Operations, the Branch Network, IT, HR, Legal, Accounting etc. The 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 but without limitation to IT & IT Security risk covering the minimum requirements as per the related CBSL regulations and its subsequent changes, Fraud risk, HR risk and Transaction Processing risk. (Refer: Appendix 1 for Responsibilities)

4.3.5 Internal Audit

The general role of **Internal Audit** is to ensure that 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 test compliance with Board approved policies and procedures with regards to risk management. (Refer: Appendix 1 for Responsibilities)

5. Risk Appetite and Risk Strategy

5.1 Risk Appetite (RAS)

5.1.1 RAS Principles

A Risk Appetite Statement (RAS) shall be developed to provide a common framework for the Board to set the boundaries of the current and projected risk profile of PMF, by correlating RAS parameters and other risk metrics with strategic decisions and corporate planning.

The Risk Appetite Statement shall be designed based on the following key principles:

1. The PMF's strategic objectives are articulated by the Board of Directors through Annual Corporate Planning. RAS shall define the boundaries for risk, in full concordance with PMF's Corporate plan and business targets.
2. PMF 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 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 threshold/limits.

4. Once the Risk Appetite Statement is discussed and approved by the BOD and the relevant committees as discussed above, it is promptly communicated across PMF's departments.
5. RAS processes shall form an integral part of the broader risk planning and budgeting.

   There should be full alignment and consistency between results and RAS.
6. RAS shall be defined comprehensively across all material sources of risk identified, covering as a minimum the following:

   a) Enterprise-wide Risk
   b) Credit Risk & Concentration Risk
   c) Market Risk
   d) Operational Risk
   e) Liquidity Risk
   f) Reputation Risk
   g) Strategic Risk

5.1.2 Guidelines for the RAS process

The RAS process entails three distinct stages:

a) **RAS Setting** consists of setting out appropriate RAS indicators and calibrating those as planned. Proposed RAS levels shall be based on current levels in PMF, 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, the RAS indicators are submitted for review and approval as part of the report.

c) **RAS Monitoring and Reporting** is done through the regular/quarterly RM reporting processes, including corrective actions if and when required. Risk Appetite Statement shall be fundamentally reviewed at least once a year (i.e., RAS Setting) as part of the process or more frequently 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.).

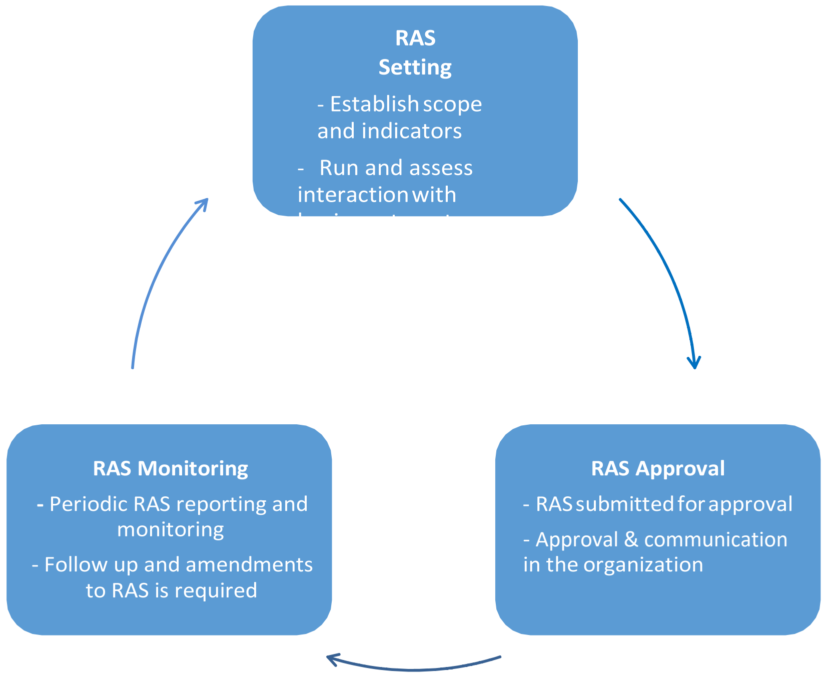


Figure 2- Summary of the RAS process

6. The Risk Management Processes

Risk management process covers the steps to be taken by PMF in the process of identifying, assessing, mitigating and treating the risks to which PMF is exposed to.

Identify	Assess		Monitor	Report
		Mitigate		
Identification of risks and issues that require investigation	Using various tools and techniques to evaluate and identify the significance of each risk identified	Consider on following treatment options: Accept/Mitigate/ Transfer	Focusing on going assessment of the agreed risk treatment	Risk reporting to Audit and Integrated Risk Management Committee

It consists of the following conceptual steps.

6.1 Risk Identification and Assessment (RIA)

The purpose of risk identification is to generate a comprehensive list of risk that may impact PMF's risk profile and may impede the achievement of PMF'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. and recording them in the Risk register.

RIA & Risk type scoping involves the following

dimensions: The following risks should be covered by RIA

as a minimum.

Type of Risk	Definition	Methods
Credit Risk	Refers to the threat of losses due failure of various counterparties to fulfil their obligations towards the institution. (for the avoidance of any doubt this definition covers also Credit Counterparty Risk) Credit risk in a narrower sense 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 PMF. Credit risk applies to both the lending book and to treasury operations.	Review of portfolio sizes (balances) as well credit performance metrics (NPL ratios, provisions etc.) Process and Product review (through the Credit Review Function)
Credit Concentration risk	Refers to the potential defaults which may be driven by a common underlying cause and may threaten the viability of PMF through correlated portfolio defaults. There are two main types of concentration risks: i. Concentration of exposures to individual customers/customer groups (single name risk – large exposure) ii. Concentration of risks arising from a group of exposures that share a common underlying risk driver (e.g., economic sector or regional concentration).	Review of % holdings in the total portfolio of specific counterparties, industries, sectors etc.
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	Interest rate and price movements, LTV Ratio for Gold Loan Size

Operational Risk	Is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Legal risk, strategic and reputational risks would come under the operational risk even defined separately as below.	Number and magnitude of or Incidents by Business lines, branches Loss data collection Root cause analysis and scenario analysis Process and Product review
Liquidity Risk	Is the risk that PMF 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 PMF.	Size of structural maturity mismatches in the balance sheet, Stress Testing Contractual and behavioral approach of Assets and Liability mismatches and related Net Interest Income (NIM)
Strategic and Business Risk	Means the risk to earnings and capital arising from changes in the business environment and from adverse business decisions	Operational income volatility assessment
Compliance Risk	PMF is committed to a high level of compliance with relevant regulations, industry codes and standards as well as internal policies and sound corporate governance principles. Identified breaches of compliance will be remedied as soon as practicable. The Company has no appetite for deliberate or purposeful violations of legislative or regulatory requirements. PMF recognizes that failure to maintain a no appetite position for Compliance Risk may result in outcomes which may create systemic risk and catastrophic outcomes.	Compliance Audits Compliance reviews
Reputational Risk	Refers to the potential adverse effects, which can arise from PMF's reputation being tarnished due to factors such as unethical practices, regulatory actions, customer dissatisfaction and complaints, negative/adverse publicity etc.	Number and severity of incidents with large reputational impact for PMF

6.2 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 PMF's financial position, market standing and relationship with key stakeholders.

6.2.1 Principles of Risk Measurement

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

1. Quantitative Assessment Limitations: 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 effort and should always be tempered by expert judgement.
2. Clear and transparent methodologies: 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 risk metrics accordingly
3. Non-arbitrary methodologies: Methodologies should not follow purely judgmental assumptions but should be backed by objective (i.e., data driven) evidence whenever practical.
4. 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.
5. Principle of proportionality: Measurement methodologies have to be developed in correlation with the size and complexity of PMF's position.
6. Responsibility: the ultimate responsibility for comprehensive and accurate risk measurement lies with the Board of Directors through the Board Risk Management Committee. The BIRMC mandates the CRO and the risk management function of PMF to assess and propose the most accurate and relevant measurement options for each type of risk covered by this IRMF.
7. Consistent usage: Metrics and analytics used to measure risks shall be used consistency by PMF.
8. Aligned with CBSL guidelines and good international practices. As a minimum, the PMF 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.

6.2.2 Risk Specific Measurement Guidelines

Type of Risk	Guidelines
Credit Risk	Credit Risk Management Unit is responsible for developing, administering and implementing internal rating systems in PMF across all material portfolios. The internal rating system shall provide a robust classification of credit risk by type of client and type of transaction. PMF 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: I. Shall have two separate dimensions, whenever possible, to reflect: (i) the risk of borrower default and (ii) transaction-specific factors II. Must have a meaningful distribution of exposures across grades with no excessive concentration, on both its borrower-rating and its facility-rating scales. III. The obligor rating shall incorporate both quantitative (financial ratios) and qualitative standards (industry, payment history, credit reports, management, purpose of the loan, quality of financial information, facility characteristics *etc*.) IV. Must have a minimum of seven grades for non-defaulted obligors, and one for defaulted obligors. PMF will have a Master Rating Scale, to which all the score cards' / rating models' output will be aligned with. V. 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 VI. 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 as a minimum for the Corporate and SMEs across two dimensions: single name – large exposure concentration and industry concentration. Concentration may be measured initially trough balance concentration indicators (e.g., HHI index) or the portfolio share of top N clients or industries till more sophisticated portfolio correlations measures are available.

Market Risk	Movement of market factors arising out of price sensitivities of funding sources, investments, commodity prices including Re-pricing risk and market yield curve risk - Price/interest rate changes - Lending products with shorter re-pricing cycle to reduce interest rate sensitive gaps (periodical review – ALCO), Borrowing rate changes with AWPR & Risk free instrument rate changes - NII & NIMs - Insurance adequacy - LTV
Liquidity Risk	The foundation for all liquidity risk measurements shall be the cash flow gap analysis. Cash Flow gap analysis shall take the form of: 1. Static Liquidity Analysis based on a business 'run-off' scenario using various CF allocation rules (regulatory and internal cash flow allocation rules). 2. The CF analysis shall also allow for the following amendments: 2.1. To be amended to reflect *stressful conditions* when running stress testing 2.2. To accommodate *client behavioral elements* that can have a material impact on the liquidity profile of the PMF 2.3. To accommodate *future business growth and balance sheet transformation* (i.e., dynamic liquidity analysis) Cash flow analysis shall form the basis for liquidity ratio analysis (e.g., Liquid assets ratios, or 30 days liquidity coverage ratios). Ratio analysis shall enable the PMF 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
Operational Risk	Measurement of OR shall be done through the following methodologies (applied jointly): 1. Risk occurrence and severity estimation through Risk and Control Self-Assessment (RCSA) and scenario analysis through risk events performed regularly (at least annually) or whenever a new product, service or a process is introduced or any amendments are made to existing ones 2. For the key risks identified under RCSA, PMF should develop indicators which can assist PMF in monitoring its key risks (Key Risk Indicators). These indicators should be quantitative in nature and periodically reported to senior management and Board. 3. Operational loss estimates shall be developed based on branches and Head Office Units reporting any operational losses experienced.
Strategic and Business Risk	Strategic and business risk is less amenable to quantification although an earnings volatility approach may be applied. The IRMF expects ALCO and BOD to assess strategic risk by carefully assessing business implications for all strategic decisions considered (i.e., scenario analysis).
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.

6.3 Risk Reporting and Monitoring

6.3.1 Principles of Risk Reporting

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

1. Integrated report- 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.
2. 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 PMF's sources, including accounting data where appropriate, to ensure that the risk data is accurate
3. Access and Infrastructure- PMF'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)
4. Timeliness- PMF 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
5. Distribution - Risk management reports should be distributed to the relevant parties, including without limitation to Board members and relevant members of the management team, while ensuring confidentiality.

6.3.2 Risk Specific Reporting Guidelines

Type of Risk	Guidelines
Enterprise wide	The Enterprise-Wide risk reporting sections shall address as a minimum the following elements: I. Overview of the balance sheet and profitability, including compositing and growth of specific items II. Track levels and trends of key balance sheet ratios, including benchmarking against the industry III. Enterprise-wide RAS indicators level and trends vs. target levels IV. Capital adequacy and RWA breakdown

Credit Risk & Concentration Risk	CR shall be providing a detail insight into the quality and structure of the portfolio, as follows: I. Credit Risk RAS indicators and credit risk limit levels and trends vs. target levels II. Lending and treasury portfolio breakdown by relevant sub-portfolios, economic sectors, regions, including balances, growth and trends III. Credit quality analysis through rating structure and rating migration analysis IV. Credit performance review through NPL and provisioning coverage analysis by product, region and portfolio. V. Collateral and provisions coverage reports VI. Top borrower analysis (outstanding balances, delinquency levels, collateral coverage etc.) VII. Off Balance Sheet analysis by type of product and sub-portfolio VIII. Concentration analysis by economic sector, region or single borrower/group. IX. Credit risk stress testing results
Market Risk	The following elements shall be covered, as a minimum: I. Market Risk exposure vs. RAS targets levels and other limits II. Brief description of market dynamics over the reporting quarter/year covering major relevant risk factors (prices/rates, equity indexes, bond yields, FX rates etc.) III. Actual position and performance versus portfolio levels, by major risk factor or sub-portfolio (e.g., equity, fixed income) IV. Market risk stress scenario analysis and results
Liquidity Risk	The following elements shall be covered (as a reference): I. Exposure vs. RAS target levels and other limits II. General funding position of PMF, including trends over the last quarter/year III. Regulatory and internal cash flow mismatch analysis as well as trend analysis in cash flow coverage ratios IV. Stress scenarios/testing results
Operational Risk	The following elements shall be covered (as a reference): I. Exposure vs. RAS target levels and other limits II. OR Losses by various dimensions (business lines, products and risk type) III. RCSA risk profiling by various dimensions (business lines, products and risk type) IV. Risk level dynamics and trends by risk types (i.e., SRTs) V. KRIs levels and trends
Reputational Risk	I. Description of reputational incidents over the reporting horizon, including mitigation action taken

7. Stress Testing

7.1 Principles

Stress testing is a critical component of the PMF's risk management system. The main goal of Stress Testing is to quantify the impact of stressed yet plausible macroeconomic (including the political and geopolitical aspects) and PMF specific shocks on PMF's financial position including its long-term viability.

The following principles shall apply to any stress testing framework of PMF:

1. <u>Stress Testing Governance</u>

Stress testing shall form an integral part of the overall risk governance and risk management culture of PMF. Authority over PMF's stress testing framework rests with the PMF's Board of Directors and senior management. While the Board is ultimately is responsible for ensuring that PMF 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 processes and procedures, and ensure compliance with these policies and procedures

A) Review and evaluate stress test results, discuss implications and take prompt remedial action where necessary.

B) Finally, Risk Management, through the BIRMC, is also responsible for regularly reporting stress testing results to the Board.

2. <u>Stress Testing Documentation</u>

Stress Testing Framework shall be fully documented as part of each Risk Policy, and shall include:

i) Frequency and procedure for identifying the principal risk factors, which affect PMF's portfolio and required to be stressed.

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

ii) Forward Looking

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

Although historical information should be utilized in stress testing, PMF' 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 PMF (using hypothetical scenarios, for example).

iii) Frequency of analysis

PMF shall aim at preparing stress test results on a once in 2 months cycles and in situations where it deems fit.

iv) Scope of Risk Coverage

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

v) 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, PMF should not run purely arbitrary stress scenarios that may distort the assessment of risks.

vi) 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 a regular and timely manner.

More importantly, stress test results should be directly linked to decision-making related to business strategies and management of the risk profile.

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

7.2 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 stress scenarios shall be categorized into:

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

II. **Moderate Stress Scenario shall reflect a severe but plausible recessionary scenario.** This is once in 20-30 years scenarios. This is a severe recessionary episode where local vulnerabilities blend with regional crisis situation.

III. **Severe or Worst-case scenarios** is a scenario reflecting a severe global downturn (once in 100 years scenarios) with dramatic consequences in the local market.

2. Types of Stress Testing

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

I. ***Sensitivity Analysis***: seeks to identify how portfolios respond to the movement of a single risk parameter, while holding all others constant. While it is a simple and easy to understand approach, risk factors rarely move in isolation even for a short period of time. In effect in times of stress, risk factors tend to become increasingly correlated and this should also be captured by the methodologies run by PMF.

II. ***Scenario Analysis*** on the other hand requires movement of multiple risk parameters simultaneously with the source of the stress event being well defined (the "scenario"). The main advantage of this approach is that it does not examine risk parameters in isolation, instead it tries to identify causalities and correlations between a number of risk drivers. Scenario analysis can make use of hypothetical macroeconomic scenarios or major systemic shocks that occurred in the past.

Stress testing are performed for the following instances.

- Capital Adequacy – Key aspects in the Internal Capital Adequacy Assessment Process (ICAAP) model considering credit risk, liquidity risk, market risk and operational risk aspects (strategic risk, regulatory risk, reputational risk, IT risk,..ets) and macro-economic factors in order to have healthy level of capital buffers (Refer the appendix 2)

- Gold loan business – Market price fluctuations, changes in the carotages and other market vulnerabilities (Refer the appendix 3)

- Equity portfolio – Setting up cut-loss limits and perform stress testing for the equity portfolio to mitigate equity price risk (Refer the appendix 4)

- Liquidity risk – Liquidity position, Contractual and behavioral approach of Assets and Liability mismatches and related Net Interest Income (NIM) (Refer the appendix 5)

- Stress testing on earnings, interest income

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 PMF

(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) Interpreting the results

7.3 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 regard to: (i) the increase in default probabilities and NPLs (ii) increase provisioning levels; (iii) slowdown in portfolio growth (iv) decrease in the value of collateral and consequent 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 (e.g., high deposit withdrawal rates) 2. 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.
Market Risk	Various market variables shall be analyzed in terms of significant historical or hypothetical shocks such as: (i) Widening of credit spreads for the Sri Lankan Government (ii) Sharp drop in equity indexes (iii) Steep and sudden devaluation of the local currency (iv) 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.)

Risk area	**Risk indicator**	**Risk Owner**
Fraud	Number of fraud events	Risk department
Legal	Amount paid by the company on account of court order	Legal department
Clients	Number of customer complaints	Marketing department
HR	Staff turnover ratio	HR department
IT	Systems downtime	IT department
Security	Number of information security breaches	Head of IT
Compliance	Number of instances of regulatory fines and penalties	Head of Compliance

7.4 Business Contingency Planning

1. Contingency plan for liquidity crises and capital shortfalls

Contingency plan (CP) addresses PMF's strategy for handling liquidity crises and capital shortfalls. PMF shall have a clear plan on managing liquidity risk and solvency ratios in market crisis scenarios. The CP shall be based on PMF's current liquidity and capital position of PMF, stress testing output and business plans.

ALCO shall be responsible for drafting and activating the CP. The CEO will have to provide approval for the activation of the same. BIRMC and BOD will approve the CP.

This will address the following administrative policies and procedures:

1. Responsibilities of senior management during a liquidity or capital crisis situation
2. Task force to handle the crisis: Names, addresses and telephone numbers of members of the Crisis Committee Unit (CCU) part of ALCO. CCU shall include the CEO, chief risk officer (CRO), Head of Finance, Heads of relevant business departments.
3. Procedures shall be documented and the chain of command and communication process shall be clearly defined.
4. CP shall be regularly reviewed and updated at least on an annual basis to take into account both internal and external developments.

2. Operational Business Continuity

To get prepared for severe disruptions and eliminate or significantly reduce potential damage from high impact events the company establishes and maintains business continuity management framework commensurate with the nature, size and complexity of companying operations. The framework rests on proper organizational structure, workflow, practices and infrastructure and described in line with the Board approved Business Continuity Management Policy. the business continuity management internal policy .

One of the core element of business continuity management is a planning process starting from identification of critical business areas, assets or operations, main threats and vulnerabilities. They are enough to build scenarios of business disruptions with various inputs, assumptions, key internal and external dependencies, make impact analysis and determine appropriate tolerance levels, e.g. recovery time objectives (RTO) and recovery point objective (RPO).

The company performs annual Business Continuity Planning (BCP) drill.

8. Risk Management Framework Documentation

8.1 Guidelines for Framework Documentation

The IRMF sets out the guidelines and principles for the documentation of RM policies and processes as follows:

1. The risk policy structure of PMF is organized at three levels:
   i. IRMF defines the high-level principles and standards and describes the entire Risk Management Framework
   ii. The RAS 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.

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

3. Risk Polices have to document comprehensively the management of all material risks PMF is facing. In so doing, the RMF has to identify, measure and manage all material risk, as well as all the forms risks may take. For instance, in the case of credit risk policies, it should cover not only direct credit risk but also counterparty risk, indirect risk or guarantor risk and off-balance sheet risk.

4. All Risk Polices have to be reviewed and vetted by BIRMC and approved by the Board. In the case of Liquidity and Market Risk, as well as the RAS 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:

1. Definitions and Background

1.1 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.

2. Governance

2.1 Diagram of all the units/functions involved in the management of that specific risk, including reporting lines.

2.2 Describe for each stakeholder a 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.

2.3 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.

3. RAS and Risk Limits

3.1 Restate the relevant RAS components and the affiliated threshold levels. The documentation of risk specific RAS elements shall be consistent with the RAS Policy.

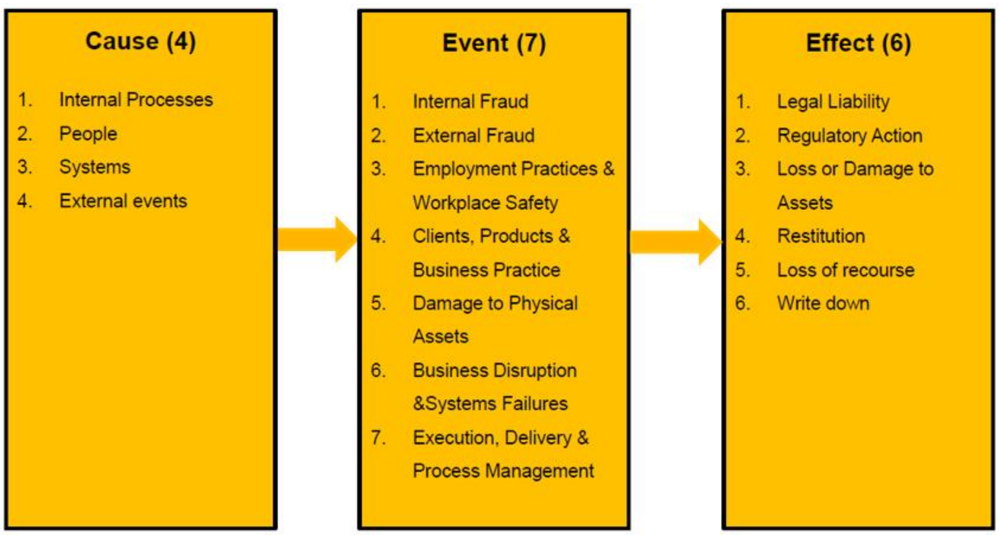
3.2 Define risk specific limits aligned with the RAS indicators. These are 'level 2' limits defined in subordination to the RAS limits and thresholds. These limits have to include as a minimum, regulatory limits and potentially other/internal limits.

3.3 The following limit 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 a Group of connected obligor limits (i.e., single exposure limits) (ii) Industry concentration limits (iii) Related party exposure limits (iv) Maximum NPL ratio limits (per portfolio) (v) Minimum collateral coverage ratios (averages per portfolio) (vi) Minimum provisioning Cover limit
Market Risk	The following limits shall apply indicatively for market risk part of Market Risk Policy: (i) Limits as per the policies, procedures and regulatory concerns (ii) Instrument specific limits (if relevant)

<u>Liquidity Risk</u>	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) Loan to Deposits limits (iv) Deposit concentration limits (v) Minimum survival horizon Limits shall be defined by currency.
<u>Operational Risk</u>	The limits shall apply indicatively for Operational Risk
<u>Emerging Risk (EM)</u>	Identifying new emerging frontier risks that have the potential to affect the business over time. Risk impacts to the above main listed risks types with possible risk events; - Impacts from economic downturn induced by the man-made or natural disasters - Impacts on the health and safety regulations - Impacts from developing trends in the IT security to the PMF

<u>Operational Risk</u>



Cause categories. Operational risk may occur due to the following internal and external causes:

a) Internal causes:

- Processes: imperfections of the internal procedures and organization of company operations
- People: erroneous or intentional breaches of the established policies made by staff
- Systems: failures of systems/technology and equipment within the control of the company

b) External causes:

- People: erroneous or intentional actions of third parties against the company interests
- Systems: failures of systems/technology and equipment resulted from activities outside the company
- External: adverse external circumstances beyond the control of the company

Event categories. Risk events resulted from combination of risk causes are classified into the following:

(1) Internal Fraud: losses due to acts of a type intended to defraud, misappropriate property, or circumvent regulations, the law or company policy, excluding diversity / discrimination events, which involves at least one internal party

(2) External Fraud: losses due to acts of a type intended to defraud, misappropriate property, or circumvent the law by a third party

(3) Employment Practices and Workplace Safety (EPWS): losses arising from acts inconsistent with employment, health or safety laws or agreements, from payment or personal injury claims, or from diversity / discrimination events

(4) Client, Products, and Business Practices (CPBP): losses arising from an unintentional or negligent failure to meet a professional obligation to clients or from the nature or design of a product

(5) Damage to Physical Assets (DPA): losses arisen from natural disasters or human losses from external sources, e.g. terrorism, vandalismompany

(6) Business Disruption and System Failures (BDSF): losses arising from disruption or failures of hardware, software, telecommunications, utility outage or other business / systems/technological disruptions

(7) Execution, Delivery & Process Management (EDPM): losses arising from failed transaction processing or process management, from relations with trade counterparties and vendors

Loss categories. Risk events are supposed to make negative impact on the company performance in the form of direct costs, indirect costs or their combination that can be used for further risk classification in which company uses incident reporting framework (Appnedix 5) to record risk events arising through direct costs while recording all risk events in the Risk register:

a) Direct costs:

- Regulatory fines and penalties
- Legal charges and financial liability
- Voluntary client compensations
- Non-judicial staff payments
- Impairment on assets damage
- Repairs and replacement costs
- Write down of assets
- Pending losses
- Provisions
- Other losses

b) Indirect costs:

- Timing costs
- Investigation costs
- Opportunity costs
- Enhancement costs
- Insurance costs
- Damage to reputation

Specific categories. In addition to the main risk types there are few minor level subtypes that fall into operational risk classification across various categories and draw special attention of the institution:

(1) Legal risk: damage caused by litigation of the Company with third parties, breaches in the legal registration of the company operations, the lack of legal protection of interests of the company, and unforeseen amendments to the legislation

(2) Compliance risk: losses arisen from breach or non-compliance with the requirements of legislation, regulations, regulatory bodies, business practices, internal rules and procedures, ethical business standards, including those established by associations the company is a member

(3) Fraud risk: losses due to deliberate illegal actions of company employees, contractors (clients) and third parties for personal gain and against the company interests

(4) Cyber security risk: losses arising from unauthorized access to information systems of the company, misuse of technology and violation of the confidentiality of restricted information

(5) Business interruption risk: losses arising from internal weaknesses to withstand threats of disruption or failure in companying operations above established recovery tolerance levels

(6) Third-party risk: losses arising from failure to transfer risk due to operational inability of critical counterparties to perform outsourcing services or provide insurance coverage as expected.

4. Risk Identification, Assessment and Measurement

The following Policy documentation standards apply by risk type:

4.1 Credit Risk

The Policy shall detail credit risk identification and measurement for:

a) Individual transactions underwriting, by reiterating in brief the main stages of the lending process (from origination to workout) alongside controls embedded in the lending process (e.g., financial reviews, credit bureau checks, collateral valuation, approval processes etc.). The process description should be consistent with the Credit Manual. The Policy shall reference all the Policies and Manuals to be used by Credit Risk Management when reviewing individual transactions.
b) Portfolio monitoring and review,
    1. Rating development, maintenance and usage standards, by portfolio
    2. Description of rating and scoring methodologies including estimation, back-testing and validation.
    3. Description of the portfolio quality measures used in portfolio reporting and monitoring (e.g., NPL ratios, collateral coverage ratios)

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 IRM Framework.

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 (factoring in future business on both sides of the balance sheet, as budgeted).
d. Definition for all the liquidity risk ratios used for internal/external reporting.
e. 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.
f. Cash management (this is of particular concern having to optimize the cash allocations between branches in order to mitigate operational risks and at the same time provide sufficient liquidity for day-to-day management of the lending activities)

4.3 Market Risk

The methodology for identification and measurement of Market Risk shall be detailed as follows:

a. Stress testing scenarios definition, as well as subsequent calibration methodology
b. Other risk measures used in market risk measurement (exposure values etc.)

4.4 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

9. Branch supervision controls

Risk department would perform branch level risk assessments on the internal control aspects in order to identify the top risk events and required internal controls and recommendations to the Risk owners to mitigate branch level risks.

10. Maintenance of Minutes/records

The secretary to the committee arranges the meetings periodically in line with the CBSL rules and guidelines and its subsequent changes in the form of minutes, voice or video recordings and maintenance of such records and other secretarial functions under the supervision of the chairman of the committee.

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, risk reporting structure and contents, stress testing rules and processes ii. Set out PMF's business and risk/capital strategy once a year and oversee implementation of business and financial targets. 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 PMF on the importance of the risk management function. v. Ensure that all material risks are covered by PMF'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 adopting regional best practices vii. Ensure that the PMF's Risk Management Framework is subjected to effective independent review by internal audit
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, risk limits, appropriateness of risk reporting etc. ii. Review risk profile at least quarterly through ongoing risk reports including also Stress Testing results circulated periodically in line with the CBSL rules and guidelines. iii. Review of risk management performance, including CRO effectiveness iv. Permanently communicate with BIRMC on RMF implementation/compliance issues, risk profile monitoring, etc. v. Review compliance of PMF with respect to RMF provisions

BOARD AUDIT COMMITTEE	i. Approving policy on 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
ALCO	i. 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. ii. Product Pricing and FTP, including methodology and revision of actual FTP rates iii. Business Planning: 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 iv. Assess impact of macro environment on the performance of PMF and impact on its assets/liability portfolios and implement necessary tactical or strategic change v. Approval of new products with reference to the ALM Policy and ALM risks vi. 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.
CREDIT COMMITTEES	i. Approve specific transactions within its approval authority ii. Suggest Credit Policy amendments to Credit Dept. iii. Ensure loans originated by PMF are within the approved lending rules, including Credit Policies and Credit Risk Management. iv. Monitor credit quality of lending portfolio, including delinquency status and execute remedial action for non-performing transactions v. Coordinate with Recovery and Collection functions as part of the workout efforts
RISK MANAGEMENT DIVISION (RMD)	The roles and responsibilities of the RMD are laid out on two levels: h) 'core' roles and responsibilities valid across various risk categories and i) 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. Develop adequate data and systems to support all required risk analytics iv. Monitor on a constant basis adherence to various limit structures and risk thresholds v. Conduct risk review on new products regarding their operational and financial implications for PMF and alignment to risk management framework vi. Regularly (at least monthly) report to the BIRMC the risk profile of PMF, compliance with various limits/RAS, as well as strategic initiatives taken by the RMD. vii. Run stress testing across all material risks, communicate results and suggest mitigation action through regular reporting to BIRMC.
INTEGRATED RISK MANAGEMENT (IRM)	i. Review of all risk related policies before approval to check compliance with the principles set out in the 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 process development as the RMD representative in the process. vi. Ensure reporting covers all material risks to allow BIRMC, the CRO and any other relevant stakeholder to monitor the risk profile of PMF against RAS and other limits. vi. IRM to consolidate all risk specific reports and present the entire reporting package to the recipient on behalf of the CRO.

CREDIT RISK MANAGEMENT	i. Reviews 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 the 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 to 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, 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 on the developed tools and methodologies
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 ALCO at least monthly, and to the BIRMC at least quarterly to allow accurate and timely review of risks. iv. Coordinate with IRMD on new implementation

OPERATIONAL RISK	i. Establish Operational Risk and any supporting procedures ii. Establish the methodology to conduct RCSA and prepare all necessary templates, scoring sheets, questionnaires and accessories for the same iii. Collect and maintain an operational loss events database ensuring timely, comprehensive and accurate capturing of Op. Loss Incidents. iv. 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. v. 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 vi. 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 and BIRMC. vii. Review new processes and products for embedded operational risks and provide recommendations to the BIRMC before approval. viii. Coordinate with IRMD on related operational risk measures to be used in RAS and by Finance for capital and liquidity projections
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, 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

Stress testing on Capital Adequacy

Based on month ended 20xx (Unaudited Financials) LKR Mn

Position of Core Capital

		Actual	scenario I	scenario II	scenario III	To meet-up Regulatory Minimum
Stressed scenarios			25.00%	50.00%	75.00%	
Estimated impact on the impairment from the NPL	10 : 4					
Credit Risk - Impact of borrower defaults **Impact from borrower defaults in possible risk age 3+** Total Outstanding value						
Strategic risk - Non-meet up of the target bottom line (profit) Forecasted bottom line loss (Cumulative loss till xx.ss. 20xx: Rs.131.40Mn, Avg. loss Rs.13Mn/Month)						
Reputational risk - Major litigation events Demanded value as per the cases filed by the Ex-employees						
Total impact						
Stated Capital Statutory Reserve Fund Retained Profit						
Core Capital Adjusted						
Risk Weighted assets as per the CBSL reporting						
Capital Adequacy Ratio (CAR)						

Assumptions

- No change in the Risk weighted assets
- No portfolio growth due to the impact
- Income and expenses are constant
- The company assumes a worst case scenario of an increase of NPL by 75% for the entire portfolio.

Appendix 3

Market Value of the Gold loan portfolio						Loss of 1K			Loss of 2K		
Branch	Portfolio value (Gross)	Market Value	Margin of safety (cushion)	LTV (Based on Market Value as month-end	IR %	Market Value	Margin of safety (cushion)	LTV (Based on Market Value as month-end	Market Value	Margin of safety (cushion)	LTV (Based on Market Value as month-end
Total											

Market Value of the Gold loan portfolio						Drop of market prices by 5%			Drop of market prices by 10%			Drop of market prices by 20%		
Branch	Portfolio value (Gross)	Market Value	Margin of safety (cushion)	LTV (Based on Market Value as month-end	IR %	Market Value	Margin of safety (cushion)	LTV (Based on Market Value as month-end	Market Value	Margin of safety (cushion)	LTV (Based on Market Value as month-end	Market Value	Margin of safety (cushion)	LTV (Based on Market Value as month-end
Total														

Market Value of the Gold loan portfolio						Loss of 1K				Drop of market prices by 5%		
Branch	Portfolio value (Gross)	Market Value	Margin of safety (cushion)	LTV (Based on Market Value as month-end	IR %	Market Value	Margin of safety (cushion)	Insurance adequacy against the MV	LTV (Based on Market Value as month-end	Market Value	Margin of safety (cushion)	LTV (Based on Market Value as month-end
Total												

Appendix 4

Company stock	Price index	Gross position	Net position (Normal)	Net position (Low)	Net position (Medium)	Net position (High)
BIL N0000	ASPI					
CCS N0000	ASPI					
HAYL N0000	ASPI					
LOLC N0000	ASPI					
RCL N0000	ASPI					
EXPO N0000	ASPI					
LIOC N0000	ASPI					
ACL N0000	ASPI					
Gross equity position						
Movement in price						

Stress test scenario	Rate shock
Low	-10%
Medium	-25%
High	-50%

Cut-loss Limits

Element	Description / Limit	
Portfolio value (total holding)	Board approved value (Gross value: Weighted Avg. buying price [FIFO method] *the no. of shares holding)	
Total holding	Purchase Price + Brokerage - Dividend Received	
Sector exposure	Cap	Maximum - LKR 4Mn
Security exposure	Cap	Maximum - LKR 2Mn
	Stock holding value	Purchase Price + Brokerage - Dividend Received
	Number of securities	Minimum 5 – Maximum 20
Take-profit	40% rise in the value of security over the particular stock Decided on a case-by-case basis	
Cut-loss – individual security	20% fall in the value of security.	
Cut-loss – Portfolio	A special notice will be given to the ALCO in a fall in the value of the portfolio of LKR 5 Mn (Realised + Mark to market) for the financial year.	
	Value of security/ portfolio	Purchase Price + Brokerage+ Funding Cost - Dividend Received
Holding period	Security	Out-of-the-money = consecutive 180 days

Appendix 5

Contractual Maturity of Assets & Liabilities (Liquidity Risk) – Month-ended 20xx LKR - "000"

Assets or Liability (a)	As at 30th Nov 2022	Less than 7 Days	7-30 Days	1-3 Months	3-6 Months	6-12 Months	1-3 Years	3-5 Years
Total Assets								
Cash								
Due from Banks								
Investments-Current								
Loans & Advances - Current								
Loans & Advances - NP								
Fixed Assets								
Other Assets								
Total Liabilities								
Total Capital Fund								
Deposits								
Borrowings								
Other Liabilities								
Maturity Gap								
Cumulative Gap								

Behavioral Maturity of Assets & Liabilities (Liquidity Risk) – Month-ended 20xx LKR - "000"

Assets or Liability (a)	As at 30th Nov 2022	Less than 7 Days	7-30 Days	1-3 Months	3-6 Months	6-12 Months	1-3 Years	3-5 Years
Total Assets								
Cash								
Due from Banks								
Investments-Current								
Loans & Advances - Current								
Loans & Advances - NP								
Fixed Assets								
Other Assets								
Total Liabilities								
Total Capital Fund								
Deposits								
Borrowings								
Other Liabilities								
Maturity Gap								
Cumulative Gap								

Risk on Net Interest Margin (NII) %

Assets or Liability (a)	As at 30th Nov 2022	1-3 Months	3-6 Months	6-12 Months	1-3 Years	3-5 Years
Assets						
Lease Loan						
Gold Loan						
Margin Trading						
Liabilities						
Deposit						
Borrowings						
Preference Share						
Saving						
Net Interest Margin (NII)						

Appendix 6

Confidential

PMF FINANCE PLC
Incident Report

To :
Through : **Risk Dpt**
From :
:
Subject :
Date :

Client profile/Transaction particulars:

Incident Report –

Any non-compliance/non-Adherence;

Other considerations (if any);

Control Weakness Identified & Remedial Actions

Impact / Implications

Responsibility

Business Unit Head/Branch Manager **Responsible Officer**

Notes (if any):