

# THE RISK MANAGEMENT APPROACH

## ENTERPRISE RISK MANAGEMENT FUNCTION



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## ABBREVIATIONS

The following abbreviations are used throughout the document.

BOU .....	Bank of Uganda
ERM .....	Enterprise Risk Management
EXCOM .....	Executive Committee
RMC .....	Risk Management Committee
BAC .....	Board Audit Committee
ICT .....	Information and Communication Technology
KPIs .....	Key performance Indicators
KRI .....	Key Risk Indicator
RCSA .....	Risk and Control Self-Assessment
UGX .....	Shillings

## 1. INTRODUCTION

NCBA Bank Uganda Ltd (NCBA or the Bank) manages business activities within risk management guidelines including those provided by regulators (the Central Bank and other relevant Authorities in the financial services sector like Capital Markets Authority, Insurance Regulatory Authority, Financial Intelligence Authority) and international best practices focusing on the Bank's ability to manage the risks inherent in financial services business.

The Bank operates on the understanding that risks will have to be taken and effectively managed in the normal course of business as opportunities are explored with the objective of maximizing earnings potential, thus increasing the likelihood of success in meeting business objectives. Resources at a cost that is proportionate to the business risks undertaken are deployed to identify, measure and proactively manage threats and uncertainties that may come with all such risks with a view to protect against unforeseen losses, ensure earnings stability, reduce the possibility of failure and prevent the Bank from suffering unacceptable loss.

## 2. THE NCBA APPROACH TO RISK MANAGEMENT

NCBA uses an enterprise-wide risk management (ERM) approach for the management of risks. ERM provides uniform processes to identify, assess, manage, mitigate, and report on key risks. It supports the Board corporate governance needs, enables informed decision-making, and identifies areas for value optimization.

The ERM Program is governed by the Enterprise Risk Management Framework which;

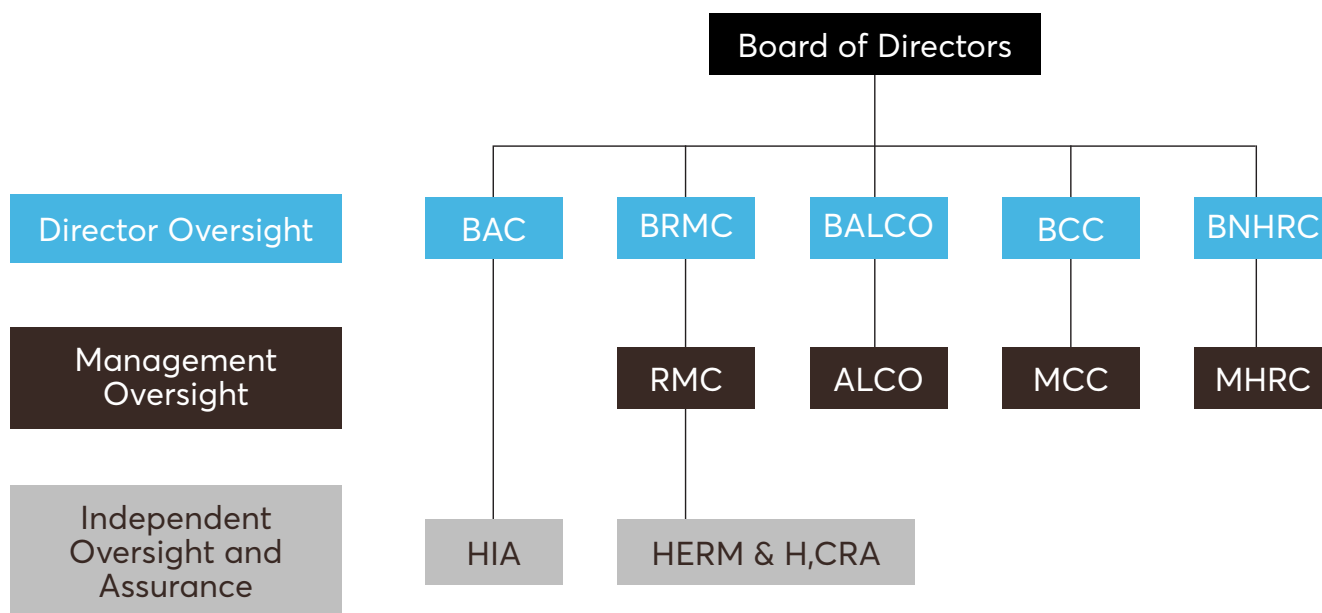
- Is geared at optimizing the Bank's risk management capability through a structured development of an effective risk management infrastructure that is aligned to the Bank's business strategy, acceptable risk appetite and consists of the following elements: Business Risk Management Policies, Business Risk Processes, People and Organization, Risk Management Reports, Risk Management Methodologies, Risk Management Systems and Data.
- Outlines the approach to the management of risk and provides the basis for setting frameworks and policies, and establishing appropriate risk practices throughout the Bank.
- Defines the risk management process and sets out the activities, tools, techniques and the operating model to ensure material risks can be identified and managed.
- Ensures appropriate responses are in place to protect the bank and its stakeholders.
- Sets out principal risks and assigns clear ownership and accountability for these risks.
- Risk management is carried out under policies approved by the Board of Directors.
- The Board approved a risk appetite to guide all risk tolerances as well as written policies covering principal risks such as Strategic, Credit, Operational, ICT, Compliance, foreign exchange, interest rate, liquidity, Environmental and Social Governance (ESG) and Anti Money Laundering Risks.
- The internal audit function independently audits the adequacy and effectiveness of the Bank's risk management, control and governance processes.
- The Head of internal audit reports and provides independent assurance to the Board Audit Committee and has unrestricted access to the Chairman of the Board Audit Committee.

The Bank further employs "three lines of defence governance model" in its risk management framework to implement and control decisions on strategy, risk and capital that are taken by the Board.

- First Line of Defence:** Own and manage the risks. They are responsible for implementing corrective actions to address process and control deficiencies; maintaining effective internal controls and execute risk and control procedures on a day-to-day basis. They also identify, assess, control and mitigate risks to ensure the achievement of set goals and objectives.

- b. **Second Line of Defence:** Includes the risk management function that facilitates and monitors the implementation of effective risk management practices and the compliance function that monitors Compliance Risk. Other key functions include independent identification and monitoring of risks including monitoring the integrity of risk identification process by various risk owners, establishment and enforcing the implementation of an overall Bank Risk Management Framework, ensuring that risk policies, policy standards, practices and policy guidelines are documented, communicated to staff, appropriately followed and regularly (at least once a year) updated, monitoring and analyzing risk trends including risk-awareness culture, building a risk awareness culture within the Bank including appropriate education and training to staff and specifically the functional risk champions, implementation of a comprehensive stress testing program, independent reporting to the Board Risk Management Committee (BRMC) on the management of Risk within the Bank.
- c. **Third Line of Defence:** Provides objective assurance on the effectiveness of governance, risk management and internal controls. Managed by the internal Audit function to ensure identification and prioritization of risks, bring to the attention of management any shared risks not owned by process owners, independently assess regulatory and internal policies compliance and make recommendations for improvement.

#### 4. THE RISK GOVERNANCE STRUCTURE AND BOARD MANDATE



**Board oversight:** BAC – Board Audit Committee, BRMC – Board Risk Management Committee, BALCO – Board Asset & Liability Management Committee, BCC – Board Credit Committee, BNHRC – Board Nominations and Human Resources Committee.

**Management oversight:** RMC – Risk Management Committee, MCC- Management Credit Committee, ALCO – Asset & Liability Management Committee; and MHRC - Management Human Resources Committee .

**Independent oversight and Assurance:** HIA – Head, Internal Audit, H,ERM – Head, Enterprise Risk Management and H,CRA –Head Compliance and Regulatory Affairs

## Board of Directors (BOD)

In accordance with the NCBA Board Charter and Terms of Reference, the Board has all the necessary oversight powers for effectively directing and supervising the management of the business and affairs of the Bank. The Board is ultimately responsible for oversight and approval of Bank Corporate Governance, Strategy, Compensation planning, Corporate values, Risk Management framework and Senior Management structure. An independent director shall chair the Board.

	Board Risk Management Committee	Board Assets And Liabilities Management Committee	Board Credit Committee	Board Nominations and Human Resource Committee	Board Audit Committee
<b>M A N D A T E</b>	The role of the Board Risk Management Committee is to assist the Board in its independent oversight responsibilities for risk management and compliance practices in the Bank.	<p>The BALCO is responsible for establishing broad guidelines on the Bank's tolerance for risk and expectations from investment.</p> <p>Shall assist the Board on Strategic and key business execution policy matters of the Bank with a core focus on the enhancement of Shareholder value through guiding Management on the continuous growth of the business units.</p>	BCC is responsible for formulating and implementing a Credit Strategy and Policy/ (ies) clearly setting out the acceptable risk appetite and tolerance limits that the Bank is willing to take on; and the level of profitability that the Bank expects to achieve for incurring the various credit risks.	The BNHRC shall provide oversight on the appointment, remuneration and separation from the bank of senior management and other key personnel and ensure consistency with the Bank's culture, objectives, strategy and control environment	Independent oversight on financial reporting and internal controls in the Bank. Oversees and appraises the quality of Bank's internal controls including the scope and frequency of audits conducted by the internal Auditors and their recommendations, confirming appropriate action taken by management. Oversees the financial reporting process and ensures external auditors are appointed by Shareholders.
<b>C O M P O S I T I O N</b>	Chaired by an Independent Non-Executive Director and, including the Chairperson, consists of two Non-executive directors.	Chaired by an Independent non-executive director and, including the chairperson, consists of two non-executive directors.	Chaired by an independent non-executive director and, including the chairperson, consists of two non-executive directors.	Chaired by an independent non-executive director and, including the chairperson, consists of two non-executive directors.	Chaired by an Independent Non-Executive Director and consist of Non-Executive Directors.

## 5. THE RISK APPETITE

NCBA enforces its risk culture through several governance documents including the code of conduct and the Risk appetite. Risk appetite is the aggregate level and type of risk the Bank is willing to accept given its risk capacity. The Board approved risk appetite is established, communicated and monitored within the Bank through policies, policy guidelines, limits/tolerances, procedures and systems.

The Board reviews and approves the risk appetite of the Bank and ensure the framework is embedded in the Bank by holding senior management accountable for its effectiveness.

On a quarterly basis, the Board of Directors through the Board Risk Management Committee (BRMC) reviews the aggregated residual risk profile of the Bank and assesses this against the approved target quantitative and qualitative risk metrics defined in the risk appetite and receives updates from Senior Management on the status of corrective actions.

During the annual review of the risk appetite, BRMC and Management consider the following key elements: Bank's risk capacity, Business plan and strategy, Regulatory requirements, Shareholder expectations and Significant developments in the industry in all the markets the Bank operates.

## 6. RISK REPORTING STRUCTURE

The Enterprise Risk Management (ERM) function reports directly to the Board of Directors through the Board Risk Management Committee (BRMC) to ensure independence.

The Bank Senior Management also receives regular briefing on the Bank's risk profile directly from the ERM function.

The ERM function oversees all activities related to risk management within the Bank.

## 7. STRESS TESTING

Stress testing is defined as the various techniques used by financial Institutions to gauge their potential vulnerability to exceptional but plausible events. It involves defining potential extreme adverse future economic scenarios and the wider environment within which the tests are developed, evaluated and used within the decision-making process.

The bank's stress testing process involves measuring the sensitivity of it's credit risk portfolios, operational risk exposures, market risk exposures and liquidity to changes in economic variables under extreme scenarios.

Stress testing is performed on a regular basis in order to assess the impact of a severe economic downturn on the Bank's risk profile and financial position. Stress testing complements traditional risk measures and represents an integral part of the Bank's strategic and capital planning process.

Our stress testing encompasses relevant scenarios covering global and local conditions including macroeconomic, industry, reverse scenarios, and management judgement based on analysis such as single name, sector, deposit, book downgrades and product concentrations.

The Bank uses two types of stress testing methodologies including Sensitivity Analysis and Scenario Analysis.

## 8. RISK TREATMENT STRATEGIES

Risk treatment is the way in which the Bank aligns identified risks to the objectives and strategies of the organization. Aligning the Bank's risk strategy to business strategy requires maintaining relevant and timely information on the Risk Portfolio. The bank applies the following risk management strategies in Risk Treatment.

An action to respond to a Residual Risk by affecting risks and/or risk responses in one of the following ways:

### **Risk Reduction**

- Control risk through internal processes with deliberate actions that reduce the likelihood to undesirable events.
- Test strategies, products, or services on a limited basis and evaluate results.
- Respond to contingencies by documenting effective plans and empowering appropriate personnel to make decisions.
- Improve capabilities to manage a desired exposure.
- Relocate operations in order to transfer risk from one location.
- Diversify financial, physical, customer, employee/supplier and asset holdings used by the bank's business model.

### **Risk Transfer**

- Insure through a financially capable party.
- Reinsure with other insurers to reduce portfolio exposures.
- Hedge risk by making feasible changes in operations.
- Outsource processes.

### **Risk Acceptance**

- Retain risk at its present level while working around the clock to find a better mitigation for the risk.
- Reprice products and services by including an explicit premium in the pricing to compensate for the risk undertaken.
- Accepted risks are monitored and reviewed within 180 days under the risk acceptance program.

### **Risk Avoidance**

- Prohibit high-risk activities, business models, transactions, financial losses and asset exposures through appropriate bank policies, limit structures and standards.
- Stop specific activities by redefining objectives, refocusing strategies and policies, and redirecting those resources to better yielding activities.

### **Continuous monitoring**

- Establish a robust monitoring system to track changes in the risk landscape.
- Regularly review and updated risk assessments to reflect changes in the business environment.





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**Go for it**