# TABLE OF CONTENTS

## I. INTRODUCTION
- A. POLICY
- B. OBJECTIVES OF THE MANUAL
- C. SCOPE AND LIMITATION OF THE MANUAL
- D. TARGET USERS OF THE MANUAL
- E. REVISION AND REVIEW OF THE MANUAL
- F. FORMAT/LAY-OUT OF THE MANUAL
- G. ADMINISTRATION, DISTRIBUTION AND MAINTENANCE
- H. REVISION HISTORY

## II. RISK MANAGEMENT CHARTERS
- A. RISK MANAGEMENT COMMITTEE CHARTER
  - 1. ROLE AND AUTHORITY
  - 2. COMPOSITION
  - 3. MEETINGS AND PROCEDURES
  - 4. DUTIES AND RESPONSIBILITIES
    - 4.1. Core Duties and Responsibilities
    - 4.2. Specific Duties and Responsibilities
  - 5. INDEPENDENCE
  - 6. REVIEW OF THE CHARTER
  - 7. EFFECTIVITY
- B. RISK MANAGEMENT UNIT CHARTER
  - 1. DUTIES AND RESPONSIBILITIES
    - 1.1. Core Duties and Responsibilities
    - 1.2. Specific Duties and Responsibilities
  - 2. OPERATIONS
  - 3. REVIEW OF THE CHARTER

## III. RISK MANAGEMENT FRAMEWORK
- A. RISK MANAGEMENT POLICY STATEMENT
- B. GENERAL RISK MANAGEMENT FUNCTIONS
- C. RISK MANAGEMENT CONCEPTUAL FRAMEWORK
- D. RISK MANAGEMENT IMPLEMENTATION
- E. LEVELS OF RISK MANAGEMENT
- F. RISK MANAGEMENT APPROACHES

## IV. RISK MANAGEMENT STRUCTURE
- A. RISK MANAGEMENT STRUCTURE AND RESPONSIBILITIES
  - 1. Risk Management Organizational Structure
  - 2. Risk Management Roles and Responsibilities

## V. ENTERPRISE RISK MANAGEMENT PROGRAM
- A. BACKGROUND/RATIONALE
- B. OBJECTIVES
- C. THE ENTERPRISE RISK MANAGEMENT APPROACH
  - 1. Conduct of Risk Awareness Sessions
  - 2. Risk Appetite Setting
  - 3. RM Process
  - 3.1. Risk Identification
  - 3.2. Risk Measurement
  - 3.3. Risk Control
VI. RISK MANAGEMENT FOUNDATION ......................................................................................... 27

A. CORPORATE VISION AND MISSION ................................................................................. 27
   1. Vision ........................................................................................................................... 27
   2. Mission ....................................................................................................................... 27
B. GUIDING PRINCIPLES AND BUSINESS OBJECTIVES .................................................. 27
C. ORGANIZATIONAL STRUCTURE ...................................................................................... 28
D. RISK MANAGEMENT STRATEGY .................................................................................... 28
E. RISK APPETITE AND TOLERANCE .................................................................................. 28
F. RISK DICTIONARY ........................................................................................................... 29
   1. CREDIT RISKS ........................................................................................................... 29
   2. COMPLIANCE RISKS ................................................................................................. 29
   3. LIQUIDITY RISKS ...................................................................................................... 31
   4. INTEREST RATE RISK ............................................................................................... 31
   5. OPERATIONS RISKS .................................................................................................. 32
   6. REPUTATION RISKS ................................................................................................... 34
   7. STRATEGIC RISKS ..................................................................................................... 35

VII. RISK MANAGEMENT PROCESS ....................................................................................... 37

A. CREDIT RISK MANAGEMENT .......................................................................................... 37
   1. Credit Risk Management Framework ........................................................................... 37
   2. Basic Credit Risk Management Principles .................................................................. 38
   3. Credit Risks Exposures ............................................................................................... 39
   3.1. Market Identification ............................................................................................... 39
   3.2. Credit Initiation ........................................................................................................ 39
   3.3. Documentation and Disbursement .......................................................................... 40
   3.4. Portfolio Management .............................................................................................. 40
   4. Measuring and Managing Credit Risk ........................................................................ 40
      4.1. “Know Your Customers” Procedures .................................................................. 40
      4.2. Credit Approval Process ....................................................................................... 41
      4.3. Credit Assessment Methodology ......................................................................... 44
      4.4. Credit Pricing ......................................................................................................... 51
      4.5. Credit Enhancement ............................................................................................. 51
      4.6. Collection ............................................................................................................... 52
      4.7. Credit Classification and Provisioning ................................................................... 53
      4.8. Loan Impairment Testing ...................................................................................... 54
      4.9. Credit Limit and Concentration .......................................................................... 55
      4.10. Legal Review ......................................................................................................... 57
      4.11. Internal Audit ........................................................................................................ 57
      4.12. Documentation and Credit File Maintenance ...................................................... 58
      5. Credit Risk Monitoring and Reporting ....................................................................... 58
B. MARKET RISK AND LIQUIDITY RISK MANAGEMENT ..................................................... 61
   1. Market and Liquidity Risks Exposure .......................................................................... 61
   2. Measuring and Managing Market and Liquidity Risks ............................................... 63
      2.1. Market and Liquidity Risks Limits ......................................................................... 63
      2.2. Market and Liquidity Risk Analysis ....................................................................... 63
      2.3. Funding and Liquidity Plan ..................................................................................... 65
      2.4. Contingency Funding Plan ..................................................................................... 65
      2.5. Diversification of Liquidity Providers ..................................................................... 65
      2.6. Market and Liquidity Risks Controls and Audit ...................................................... 65
   3. Market and Liquidity Risks Monitoring and Reporting ............................................... 66
C. OPERATIONAL RISK MANAGEMENT .............................................................................. 67
   1. Operational Risk Management Framework ................................................................... 67
   2. Basic Operational Risk Management Principles ......................................................... 68
3. Operational Risk Sources ........................................................................................................... 68
  3.1. Process ................................................................................................................................. 68
  3.2. People .................................................................................................................................. 69
  3.3. Systems ............................................................................................................................... 69
  3.4. External Events ..................................................................................................................... 69
4. Classification of Operational Risks ......................................................................................... 69
   4.1. Internal Fraud ....................................................................................................................... 69
   4.2. External Fraud ..................................................................................................................... 70
   4.3. Employment Practices and Workplace Safety ................................................................. 70
   4.4. Clients, Products and Business Practices ......................................................................... 70
   4.5. Damage to Physical Assets ............................................................................................... 70
   4.6. Business Disruption and System Failures ........................................................................ 70
   4.7. Execution, Delivery and Process Management ............................................................... 70
5. Measuring and Managing Operational Risk ............................................................................ 70
   5.1. Operational Risk Identification and Assessment Tools ..................................................... 70
   5.2. Testing and Verification of Internal Operational Risk Controls ........................................ 71
   5.3. Operational Risk Management Audit ................................................................................ 72
   5.4. Institutionalization of Risk Management Culture ............................................................. 72
   5.5. Business Continuity Management .................................................................................... 72
   5.6. Adoption of Instruments for Risk Sharing ....................................................................... 72
6. Specific Measures of Operational Risk Management ................................................................ 73
   7. People Risk Management ...................................................................................................... 74
    7.1. Classification of People Risk .............................................................................................. 74
8. Technology/Information Technology (IT) Risk Management .................................................... 76
   8.1. Technology/IT Risk Elements ............................................................................................ 76
   8.2. Technology/IT Risk Management Process ....................................................................... 76
   8.3. IT Risk Identification ......................................................................................................... 77
   8.4. IT Risk Control .................................................................................................................. 79
   8.5. IT Risk Action Plan ............................................................................................................. 79
9. Operational Risk Monitoring and Reporting .......................................................................... 79
D. LEGAL RISK MANAGEMENT .................................................................................................. 80
   1. Legal Risk Management Framework ..................................................................................... 80
   2. Legal Risk Exposures ............................................................................................................ 80
    2.1. Defective Contracts .......................................................................................................... 81
    2.2. Lawsuits ............................................................................................................................ 81
    2.3. Adverse Judgments ........................................................................................................... 81
3. Measuring and Managing Legal Risks .................................................................................... 81
   3.1. Legal Review ....................................................................................................................... 81
   3.2. Standardization of Legal Documents ................................................................................ 82
   3.3. Legal Consultations ........................................................................................................... 82
   3.4. Other Legal Risk Control .................................................................................................. 82
4. Specific Measures of Legal Risk Management .......................................................................... 82
   5. Legal Risk Monitoring and Reporting .................................................................................. 83
E. COMPLIANCE RISK MANAGEMENT ....................................................................................... 84

ANNEXES

Annex “A” – BSP Circular No. 510 Series of 2006
Annex “C” – BSP Circular No. 494 Series of 2005
Annex “D” – Standard Evaluation Requirements
Annex “E” – Steps on the Accomplishment of Risk Control Self-Assessment (RCSA) Matrix
Annex “F” – Operational Risk Event Categories
Annex “G” – List of Risk Management Reports
I. **INTRODUCTION**

A. **POLICY**

The Risk Management Manual sets out LBP Leasing Corporation’s (LBP Lease or the Corporation) risk management policies and guidelines. It aims to provide a common and systematic approach for managing risks of the Corporation.

B. **OBJECTIVES OF THE MANUAL**

The Risk Management Manual shall also address the following specific objectives:

- To facilitate the achievement of the LBP Lease’s strategic and operational goals through reduction of threats and maximization of opportunities that would otherwise create barriers;
- To attain a meaningful diversification of exposure across many industry sectors, borrowers, products, collateral;
- To achieve acceptable quality of major risk assets while balancing with objective of sustaining growth in shareholder value;
- To establish a proactive risk-based culture by disseminating relevant management philosophy and best practices on risk management by providing guidance to risk taking units; and
- To identify major business risks in order to measure and monitor degree of risks and possible losses in the future.

C. **SCOPE AND LIMITATION OF THE MANUAL**

The Risk Management activities of LBP Lease are built on the existing policies and standards, organization as well as on the human resources of the Corporation. It is important to recognize that Risk Management is an activity critical to LBP Lease’s success and that responsibility for managing the risks is spread across all business units and functions. The policies and procedures contained in this Manual are intended to ensure that the Corporation applies prudence and accountability in its risk-taking activities while retaining competitive flexibility.

D. **TARGET USERS OF THE MANUAL**

The content of this manual is provided to satisfy the needs of these users this may include the following among others:

1. **Board of Directors/Management**
2. **Risk Management Unit/Risk Management Committee** – To aid as a basis for reviewing, verifying and monitoring adherence to risk management policies and procedures thus enabling them to exercise their oversight functions effectively;
3. **Authorized Risk Takers** – To serve as a guide for their day-to-day risk taking activities;
4. **Regulatory/Supervisory Bodies** – To provide information pertaining to LBP Lease operations for the efficient discharge of their regulatory functions.
E. REVISION AND REVIEW OF THE MANUAL

The Risk Management Manual of the Corporation shall be reviewed and updated at least once a year or as often as may be necessary by the Risk Management Unit (RMU) to incorporate changes in procedures, forms or policies. The revised manual shall be presented to the Risk Management Committee and Board of Directors for approval.

F. FORMAT/LAY-OUT OF THE MANUAL

The contents of this Manual shall be printed in a form with the following information:

- Title of the Manual
- Initial Issue Date
- Revision No. – represents the number revision from the initial issuance.
- Revision Date – indicates the most recent date the policy/procedure was revised.
- Page No. – represents the sequential page number of the sheet as part of the Manual.

G. ADMINISTRATION, DISTRIBUTION AND MAINTENANCE

The Risk Management Unit shall maintain the master copy of the Risk Management Manual which shall serve as a complete reference for all risk management policies and procedures. The Risk Management Unit shall also ascertain that adequate copies of the Risk Management Manual are printed, including additions, amendments, revisions or updates thereon, which shall be distributed to the concerned units/departments.

H. REVISION HISTORY

<table>
<thead>
<tr>
<th>Initial Issue/Revision Date</th>
<th>Date Approved</th>
<th>Previous Version</th>
<th>Revised Chapters</th>
</tr>
</thead>
<tbody>
<tr>
<td>October 2009</td>
<td>(BOD Res. No. 09-158)</td>
<td>n/a</td>
<td>Initial Issuance</td>
</tr>
</tbody>
</table>
II. RISK MANAGEMENT CHARTERS

A. RISK MANAGEMENT COMMITTEE CHARTER

1. ROLE AND AUTHORITY

The Risk Management Committee (RiskCom or the Committee) is appointed by the Board of Directors (BOD) to assist in the fulfillment of the BOD’s risk management responsibilities as defined by applicable laws and regulations.

The Committee shall monitor the risk environment for LBP Leasing Corporation (LBP Lease or the Corporation) and provide direction for the activities to mitigate to an acceptable level the risks that may adversely affect the Corporation’s ability to achieve its goals.

The Committee’s responsibility is one of oversight and review. Risk management undertaking of the organization remains to be the responsibility of the LBP Lease’s Management. The RiskCom shall have direct access to, and receive regular reports from the Management. It shall have the power to conduct or authorize inquiry into any matter within the scope of the Committee’s responsibilities.

2. COMPOSITION

The BOD shall appoint RiskCom members composed of at least three (3) members of the Board of Directors who shall possess a range of expertise as well as adequate knowledge of LBP Lease’s risk exposure to be able to develop appropriate strategies to prevent losses and minimize the impact of losses when such occur. The Board shall designate one of the RiskCom members as the Chairperson of the Committee. The members of the Committee shall serve until such member’s successor is duly elected.

3. MEETINGS AND PROCEDURES

The RiskCom shall hold regular meetings at least quarterly, or as often as it considers necessary and appropriate. The RiskCom Chairman or the majority of its members may call a special meeting when deemed necessary. A majority of the members will constitute a quorum.

A notice of each meeting confirming the date, time and venue must be forwarded to each member of RiskCom before the scheduled date of the meeting. The agenda of each meeting will be circulated, whenever reasonably practicable, to each member prior to the meeting.
The Risk Management Officer shall serve as the Secretariat of the Committee and shall keep written minutes of its meetings. Minutes of the proceedings shall be signed by the Secretariat and the members of the Committee and made available prior to the next meeting and approved therein.

The Committee may request any director, officer or employee of LBP Lease or other persons whose advice and counsel are sought by the latter to attend any meeting in order to provide information as it deems necessary.

The Committee shall report to the Board of Directors matters discussed at each meeting along with the actions taken during said meeting.

4. DUTIES AND RESPONSIBILITIES

4.1. Core Duties and Responsibilities

The RiskCom shall perform the following core duties and responsibilities:

a. Perform oversight risk management functions including crisis management, in the areas of mitigating/managing credit, market, liquidity, operational, reputational, legal and other risks. It shall include receiving and reviewing from Senior Management periodic information on risk exposures and risk management activities.

b. Develop the Risk Management Policies of the Corporation, ensure compliance with the same, and ensure that the risk management process and compliance are embedded throughout the organization.

c. Provide quarterly reporting to, and updating the Board on key risk management issues.

4.2. Specific Duties and Responsibilities

The RiskCom shall perform the following specific duties and responsibilities:

a. Review the Corporation’s risk register to understand the current risk environment including emerging risks, the interrelationship between risks and in the context of the Corporation’s risk appetite.

b. Review or discuss, as and when appropriate, with Management, the Corporation’s risk management and risk assessment guidelines and policies on business risks including but not limited to risks related to credit, market, liquidity and operations.
c. Review the major risk exposures of the Corporation against established risk measurement methodologies and the steps Management has taken to monitor and control such exposures.

d. Receive reports regarding the results of risk management reviews and assessments.

e. Supervise the Corporation’s process and policies for determining risk tolerance and review management’s measurement and comparison of overall risk tolerance to established level.

f. Oversee management functions and approve proposals regarding LBP Lease’s policies, procedures, and practices relative to management of business risks ensuring that:
   i. limits are observed
   ii. system of limits remain effective; and
   iii. immediate corrective actions are taken whenever limits are breached or whenever necessary

g. Ensure compliance with written policies and procedures related to the management of risks in LBP Lease which shall include:
   i. comprehensive risk management approach;
   ii. detailed structure of limits, guidelines and other parameters used to govern risk-taking units;
   iii. clear delineation of lines of responsibilities for managing risk;
   iv. adequate system for measuring risk; and
   v. effective internal controls and comprehensive risk reporting process

h. Review other major risk exposures as deemed appropriate.

i. Review and assess the likelihood and magnitude of the impact of material events on the Corporation and/or recommend measures, responses or solution to avoid or reduce negative impact of material events;

j. Endorse to the Board of Directors the appointment and, when and if appropriate, replacement of the Risk Management Officer, who shall report directly to the Committee.

k. Report Committee activities to the BOD when and with such recommendations as deemed appropriate or required.

m. Perform such other duties and functions and/or assume such responsibilities as may be delegated by the BOD.

5. **INDEPENDENCE**
   The RiskCom shall be an independent committee and for this purpose, it shall report directly to and hold office on the authority of the Board of Directors.

6. **REVIEW OF THE CHARTER**
   The RiskCom shall conduct review and assessment of the Charter from time to time in order to determine its adequacy and make improvements thereof that the Committee considers necessary or valuable. The Board will approve any amendments to the Charter that will emanate from the review based on the recommendation of the RiskCom.

7. **EFFECTIVITY**
   This Charter shall take effect upon approval of the Board of Directors.

B. **RISK MANAGEMENT UNIT CHARTER**

1. **DUTIES AND RESPONSIBILITIES**

   **1.1. Core Duties and Responsibilities**
   The Risk Management Unit (RMU) shall monitor the risk environment for LBP Leasing Corporation and provide direction for the activities to mitigate, to an acceptable level, the risks that may adversely affect the Corporation’s ability to achieve its goals. RMU shall facilitate continuous improvement on the Corporation’s capabilities around managing its risks. It shall monitor and evaluate the risk management process of the Corporation and undertake enhancement when needed.

   **1.2. Specific Duties and Responsibilities**
   a. Develop and implement a sound and structured risk management framework for the Corporation.

   b. Undertake periodic review and assessment of the Risk Management (RM) framework to ensure its effectiveness and relevance to the prevailing risk environment.

   c. Formulate and implement risk management plan, programs, policies and guidelines to execute applicable strategic actions to monitor risk
initiatives undertaken by the Corporation to identify, assess, control and report credit, market, operational as well as enterprise-wide and group-wide risks.

d. Initiate regular review of the Corporation’s risk profile and cause identification of emerging risks.

e. Apply qualitative and quantitative methodologies to assess and measure risks.

f. Evaluate the effectiveness of risk mitigation measures and current RM strategies and recommend possible policy enhancements or modifications when needed.

g. Monitor and assess risks and prepare risk reports to Management and the Board of Directors (BOD).

h. Provide guidance regarding ERM infrastructure including systems, processes and organizational structure.

i. Carry-out other duties and responsibilities delegated to it by the Risk Management Committee (RiskCom) and/or the President/CEO, related to the purposes of the RMU.

2. OPERATIONS

The Risk Management Officer reports functionally to the RiskCom and administratively to the President/CEO. Given the size of the LBP Lease’s operations, the RMU shall handle all relative risks exposures of the Corporation.

3. REVIEW OF THE CHARTER

RMU shall perform a review and assess, at least annually, the adequacy of this charter and any improvements to this charter that the RiskCom or President/CEO may consider necessary and valuable. RMU shall conduct such reviews in a manner as it deems appropriate.
III. RISK MANAGEMENT FRAMEWORK

To structure and formalize the Risk Management activities across the organization, LBP Leasing Corporation has developed a risk management framework. The Corporation’s business units are required to implement and use this common Risk Management framework.

A. RISK MANAGEMENT POLICY STATEMENT

LBP Leasing Corporation (LBP Lease) takes risks inherent to its strategy in order to achieve its corporate and business units’ objectives and to deliver better shareholder returns. Thus, managing these risks forms an essential part of the Corporation’s business. The aim of risk management within LBP Lease is to provide reasonable assurance that the risks associated with achieving the business objectives is understood and that these risks are addressed appropriately at all levels within the organization. This is achieved by ensuring that at all times:

a. Risks are properly identified, assessed, managed and reported;
b. Risk ownership is taken and communicated;
c. Resources are effectively and efficiently allocated to manage risks;
d. Risks that could significantly affect the employees, the Corporation, the suppliers or the clients are suitably managed;
e. The Corporation is compliant with regulatory and legal requirements.

B. GENERAL RISK MANAGEMENT FUNCTIONS

The general functions of Risk Management are the following:

a. Develop and implement risk management framework and program;
b. Review the Corporation’s risk profile and identify new and emerging risks;
c. Assess and measure risks;
d. Recommend policies, systems and procedures to control risks and address risk management effectiveness gaps;
e. Evaluate the effectiveness of risk mitigation strategies; and
f. Monitor risks based on external and internal conditions and continually enhance risk management process.

C. RISK MANAGEMENT CONCEPTUAL FRAMEWORK

The Risk Management process and practices of the LBP Leasing Corporation shall be anchored on its mandates taking into consideration the Vision/Mission, strategies & business objectives, structure, policies and overall risk management strategy.

The Risk Management Process is based on the guidelines / directions set forth by Bangko Sentral ng Pilipinas (BSP) in circular no. 510 series of 2006 (see Annex "A").

Risk reporting shall apprise LBP & Subsidiaries Top Management on the material risks the Corporation are faced with & shall assist in decision-making, specifically in determining viable solutions to address such risks.
D. RISK MANAGEMENT IMPLEMENTATION

The Risk Management Implementation Framework is based on Risk Management ISO 31000 and involves a Plan, Do, Check & Act process.

The Risk Management objectives will serve as guide in designing the Risk Management Framework & Program, while the execution of the Risk Management program shall be manifested by the Risk Management action plans. Regular risk monitoring and reporting shall be done and an annual risk assessment shall determine effectiveness of risk control measures and the relevance of remaining risks. The assessment shall also ensure continuous improvement of the risk management process and practices.
The Risk Management Process highlights risk management performed at three different levels: Strategic Level; Portfolio Level; and Transactional Level.

1. **Risk Management at the Strategic Level** generally involves risk oversight and risk policy formulation and approval. Along the risk and control “lines of defense”, this level is ultimately responsible for the effectiveness of risk management activities across the organization.

The highest level of risk management involves: the LBP Lease President/CEO, the Risk Management Committee, other Board-level committees, and Committees representing the Business Units.

The Risk Management Committee performs the risk management oversight at LBP Leasing Corporation. They are responsible for reviewing and approving the RM program. The Risk Management Committee is responsible for setting the risk appetite, approving policies and strategies.
The President/CEO, Board-level committees and Business Unit Committees are responsible for creating a risk culture that promotes a deep sense of risk awareness among the Corporation's officers and staff.

2. **Risk management at the Portfolio Level** is the second “line of defense” and is generally responsible for risk analysis, control and management reporting.

Portfolio level risk management involves the Group/Unit Heads and the Risk Management Unit of the Corporation.

The Group/Unit Heads with the RM Unit are responsible for analyzing and controlling risks reported by the business units/ART under them. They monitor the occurrence of policy breaches and procedural infractions and deviations and ensure that risk measures are properly applied by the business and support units. Should controls fail in addressing risks, the Group/Unit Heads should review attendant policies and propose workable adjustments when necessary.

The Risk Management Unit/Business Unit Heads collate and consolidate all risk reports from its various risk-taking units and prepares the necessary analysis. The consolidated risk reports are then submitted by the Risk Management Unit to the Risk Management Committee and Board of Directors.

Portfolio-level risk reports generated by the Group/Unit Heads and RM Unit are escalated to the Board of Directors and Senior Management. These management reports should provide snapshots of overall risk positions of the Corporation and should enable the BOD to evaluate performance from a risk-adjusted perspective and to initiate the necessary adjustments in the overall business strategy.

3. **Risk Management at the Transactional Level** is the first “line of defense” and is comprised of the business and support units that are directly responsible for the processes and the risks.

The transactional level involves specifics of day-to-day risk-taking activities as performed by the risk owners or the Authorized Risk Takers (ARTs). All transactions of ARTs should conform to LBP Lease’s policies and procedures and should be within specified limits and approving authorities.

Identification and recognition of risks and the occurrence of risk events are documented by the ART and reported to the Business Unit Head.

Risks are measured and quantified in terms of its impact on the unit’s operations and on the targeted revenues.
Risk mitigation strategies are applied, whenever possible, to address or resolve the risk event(s).

Situations requiring actions by next higher officer should be escalated by the ARTs in a proper and timely manner.

Reports on risk events, policy breaches and procedural infractions and corresponding risk mitigation strategies taken should be elevated to the Group/Unit Heads. On a regular basis, risk reports should be prepared and submitted by the risk-taking units to the Group/Unit Heads.

![Levels of Risk Management Functional Delineation Units Responsible](image)

**Figure 4.0 Risk Management Process**

**F. RISK MANAGEMENT APPROACHES**

Risk management may be undertaken using two approaches: the Silo and the Integrated approach. The silo approach tackles risks on an individual or compartmentalized basis and is usually transactional and reactive. It concentrates on how individual business units operate and perform, and each department is responsible for managing its respective risks.

The Integrated Approach, on the other hand, considers risks at all levels of the organization, from strategic to the day-to-day job of customer facing employees. It is a company-wide and proactive and considers interdependencies of units as well as the inter-relationship of risks.
IV. RISK MANAGEMENT STRUCTURE

A. RISK MANAGEMENT STRUCTURE AND RESPONSIBILITIES

Risk Management must start at the top and pervade the entire organization to create a strong culture of risk assessment. The idea is to improve risk-taking ability by pushing decision making to the lowest level, without losing centralized oversight and control. Continuous communication between different levels of the organization must be implemented to ensure that the risk management process works. Presented below are the Risk Management organizational structure and the roles and responsibilities of various stakeholders in the risk management activities of the Corporation.

1. Risk Management Organizational Structure

![Diagram of Risk Management Oversight Structure]

Figure 1.0 Risk Management Oversight Structure
2. **Risk Management Roles and Responsibilities**

2.1. **LBP Risk Management Group (LBP – RMG)**
   a. Provide assistance to LBP Lease in the development of risk management framework and program
   b. Oversee implementation of risk management framework and program which includes the following:
      i. Provide guidance in risk identification, assessment and measurement
      ii. Aggregate/report LBP Lease’s risk exposures and results to LBP Risk Committee
      iii. Ensure implementation of appropriate risk management policies
      iv. Monitor effectiveness of risk management strategies and adherence to risk management practices and processes
      v. Assist in promoting risk culture on the organization
   c. Assign departments (BRMD, CPRMD, TRMD) under RMG to perform the following: enable, collect, analyze, synthesize and prepare macro risk report.

2.2. **LBP Lease Board of Directors**
   a. Approve and confirm RM Framework, RM Program, Risk Appetite and other RM deliverables
   b. Designate Committee and/or Unit to ensure proper communication and implementation of risk appetite/RM Controls once approved
   c. Ensure risk management strategies reflects LBP’s appetite and tolerance for risks
   d. Review and approve changes/amendments to the RM deliverables

2.3. **LBP Lease Risk Management Committee**
   a. Perform risk management oversight on LBP Lease
   b. Review and approve the RM Framework, RM Program, Risk Appetite and Risk Policies of LBP Lease proposed by the Corporation.
   c. Monitor overall risk profile and compliance with risk policies
   d. Approve/escalate RM deliverables for reporting to LBP Lease Board of Directors
   e. Review and recommend enhancements on risk management practices of the Corporation

2.4. **Business Units**
   a. Monitor occurrence of risk events, policy breaches & procedural infractions and ensure that these are documented and reported to unit heads and/or Senior Management
   b. Identify new and emerging risks
   c. Measure potential impact of risks
d. Analyze and control risks  
e. Ensure proper implementation of risk management strategies

2.5. Risk Management Unit

a. Develop and enhance processes, methodologies and a common language to identify, assess and manage risks of importance  
b. Facilitates an improved understanding of risk information in key decision making and governance processes.  
c. Monitor & consolidate risks encountered by various business units  
d. Assist in the preparation of risk management strategies and action plans  
e. Prepare risk reports and present to LBP Lease Risk Management Committee for submission to LBP-RMG  
f. Monitor implementation of risk management strategies and action plans  
g. Determine residual risks and propose measures to mitigate/eliminate risks  
h. Update concerned units regarding RM activities, deliverables and directions.  
i. Provides assistance to all units of the Corporation for their risk management activities
V. ENTERPRISE RISK MANAGEMENT PROGRAM

A. BACKGROUND/RATIONALE

The Risk Management (RM) Program shall serve as the blueprint for the implementation of RM. The program derives its foundations from the RM framework and translates applicable concepts to operational terms.

Recognizing that RM is an essential component of corporate governance of LBP being LBP Lease’s Parent company, the RM program of the Corporation shall be done with the guidance of the Bank’s Risk Management Group.

The program includes relevant methodologies and tools that will be used in implementing RM. It will be based on the mandate and nature of business operations, the structure and the risk appetite of LBP Lease among others.

The RM program is a start-up and utilizes the basics of risk management. In the future the program is expected to evolve as new regulatory requirements are issued, new risks are experienced and innovative RM practices are developed.

B. OBJECTIVES

The objectives of the RM Program are as follows:

a. To systematically improve the RM capabilities of LBP Lease
b. To establish Enterprise Risk Management (ERM) process
c. To identify relevant RM tools that will be used to implement the program
d. To promote RM culture in the Corporation

C. THE ENTERPRISE RISK MANAGEMENT APPROACH

In order to effect consistency in approach and process, LBP Lease shall utilize the integrated approach in RM, otherwise known as the Enterprise Risk Management (ERM).

ERM is defined as the process, effected by an entity’s board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives.
Figure 5.0 Enterprise Risk Management Process

ERM is a continuing process, premised on circumstances that affirm the variability of risks. The risks identified today may be irrelevant in two years, hence, innovative products and services may require new RM practices. RM strategies may not have fully addressed present risks and residual risks require additional strategies. These, among others, explain the necessity of a continuing ERM process.

Presented in Figure 6.0 is a detailed process flow of the ERM and the corresponding outputs of each activity that will be implemented.
1. **Conduct of Risk Awareness Sessions**

Risk awareness sessions shall jumpstart ERM implementation. The briefings shall be for the Board of Directors, Senior Management and Rank & File. The sessions shall be facilitated by RMG and ODD of LBP.
2. **Risk Appetite Setting**

Risk Appetite is the level of enterprise-wide risk that a company can successfully manage over an extended period of time. It is a characterization of the magnitude and types of risk that a firm is willing and able to take to achieve its mission, vision, business objectives and goals. It defines the basis firms use for making business decisions, including pricing the products, determining how much risk to retain and to what extent risk should be transferred to others.

The LBP-RMG shall conduct a Risk Appetite Setting seminar that will involve activities such as analysis of the Corporation’s risk capabilities and appreciation of the fundamental concepts of risk appetite statements. This shall include a brainstorming session on LBP Lease’s definition of Risk Appetite that will eventually lead to the formulation of the Risk Appetite operating principles and implementing strategies.

Risk Appetite setting shall be participated in by the Senior Management and BOD. The Risk Appetite Statements formulated shall be presented to Senior Management, Risk Management Committee and BOD for approval.

3. **RM Process**

The RM Process (Risk Identification, Risk Measurement, Risk Control and Risk Monitoring) shall guide the Corporation to achieve ERM.

3.1. Risk Identification

Guided by the Risk Universe of LBP (Figure 7, page 13), LBP Lease shall identify its own Risk Universe. There are two general methodologies that shall be used in identifying and analyzing risks: the Risk Self-Assessment (RSA) survey at the enterprise level and the Risk and Control Self Assessment (RCSA) at the business unit level.

3.1.1. **Risk Self-Assessment (RSA) Survey**

RSA survey is a process of assessing the risks in their purest forms, i.e., without considering controls. It is a top-down approach that involves the Business Unit Heads and Senior Management in an iterative process of examining risks the Corporation is faced with.

The Risk Management Unit of the LBP Lease shall initiate the conduct of RSA and utilize the survey questionnaire used by LBP. The Corporation’s Risk Universe shall be formulated as a result of the conduct of RSA.
### Land Bank Risk Universe®

<table>
<thead>
<tr>
<th>Credit</th>
<th>Interest Rate</th>
<th>Operations</th>
<th>Compliance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market Risk</td>
<td>Interest Rate</td>
<td>Code of Conduct:</td>
<td>Fraud</td>
</tr>
<tr>
<td>Foreign Currency</td>
<td></td>
<td>Communications &amp; Investor Relations:</td>
<td>Employee Communication</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Sales &amp; Marketing:</td>
<td>Marketing</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Sales (Business Growth)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Client Relationship Management</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Product Development:</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Product Creation</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Product Pricing</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Delivery:</td>
<td>Product Delivery and Support</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>People:</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Culture</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Recruiting and Retention</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>People Development and Performance</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Succession Planning</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Information Technology:</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>IT Management</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>IT Confidentiality</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>IT Availability/Continuity</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>IT Integrity</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Business Interruption:</td>
<td>Business Continuity Planning</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Accounting and Reporting:</td>
<td>Accounting, Reporting and Disclosure</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Internal Control</td>
<td></td>
</tr>
</tbody>
</table>

| Liquidity | | |
|-----------|----------------|
| Liquidity Risk Management: | |
| Insurance | |
| Capital Structure: | |
| Leverage | |
| Capital Reserve | |
| Lending Capacity | |

---

**Figure 7.0 LBP Risk Universe**

3.1.2. Risk Control Self-Assessment (RCSA)

RCSA, on the other hand, is a structured process of determining risks and examining the effectiveness of controls at the business unit level, by the ART. RCSA is a bottom-up approach. The granular risks identified at the transaction level are escalated, validated and aligned with the Risk Universe identified under the RSA.

The RCSA document shall be used to identify risks at the Corporation’s business unit or transactional level. The RCSA template is presented below (Table 1).
Table 1. Risk Control Self-Assessment Template

3.1.3. Risk Prioritization
Based on the Risk Universe identified, the Senior Management shall prioritize, through a voting process, the critical risks of the Corporation based on impact and RM effectiveness. The risk map resulting from this activity shall be analyzed and be the basis for other RM activities discussed in Risk Measurement, Risk Control and Risk Monitoring.

3.1.4. Development of Common Risk Language
The risks that comprise LBP Lease’s Risk Universe will be defined based on their own perspective. The risk definitions shall be prepared by the Authorized Risk Takers (ARTs) and shall be deliberated upon and signed-off by the Heads of ARTs and shall be presented to Senior Management, the Risk Management Committee and BOD for approval. In case of new and emerging risks, these shall be added to the Risk Universe, and shall be given customized definitions.

3.1.5. Risk Driver Analysis
In order to further analyze risks and since risk assessment is an encompassing process, the Risk Driver Analysis (RDA) tool shall be used:
- Risk driver analysis (RDA): determines the causes and sources of risks.

This sub process shall be undertaken through workshops and focused group discussions involving the ARTs. The resulting RDA maps shall be presented by the Risk Officer to Senior Management, Risk Management Committee and BOD for approval.
3.2. Risk Measurement
Risk Measurement is the process used to quantitatively and qualitatively determine the consequences of possible outcomes or events over a given time horizon under alternative scenarios. It evaluates the impact of risks by quantifying the price of failure in terms of financials, reputation or other variables and by determining value creation opportunities. Risk measurement is a responsibility of the ARTs.

The ARTs shall identify Key Risk Indicators (KRIs) as a risk measurement activity. KRIs are forward-looking parameters that help predict the occurrence of loss events. The KRI template as shown in Table 2, page 15, shall be used for this purpose.

The Risk Officer shall present the KRI to the Senior Management, Risk Management Committee and BOD for approval.

The Bank’s RMG and its departments shall guide the Corporation in all risk measurement activities as needed.

---

<table>
<thead>
<tr>
<th>Key Risk Driver</th>
<th>Key Risk Indicator</th>
<th>Scenarios</th>
<th>Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Specify: Choose the initial risk then)</td>
<td>(Specify: Key risk indicators are measurable parameters that should be monitored and trended)</td>
<td>(Specify: The key risk indicators for this risk are necessarily dependent on the specific nature of the risk)</td>
<td>(Specify: Determine the impact of the risk by analyzing the potential consequences)</td>
</tr>
</tbody>
</table>

*Table 2. Key Risk Indicator Template*

3.3. Risk Control
Risk Control is the implementation of measures to reduce risks or to maintain risks within the risk appetite of LBP. It involves the development/ improvement and implementation of policies, systems, procedures and physical changes to address risks. Various RM options are used to reflect actions or responses of LBP to risks: Avoid, Accept, Reduce, Transfer and Exploit.

Risk Control, which is the main responsibility of the ARTs, pertains to ongoing controls embedded as far as possible in business processes that should be performed by all employees within the framework of their tasks. If controls are inadequate to address identified risks, the Subsidiary shall draw up specific actions or responses to manage risks.
Risk Control shall be comprised of two activities: RM Strategies Formulation and RM Action Planning.

3.3.1. Risk Management Strategies Formulation

The formulation of RM strategies shall be based on the Risk Drivers identified for specific risks. The following RM options / treatments shall be used: Avoid, Transfer, Reduce or Accept (Figure 8, page 16).

a. Avoid Risk – RM strategy or response or technique that involves taking steps to remove the hazard or engage in other activity or otherwise end a specific exposure (e.g., divest, prohibit, stop or eliminate)

b. Transfer Risk - RM strategy or response or technique, in which a risk is shifted to another party (e.g., insurance, outsourcing, warranty or indemnity)

c. Reduce Risk - RM Strategy or response or technique through systematic reduction in the extent of exposure to risk and/or the likelihood of its occurrence (e.g., disperse or control)

d. Accept Risk – RM Strategy or response or technique where the cost of managing is acceptable because risk avoidance would entail higher cost than the impact of risk. (e.g., reprice, self-insure, offset or plan)

![Figure 8.0 Risk Management Options Model](image)

The Corporation shall use as reference the RM Strategies Articulation template (Table 3) used under ERM of LBP. The RM Strategies template shall present the current RM strategies of LBP Lease as well as the opportunities for improvement.
Table 3. Risk Management Strategies Formulation Template

3.3.2. Risk Management Action Planning

The RM Action Planning identifies the various activities that shall be undertaken to implement the RM Strategies. Table 4, page 17 shows the RM action plan template which shall be accomplished by the ARTs under the guidance of the Risk Officer.

The RM Strategies and RM Action Plans of the Corporation shall be presented to the Senior Management, Risk Management Committee and BOD for approval.

Table 4. Risk Management Action Planning Template

The Risk Officer shall submit to LBP RMG the approved RM Action Plans which shall then be presented to LBP- RiskCom for confirmation.
3.4. Risk Monitoring

Risk Monitoring is the process of tracking and evaluating the performance and status of RM activities. Risk monitoring shall be done to determine the following:

a. RM strategies or responses crafted have been implemented as planned
b. risk action plans are effective in addressing the risks or if new responses should be developed
c. risk exposure of LBP Lease has changed from its prior state and whether risk priorities should be updated
d. new risks have occurred that were not previously identified or residual risks are still existing and require new responses
e. business assumptions are still valid and if there is a need to revisit and revise the RMPS

The Corporation shall utilize RM Action Plan Monitoring template (Table 5) used in the LBP ERM to effectively monitor actual accomplishments of identified responsible unit.

<table>
<thead>
<tr>
<th>RISK DRIVER</th>
<th>ACTION PLAN</th>
<th>RESPONSIBILITY</th>
<th>TIME FRAME</th>
<th>KEY RESULTS AREA</th>
<th>ACCOMPLISHMENTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Identified critical risk driver</td>
<td>Specific action steps to implement the RM Strategies</td>
<td>Primary unit responsible for the action plan, showing designation of unit head</td>
<td>Specific date or deadline to implement the RM Action Plan</td>
<td>Expected output from RM Action Plan</td>
<td>Actual output of responsible unit with the implementation of the RM Action Plan</td>
</tr>
</tbody>
</table>

Table 5. Risk Management Action Plan Monitoring Template

A variety of risk reports can be produced out of the risk monitoring process while a Risk Management Information System will capture the complete picture of risks through dashboards and risk maps.

The Risk Officer of the Corporation shall consolidate the risk reports and present to Senior Management, Risk Management Committee and BOD for approval. Same reports shall be submitted to LBP RMG which shall also be presented to LBP-RiskCom for notation.

D. RISK MANAGEMENT CULTURE DEVELOPMENT

The success of the RMPS rests on the extent of risk culture assimilation by an organization’s employees. To enable the risk culture to be embedded in the Corporation, the following activities may be undertaken:

a. Risk Education through conduct of training
b. The Risk Bulletin could be prepared on a quarterly basis informing all employees of the various RM activities undertaken by the organization.
c. The conduct of regular internal risk forum. The risk forum is an echo training where a staff participant to external or internal training shares the learning gained to the ART.
VI. RISK MANAGEMENT FOUNDATION

A. CORPORATE VISION AND MISSION

1. Vision
The pioneering government finance company providing financing solutions to capital asset requirements of programs and projects in support of the National Government Agenda, operating in all regions of the country by 2018.

2. Mission
To provide innovative financial services that facilitate access to capital assets that will enhance service efficiency of government offices and increase productivity and expand capacity of private enterprises.

B. GUIDING PRINCIPLES AND BUSINESS OBJECTIVES

LBP Leasing Corporation shall be:

- Solution – Provider
  LBP Lease will be innovative and creative in packaging facilities responsive to the needs of its clients.

- Learning Organization
  LBP Lease will be an organization that enhances the worth of its people, both as professionals and individuals.
  
  LBP Lease will continuously look for improvements in its operations and strive for perfection.

- Financially Sound and Strong Institution
  LBP Lease will continuously achieve profitability level desired by its stockholders.
  
  LBP Lease will maintain a sound financial position that will make it attractive to lenders and investors.

- Socially Responsible Organization
  LBP Lease shall always be conscious of its responsibility to country and society.

- Client-Oriented
  LBP Lease shall work as a team to satisfy the needs of its clients.

- ICT-Oriented
  LBP Lease will adopt appropriate technology in communication and information systems to enhance operational efficiency to serve better its clients.
C. ORGANIZATIONAL STRUCTURE

LBP LEASING CORPORATION
TABLE OF ORGANIZATION
As of November 2013

D. RISK MANAGEMENT STRATEGY

Risk is part of doing business and risk management is therefore part of day-to-day business management. LBP Lease aims to formalize risk management to the extent that business units are able to apply best-practice techniques, to share knowledge and experience, and to make the key risks to the shareholders transparent.

E. RISK APPETITE AND TOLERANCE

LBP Leasing Corporation aims to be risk aware, but not overly risk averse, and to actively manage risks to protect and contribute to the growth of the Corporation. To achieve its objectives, LBP Lease recognizes that it will take on certain risks. The Corporation aims to take risks in an informed and proactive manner, such that the level of risk is consistent with the potential rewards and that LBP Lease understands and is able to manage or absorb the impact of the risk in the event that it materializes. Management will establish such risk responses as are required to achieve the objectives in accordance with the acceptability of the risk. Quantified risk tolerances will be formulated.
and regularly updated by Management at each business-unit level. The Corporation will aim to actively avoid risks that could:

- Negatively affect the Corporation’s stakeholders (clients, employees or other stakeholders);
- Negatively affect LBP Lease reputation;
- Lead to laws or regulations being breached; or
- Endanger the future existence of the organization.

F. RISK DICTIONARY

To be consistent with LBP as its mother bank, LBP Leasing Corporation shall customize the Risk Dictionary developed by LBP based on the LBP Lease’s operation to ensure the use of a common language until such time that the Corporation is able to come up with its own risk dictionary as it implement the Risk Management Program under the guidance of LBP-RMG.

1. CREDIT RISKS
(BSP Circular No. 150 – Guidelines on Supervision by Risk)

Credit risk arises from a counterparty’s failure to meet the terms of any contract with the Financial Institution (FI) or otherwise perform as agreed. Credit risk is found in all activities where success depends on counterparty, issuer, or borrower performance. It arises any time FI funds are extended, committed, invested, or otherwise exposed through actual or implied contractual agreements, whether reflected on or off the balance sheet. Credit risk is not limited to the loan portfolio.

Credit Risk Management

Counterparty Credit Risk: Loans and Leases
Inability to review and analyse the credit quality of potential/existing borrowers to serve as basis for loan approval (at application) and to determine the probability of default (on an on-going basis), could lead to economic losses.

Prepayment
The risk that issuers or borrowers will pay principal ahead of scheduled payments can result to the Corporation’s inability to maximize its return from the security or loan.

2. COMPLIANCE RISKS
(BSP Circular No. 150 – Guidelines on Supervision by Risk)

Compliance risk is the current and prospective risk to earnings or capital arising from violations of, or non-conformance with, laws, rules, regulations, prescribed practices, internal policies and procedures, or ethical standards. Compliance risk also arises in situations where laws or rules governing certain FI products or activities of the FI’s clients may be ambiguous or untested. This risk exposes the FI to fines, payment of damages, and the voiding of contracts. Compliance risk can lead to diminished reputation, reduced
franchise value, limited business opportunities, reduced expansion potential, and the lack of contract enforceability.

**Code of Conduct**

**Ethics**
Failure to institute standards of employee behavior (Code of Conduct, CSC, and other internal rules) and corresponding sanctions for non-compliance to influence the way of business is conducted above and beyond the letter of the law, may result in control breakdowns and a perception of a lack in business integrity.

**Legal**

**Contract**
Failure to assess the favorableness of the contracts the Corporation enters into and the failure to comply with and monitor contract terms might lead to financial losses for the Corporation.

**Regulatory**

**Banking Regulations**
Failure to comply with the circulars, memoranda, advisories and other issuances of regulatory bodies as applicable to the financing industry, may result to loss of business, administrative/criminal penalties/sanctions, and loss to reputation.

**Information Security and Confidentiality**
Inability to properly manage information security and confidentiality can lead to legal exposure, regulatory sanctions, and economic losses.

**Anti-Money Laundering**
Failure to implement an effective Anti-Money Laundering Act (AMLA) compliance system exposes the Corporation to regulatory and legal risks. *(An Anti-Money Laundering Act (AMLA) compliance system refers to the measures instituted by the Corporation to prevent and deter the use of the Corporation’s facilities for laundering of proceeds of crimes and other unlawful activities in compliance with the AMLS under Republic Act 9160, as amended, its Implementing Rules and Regulations (IRR), as well as pertinent issuances of the Bangko Sentral ng Pilipinas (BSP) and subsequent applicable laws and regulations.)*

**Regulatory (SEC, BSP, BIR) Compliance**
Failure to comply with circulars, memoranda, advisories and other issuances of regulatory bodies as applicable may result to regulatory sanctions, fines, penalties and may lead to the Corporation’s insolvency and closure.
3. LIQUIDITY RISKS
(BSP Circular No. 150 – Guidelines on Supervision by Risk)

Liquidity risk is the current and prospective risk to earnings or capital arising from and FI’s inability to meet its obligations when they come due without incurring unacceptable losses. Liquidity risk includes the inability to manage unplanned decreases or changes in funding sources. Liquidity risk also arises from the failure to recognize or address changes in market conditions that affect the ability to liquidate assets quickly and with minimal loss in value.

Liquidity Risk Management

Liquidity
Failure to properly manage the Corporation’s cash flows could affect the Corporation’s ability to settle its obligations as they come due, and could lead to insolvency and regulatory sanctions.

Insurance
Inadequate insurance coverage exposes the Corporation to significant financial losses due to incidents and claims.

Capital Structure

Leverage
Inability to optimally use borrowed funding to generate wealth may result to lower shareholder value.

Capital Reserve
Failure to maintain capital surplus (on top of the minimum regulatory requirements) to serve as reserve from unforeseen losses may lead to regulatory sanctions and Corporation insolvency.

Lending Capacity
Failure to maximize loanable funds might lead to loss of business opportunities for the Corporation.

4. INTEREST RATE RISK
(BSP Circular No. 150 – Guidelines on Supervision by Risk)

Interest rate risk is the current and prospective risk to earnings or capital arising from movements in interest rates. Interest rate risk arises from differences between timing of rate changes and the timing of cash flows (repricing risk); from changing rate relationships among different yield curves affecting FI activities (basis risk); from changing rate relationships across the spectrum of maturities (yield curve risk); and from interest-related options embedded in FI products (options risk).
Market

**Interest Rate**

Inability to appropriately plan for and react to fluctuations in interest rates leads to market value losses on investment securities or cash flows shortfalls resulting from re-pricing of loans or obligations.

5. **OPERATIONS RISKS**

(BSP Circular No. 150 – Guidelines on Supervision by Risk)

Operational risk is the current and prospective risk to earnings or capital arising from fraud, error, and the inability to deliver products or services, maintain a competitive position, and manage information. Risk is inherent in efforts to gain strategic advantage, and in the failure to keep pace with changes in the financial services marketplace. Operational risk is evident in each products and service offered. Operational risk encompasses: product development and delivery, operational processing, systems development, computing systems, complexity of products and services, and the internal control environment.

Code of Conduct

**Fraud**

Willful, malicious and unethical actions of employees or other stakeholders (e.g. management, customers) aimed at realizing material or financial gains could result in operational difficulty, financial losses, and impairment of the Corporation’s reputation.

Communications and Investor Relations

**Employee Communication**

Failure to understand and respond to the communication needs of different employees will cause discontentment in the workforce resulting in operational difficulty.

Sales and Marketing

**Marketing**

Inability to articulate a compelling and consistent message that underlies the Corporation’s image and products could affect the Corporation’s competitive advantage and reduce growth and market share.

**Sales (Business Growth)**

Inability to sell and/or cross sell products and services to the Corporation’s key target markets might result to non-achievement of the Corporation’s overall strategic and financial plans.
Client Relationship Management
Inability to effectively identify and address the customers’ needs will negatively affect the Corporation’s reputation and relationship with its customers.

Product Development

Product Creation
Failure to promptly innovate products and services to take advantage of competitive opportunities in the market may result in lost business for the Corporation.

Product Pricing
Failure of the Corporation to price its products correctly or competitively might lead to financial losses or lost business opportunities.

Product Delivery

Product Delivery & Support
Failure to deliver and support products and services to meet customer expectations might lead to lost business or affect the Corporation’s reputation.

People

Culture
Inability to create and instill the accepted norms of behaviour in the Corporation as a whole may inhibit the achievement of desired performance and the accomplishment of corporate goals.

Recruiting and Retention
Inability of the Corporation to attract and retain competent employees might lead to organizational dysfunction and low morale.

People Development and Performance
Inability to develop and enhance employee skills and provide a sound employee performance management system may reduce employee motivation and may adversely impact the achievement of desired performance and conduct.

Succession Planning
Failure to create and implement a feasible continuance plan for key Corporation positions and employees might adversely affect the stability of organizational leadership and business continuity.
Information Technology

**IT Management**
Failure to effectively prioritize IT initiatives and administer IT resources may lead to lost business and hinder the achievement of the Corporation’s goals and objectives.

**IT Confidentiality**
Failure of information systems to adequately protect both IT data and IT infrastructure leads to or allows unauthorized access, or leads to destruction of information and information systems of the Corporation.

**IT Availability/Continuity**
Failure to ensure uninterrupted operations and immediate recovery from systems and implementation failures leads to lost business and losses for the Corporation.

**IT Integrity**
Failure of information system to provide accurate, reliable and timely financial and non-financial information when needed leads to operational inefficiencies or lost business opportunities.

Business Interruption

**Business Continuity Planning**
Failure to undertake the appropriate advanced planning related to critical business functions/processes may result in the Corporation’s inability to recover and maintain business operations in the event of a disruption due to natural events or terror and malicious acts.

Accounting and Reporting

**Accounting Reporting and Disclosure**
Inaccurate recording and reporting of material financial transactions in accordance with existing standards may result to regulatory sanctions for the Corporation, and may also lead to misinformed business decisions by Corporation management and other stakeholders.

**Internal Control**
Failure to establish and maintain adequate internal controls that align with stakeholder and regulatory expectations may result in errors or omissions in financial reporting, control breakdowns or fraud.

6. **REPUTATION RISKS**
(BSP Circular No. 150 – Guidelines on Supervision by Risk)

Reputation risk is the current and prospective impact on earnings or capital arising from negative public opinion this affects the FI’s ability to establish new relationships or services or continue servicing existing relationships. This
risk may expose the FI to litigation, financial loss, or a decline in its customer base. In extreme cases, the FIs that lose their reputation may suffer a run on deposits. Reputation risk exposure is present throughout the organization and requires the responsibility to exercise an abundance of caution in dealing with customers and the community.

Communication and Investor Relations

Crisis Communication
Failure to properly and promptly manage and disseminate information in the event of a crisis or disruption may result in adverse public opinion and deter risk averse stakeholders from continuing doing business with the Corporation.

Reputation
Failure to establish and maintain an image of integrity and competence in doing business will result to loss of customers and even key employees.

7. STRATEGIC RISKS
(BSP Circular No. 150 – Guidelines on Supervision by Risk)
Strategic risk is the current and prospective impact on earnings or capital arising from adverse business decisions, improper implementation of decisions, or lack of responsiveness to industry changes. This risk is a function of the compatibility of organization’s strategic goals, the business strategies developed to achieve those goals, the business strategies developed are both tangible and intangible. They include communication channels, operating systems, delivery networks, and managerial capacities and capabilities. The organization’s internal characteristics must be evaluated against the impact of economic, technological, competitive, regulatory, and other environment changes.

Governance

Board Performance
Inability of the Board of Directors to discharge their obligations and duties owed to the Corporation and its stakeholders in good faith may hinder effective strategy-setting and decision-making.

Tone at the Top
Inability of the Board and Senior Management to establish a culture of accountability, integrity, professionalism and competency may result in an unfavorably working environment and lack of integrity in the way the Corporation’s business is conducted.

Planning and Resource Allocation

Organizational Structure
Lack of a responsive organizational structure may prevent the achievement of the Corporation’s strategic goals and objectives in an efficient manner.
**Strategic Planning**
Failure to develop, implement and monitor institutional strategies and direction will threaten the Corporation's overall viability and growth prospects.

**Forecasting**
Inability to foresee macroeconomic and market trends, opportunities and threats will threaten the Corporation's competitiveness in the long run and may result in inappropriate business strategies and missed business opportunities.

**Outsourcing Arrangements**
Failure to select suitable process and service providers, effectively manage service level arrangements and adopt clear deliverables may result in increased costs and delays.

**Major Initiatives**

**Vision and Direction**
Failure to establish, align and communicate a vision and direction for the Corporation and its major initiatives, including services, products and programs, may hamper the achievement of the Corporation's objectives and strategies.

**Planning and Execution**
Failure to plan and execute programs and initiatives effectively may lead to operational inefficiencies, financial losses and project failure.

**Measuring and Monitoring of Major Initiatives**
Failure to identify appropriate performance metrics and standards to monitor attainment of objectives and targets may prevent the achievement of desired output and performance.

**Technology Implementations**
Failure to adopt and implement the appropriate system and technology to support business processes or major initiatives may lead to costly investments and work inefficiencies, and may compromise products or service delivery.

**Market Dynamics**

**Competition**
Failure to proactively recognize and respond to competitive threats will reduce the Corporation’s market share, destroy shareholder value, and adversely affect the achievement of the Corporation's strategic goals.

**Socio Political**
Failure to understand, anticipate and address social, cultural and political development and effective customer service delivery and hamper the Corporation’s ability to market and sell its products and services.
VII. RISK MANAGEMENT PROCESS

A. CREDIT RISK MANAGEMENT

Being a financial institution, the primary among the risks involve in LBP Lease’s operation is Credit Risk. Credit Risk is defined as the potential financial loss from the failure of the borrower, issuer or counterparty to pay its obligations on time, in full and as contracted on or off balance sheet. Credit risk arises from all activities dependent on customer performance and when funds are committed, invested, or otherwise exposed through actual or implied contractual agreement (whether reflected on or off the balance sheet).

Thus, there is a need for a vigorous credit risks management process. The credit risk management process of LBP Leasing Corporation aims to:

a. Protect the Corporation against any unwarranted customer or counterparty credit exposures;
b. Maintain credit risk at a manageable level;
c. Identify and avoid a material credit failure (of a significant value, which would impact earnings).

This credit risk management process provides general principles to guide the preparation of credit risk management program. It also communicates the tolerance of the Corporation’s Board and Management for credit exposures and sets forth the acceptable techniques for avoiding, mitigating, or effectively managing credit exposures.

1. Credit Risk Management Framework

![Credit Risk Management Framework Diagram]
2. **Basic Credit Risk Management Principles**

LBP Lease adheres to the following credit risk management principles that promote sound practice for managing credit risks where credit risk is present.

- **Establishment of an appropriate credit risk environment**
  Understanding the credit culture and the risk profile of the Corporation is critical to the successful management of credit risk. The loan portfolio is typically the largest asset and the predominant source of revenues. In establishing an acceptable credit risk environment, the BOD and Management should have the responsibility of not only endorsing the credit standards which are the credit culture's backbone, but should also employ them when formulating strategic plans and overseeing portfolio management. They should also conduct periodic review and approve credit risk strategies and credit risk policies of the Corporation.

- **Operate under a sound credit-granting process**
  Credit evaluation should be made against the credit fundamentals. All extension of credit must be made on an arms-length basis. There should be a clearly-established process for approving new credits as well as extension of existing credits. These criteria should include a thorough understanding of the borrower or counterparty, as well as the purpose and structure of the credit, and its source of repayment. A careful evaluation of all credit information about the borrower and the project/purpose of financing should always be observed. Granting of loan should always be based on concrete and well-defined sources of payment/s. Loan release on the other hand should only be made in accordance with the approved terms and conditions and subject to the completion of all necessary and appropriate legal documents.

  Loans should not exceed the internal single borrower’s limit set by the Corporation for individual borrowers and group of accounts. Credit related to companies and individuals must be monitored with care and appropriate steps must be undertaken to control or mitigate the risks of connected lending and/or group of accounts.

- **Maintenance of appropriate credit administration, measurement and monitoring process.**
  There should be a system for the administration of various credit risk bearing portfolios which include a system for monitoring the condition of individual credits, including determining the adequacy of provisioning and reserves, internal credit risk rating systems in managing credit risks and a system for monitoring the over-all composition and quality of the credit portfolio.

- **Adequate controls over credit risk**
There should be a system of independent, on-going credit review which should be communicated directly to the Board of Directors and Management. Credit granting should be properly managed and credit exposures should be within levels consistent with standards, internal limits and loan approving levels. The Corporation should establish and enforce internal controls and other practices to ensure that exceptions to policies, procedures and limits are reported in a timely manner to the appropriate level of management.

3. **Credit Risks Exposures**

The Corporation’s exposure to credit risks arises from its leasing and lending activities. The credit process of LBP Lease is as follows:

![Figure 9.0 LBP Lease Credit Process Flow](image)

LBP Lease’s credit process involve activities starting from the introduction of the Corporation’s products and services, packaging and approval of the credit facility and ultimately ends with the orderly payment of the credit or, remedial management for problematic accounts. The credit process flow involves the following steps:

3.1. **Market Identification**

This involves a process where the Account Management Group (AMG) identifies the client base and the appropriate credit program it will pursue. It is done pursuant to the general credit policies, programs, strategies and targets of the Corporation.

Under this process, credit risk maybe driven by inadequate market and business information, deviation in standards among others.

3.2. **Credit Initiation**
Credit initiation refers to the introduction of the Corporation’s products and services to clients and eventually the packaging and approval of the appropriate credit facilities.

Credit risk at this stage may be driven by poor credit evaluation, loss of documents and substandard packaging.

3.3. Documentation and Disbursement

Credit documentation is the process where the Account Officer ensures that all essential requisites for the validity and enforceability of the credit transaction are complied with in coordination with the Legal Servicing Unit (LSU). Under this process, credit risk may arise when LSU fails to require the submission of a vital document that would significantly affect the enforceability of the credit transaction such as duly registered Real Estate Mortgage (REM) documents covering a real estate property offered as collateral.

Credit Disbursement is the process where the Account Officer releases or disburses the loan proceeds in accordance with the approved terms and conditions, including the completion of all the necessary and appropriate legal documents as evidenced by a legal sufficiency memorandum. Credit risk may arise when the Account Officer disburses the proceeds which are not in accordance with the terms of approval.

3.4. Portfolio Management

Credit administration refers to the proper provision of credit support, control systems and other practices necessary to manage outstanding assets. Under this process, credit risk may arise from the failure of the Corporation to monitor payment for insurance coverage of projects and/or equipment financed by the Corporation.

Portfolio Management also includes the remedial management which involves set of general guidelines on how to identify tell-tale signs and other proven indicators of credit deterioration and how to respond to these early warning signals, up to the appropriate activities to manage the risks and uncertainties associated with problem credits. Credit risks arise when the Account Officer fails to detect the financial deterioration of an account resulting to absence of remedial actions.

4. Measuring and Managing Credit Risk

4.1. “Know Your Customers” Procedures

LBP Lease personnel particularly those who have face to face interaction with the clients should follow the “Know your Customer or KYC” principles. It involves understanding the clients, its profile, backgrounds, structure and organization and needs among others. Failure to adopt good KYC procedures will expose the Corporation to various risks particularly counter party credit risks.
The Corporation shall implement customer profiling, identification and due diligence procedures for new and existing clients. The procedures are incorporated in the Money Laundering and Terrorist Financing Prevention Program of the Corporation.

4.2. Credit Approval Process

LBP Lease’s first defense against excessive credit risk is an efficient and balanced approval process, and competent Account Officers (AOs). Credit initiation, evaluation, negotiation and packaging of loan proposals are performed by AOs and conducted in accordance with predetermined portfolio strategies of the Corporation. The Account Officers evaluate the creditworthiness of a borrower based on, among other things, its financial strength, current and projected cash flows, quality of management, ownership, credit standing, industry standing, value of collateral, if required and the business it is expected to bring in, before presenting the credit facility proposal to the appropriate approving authority for consideration.

The authorities authorizing transactions or customer acceptances share equal responsibility within the credit granting process and must consider and communicate any adverse information he/she is aware of that could impact a sound credit decision. Following are the lease and credit approving authorities of the Corporation:

<table>
<thead>
<tr>
<th>TRANSACTION</th>
<th>LIMITS</th>
<th>APPROVING AUTHORITY</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. APPROVAL OF:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Lease/Credit Facilities (Based on Total Exposure to Client/Group of Clients)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Over Php25.0Million</td>
<td>Board of Directors</td>
</tr>
<tr>
<td></td>
<td>Over Php5.0Million to Php25.0Million</td>
<td>Executive Committee</td>
</tr>
<tr>
<td></td>
<td>Php5.0 and below</td>
<td>Credit Committee</td>
</tr>
<tr>
<td>2. Restructuring and All Types of Payment Arrangements (Based on Total Exposure to Client/Group of Clients)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Over Php5.0Million</td>
<td>Board of Directors</td>
</tr>
<tr>
<td></td>
<td>Up to Php5.0Million</td>
<td>Executive Committee</td>
</tr>
<tr>
<td>TRANSACTION</td>
<td>LIMITS</td>
<td>APPROVING AUTHORITY</td>
</tr>
<tr>
<td>-------------</td>
<td>--------</td>
<td>---------------------</td>
</tr>
<tr>
<td>3. Amendments of Terms and/or Conditions of Approved Lease/Credit Facilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>a. Increase in LBP Lease exposure</td>
<td>Approving Body based on adjusted exposure</td>
<td></td>
</tr>
<tr>
<td>b. Reduction in Security/ collateral position</td>
<td>Original Approving Body</td>
<td></td>
</tr>
<tr>
<td>c. Reduction in approved interest rate (spread) provided with the range per Credit Manual</td>
<td>President</td>
<td></td>
</tr>
<tr>
<td>d. Other amendments except additional conditions imposed by the original approving authority</td>
<td>President</td>
<td></td>
</tr>
<tr>
<td>4. Reduction in interest rate as may be dictated by the lower cost of funds offered by various special financing programs provided that LBP Lease’s spread as previously pegged is maintained</td>
<td>President</td>
<td></td>
</tr>
<tr>
<td>5. Approval of Internal Credit Risk Rating System (ICRRS)</td>
<td>Approving Body of the Lease/Credit Facility Proposal</td>
<td></td>
</tr>
<tr>
<td>6. Approval of Credit/Lease Availment</td>
<td>President</td>
<td></td>
</tr>
<tr>
<td>7. Waiver/ Condonation of</td>
<td>Over P200,000</td>
<td>Board of Directors</td>
</tr>
</tbody>
</table>
### Transactions Limits

<table>
<thead>
<tr>
<th>TRANSACTION</th>
<th>LIMITS</th>
<th>APPROVING AUTHORITY</th>
</tr>
</thead>
<tbody>
<tr>
<td>unbooked penalties, fees and other charges</td>
<td>Over P50,000 to P200,000</td>
<td>Executive Committee</td>
</tr>
<tr>
<td>Over P25,000 to P50,000</td>
<td>Credit Committee</td>
<td></td>
</tr>
<tr>
<td>P25,000 and below</td>
<td>President</td>
<td></td>
</tr>
</tbody>
</table>

#### 8. Remedial Action

**a. Dacion en Pago**

- Over P5.0 Million
- Over P1.0 Million to P5.0 Million
- P1.0 Million and below

  - Board of Directors
  - Executive Committee
  - Credit Committee

**b. Filing of Legal Cases**

(Foreclosure, Replevin, Civil, Collection, and other Legal Cases)

- Legal Counsel/Head-AMG

**c. Enforcement of Other Means of Collection**

- Application of Guaranty Deposit & Other Recovery
- Application of Bank Deposit Hold-out
- Repossession/Voluntary Surrender
- Call on Guarantee
- Call on Pledge
- Claim on Assigned Receivables

  - President

#### 9. Write-off

- Board of Directors

#### 10. Classification of

- President
4.3. Credit Assessment Methodology

LBP Lease conducts customer creditworthiness reviews on all applications from clients, utilizing the Risk Asset Acceptance Criteria (RAAC) and an Internal Credit Risk Rating System (ICRRS) that incorporates both quantitative and qualitative factors in client evaluation.

4.3.1. Risk Asset Acceptance Criteria

The Risk Asset Acceptance Criteria (RAAC) shall serve as the basic measure of risk asset acceptance for all leasing and credit facilities of the Corporation.

**General RAAC**

The standard RAAC is presented below

<table>
<thead>
<tr>
<th>Acceptance Parameters</th>
<th>General Acceptance Criteria</th>
</tr>
</thead>
</table>
| a. Character          | • No credit or background findings on the client and/or the major stockholders and key officers that will have a significant adverse effect on the operations of the enterprise/project.  
• No credit or background findings that manifest unacceptable credit habits. |
| b. Capacity           | • With well-defined source of repayment.  
• With capacity to manage/implement the business/project.  
• Business/project meets the viability and financial ratios.  
• Debt service cover of at least 1x at all times  
• Debt-service cover shall be sufficient to service the facility based on industry standards. |
| c. Condition          | • Industry outlook (where project/business belongs) is favorable.  
• Business/project has links and/or promotes countryside development.  
• Business/project is aligned to the priority programs of the government and consistent with related government issuances.  
• No signs of pending major labor dispute.  
• Contributes to countryside development by way of providing support to forward and backward linkages.  
• Support the priority sectors of the LBP.  
• Exhibit acceptable profitability levels |
Acceptance Parameters | General Acceptance Criteria
---|---
d. Capital | • Debt-Equity ratio shall be acceptable based on industry standards  
| | • Project cost sharing of at least 5%.

- Other major considerations include the following:
  - Credit extension should result to positive account relationship earnings, and
  - Collateral securities as second way-out should be acceptable to management.
- The unified RAAC is expressed in terms of general credit fundamentals that hold true regardless of the credit facility.
- Other businesses and projects which do not fully comply with the unified RAAC, including the program specific criteria/requirements presented in the succeeding sections shall be properly justified in the credit facility proposal and approved by the credit approving group/authority.

**Specific Criteria and Requirements**

The following specific criteria shall be used to determine among others, compliance with the unified RAAC and as a basis for evaluation consistent with loan requirements and program guidelines.

- **Small and Medium Enterprises**
  - **For Start-up SMEs**
    - **Acceptance Parameters**
      - a. Collateral At least 1.0x collateral cover
      - b. Debt- Equity Ratio Not more than 80:20
    - **Qualitative Criteria**
      - Industry has a favorable outlook
      - Familiarity with the proposed project can be established
      - No adverse finding on the owners and management
      - At least 60% Filipino-owned, if corporation and 100% Filipino-owned, if sole proprietorship
      - Possess sufficient management and technical capabilities required by the enterprise.

  - **For Operating SMEs**
    - **Acceptance Parameters**
      - a. Profitability Profitable for the past 2 years
      - b. Debt- Equity Ratio Not more than 80:20
    - **Qualitative Criteria**
      - No ownership dispute for the past two (2) years
Acceptance Parameters | Acceptance Criteria
--- | ---
- No major labor dispute for the past two (2) years  
- No adverse finding on the owners and management  
- At least 60% Filipino-owned, if corporation and 100% Filipino-owned, if sole proprietorship  
- Possess sufficient management and technical capabilities required by the enterprise.

**Government Sector**

Acceptance Parameters | Acceptance Criteria
--- | ---
a. Debt Servicing | With sufficient budget available for servicing operations

c. Qualitative Criteria  
- Project must be duly approved by the proper authority

**Financial Institutions**

- **Countryside Financial Institutions**

Acceptance Parameters | Acceptance Criteria
--- | ---
a. Capitalization | Minimum required capital by BSP per circular 156 as amended
b. Risk Asset Ratio | Not less than 10%
c. Past Due rate | Not more than 18%
d. Reserve Requirement | Meets reserve requirement per latest BSP Report of Examination
e. Qualitative Criteria  
- No Major dispute among owners and management  
- No material adverse feedback on the bank, owners and management  
- No significant negative findings, observations and/or comments from BSP  
- There must be substantial decline in deposits in the last 3 years (not more than 20% per year)

- **Financing Companies and Other Non-Bank Financial Institutions**

Acceptance Parameters | Acceptance Criteria
--- | ---
a. Capitalization | Complies with minimum capitalization required by the Securities and Exchange Commission (SEC) or the appropriate regulatory authority
b. Profitability | Profitable in nominal terms for
Acceptance Parameters | Acceptance Criteria
--- | ---
 | the last 2 years
| Capital to Risk Asset Ratio | At least 10%
| Current Ratio | At least 1:1
| Net Past Due Ratio | Not more than 15%
| Qualitative Criteria | No Major dispute among owners and management
| | No material adverse feedback on the bank, owners and management
| | No significant negative findings, observations and/or comments from concerned regulatory authority

**Thrift Banks, Commercial Banks and Universal Banks**

Acceptance Parameters | Acceptance Criteria
--- | ---
a. Capitalization | Complies with minimum capitalization required by the Bangko Sentral ng Pilipinas (BSP)
b. Profitability | Profitable in nominal terms for the last 3 years
c. Capital to Risk Asset Ratio | At least 10%
e. Net Past Due Ratio | Not more than 15%
f. Net Past Due Loans to Capital ratio | Not more than 25%
c. Qualitative Criteria | No Major dispute among owners and management
| | No material adverse feedback on the bank, owners and management
| | No significant negative findings, observations and/or comments from BSP

**Local Government Units**

Acceptance Parameters | Acceptance Criteria
--- | ---
a. Revenues | LGU must have sufficient receipts from Internal Revenue Allotment (IRA) and its local revenues for the last 3 years for its expenses and projects
b. Project Equity | LGU shall contribute at least 10% of the total project cost
c. Debt Servicing | With sufficient budget available for servicing of obligation
c. Qualitative Criteria | Projects should be part of the LGU’s development plan.
### Acceptance Parameters | Acceptance Criteria
--- | ---
- Project must be duly approved by the LGU's Sanggunian Council thru a resolution.
- Project should be viable and pass appropriate test of viability.
- LGU should manifest a good image of political leadership and disciplined/progressive management of its financial statement.

### Corporate Clients

<table>
<thead>
<tr>
<th>Acceptance Parameters</th>
<th>Acceptance Criteria</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Profitability</td>
<td>Profitable in nominal terms for the last 2 years</td>
</tr>
<tr>
<td>b. Retained Earnings</td>
<td>Must be positive</td>
</tr>
<tr>
<td>c. Debt- Equity Ratio</td>
<td>Not more than 80:20</td>
</tr>
<tr>
<td>d. Qualitative Criteria</td>
<td>The corporation, its major stockholders and key officers must have good credit standings</td>
</tr>
<tr>
<td></td>
<td>No major dispute among owners and management for the past 2 years</td>
</tr>
<tr>
<td></td>
<td>No major labor problems for the past 2 years</td>
</tr>
</tbody>
</table>

### Cooperatives

<table>
<thead>
<tr>
<th>Acceptance Parameters</th>
<th>Acceptance Criteria</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Capitalization</td>
<td>At least P300,000.00</td>
</tr>
<tr>
<td>b. Profitability</td>
<td>Profitable in nominal terms for the last 2 years</td>
</tr>
<tr>
<td>c. Debt- Equity Ratio</td>
<td>Not more than 6:1</td>
</tr>
<tr>
<td>d. Past Due Ratio</td>
<td>Not more than 25%</td>
</tr>
<tr>
<td>e. Qualitative Criteria</td>
<td>Must be operating viably in the last 3 years</td>
</tr>
<tr>
<td></td>
<td>Must have adequate and competent management and administrative staff</td>
</tr>
<tr>
<td></td>
<td>No major dispute among the Directors and members in the last 2 years</td>
</tr>
<tr>
<td></td>
<td>No material adverse feedback on the cooperative, directors and management</td>
</tr>
</tbody>
</table>

### Consumer or Retail Clients

<table>
<thead>
<tr>
<th>Acceptance Parameters</th>
<th>Acceptance Criteria</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Gross Income</td>
<td>Must be gainfully employed or have been earning in the last 2 year</td>
</tr>
<tr>
<td>b. Net Cash Surplus</td>
<td>Must have a combined net take home pay or cash surplus after all debt-servicing of at least P10,000.00</td>
</tr>
<tr>
<td>c. Qualitative Criteria</td>
<td></td>
</tr>
</tbody>
</table>

---
Acceptance Parameters | Acceptance Criteria
---|---
- Must be Filipino citizen of legal age but not more than 65 years of age upon maturity of credit term
- Must prove adequate permanency of residence and easy accessibility
- Must have no pending administrative and/or criminal case filed

4.3.2. Internal Credit Risk Rating System

LBP Leasing Corporation uses an Internal Credit Risk Rating System (ICRRS) which was developed as a tool to be used by the Account Officers to objectively rate the credit worthiness of prospective borrowers. Moreover, the ICRRS provides information at a glance, the quality of particular credit.

The ICRRS shall cover the following:

a. Corporate Accounts

This shall cover all corporate/credit accounts with asset size of more than P15.0 million, except local government units (LGUs) and national government agencies/government-owned and controlled corporations (GOCCs) with regulatory functions.

The ICCRS for Corporate accounts has the following components:

i. Borrower Risk Rating (BRR)

The Borrower Risk Rating (BRR) is an assessment of the creditworthiness of the borrower (or guarantor), without considering the type or amount of the facility, or its security/collateral arrangements. It is an indicator of the probability that a borrower cannot meet its credit obligations in the foreseen manner.

In determining the BRR; the following factors shall be considered:

- Financial Condition
- Industry Analysis/competitive strategy
- Management quality

ii. Facility Risk Factor (FRF)

The Facility Risk Factor (FRF) is determined for each individual facility, taking into consideration the different security arrangements, or risk-influencing factors, to allow a more precise depiction of the risk. The risk levels of individual facilities are assessed separately. The combination of the BRR and the FRF results in the Adjusted Borrower’s Risk Rating (ABRR).
iii. **Adjusted Borrower Risk rating (ABRR)**  
The combination of the BRR and the FRF

iv. **Composite Risk rating (CRR)**  
Applicable for borrowers with multiple facilities and is determined by computing the average Adjusted BRR.

**b. Small and Medium Enterprises**

This shall be used for sole proprietorships, partnership with asset base of less than P15.0 million and corporations with assets base of less than P15.0 million. This will not apply to Local Government Units (LGUs), National Government Agencies/ Government Owned and Controlled Corporations (GOCCs) and Financial Institutions and those accounts already in remedial management.

There shall be two sets of rating system for small enterprises (1) for operating businesses and (2) for start-up businesses.

The rating system is composed of two parts:

i. Part I – rate the account against the “Cs” of credit namely: Capacity, Condition, Capital and Compliance to LBP Lease’s Specific Risk Assets Acceptance Criteria (RAAC).

ii. Part II – reflects the borrowers’ character as validated via various checkings (bank, trade, court, neighborhood, community, etc.)

**c. Financial Institutions**

All financial institutions (FIs) that will be extended with credit facility shall be subjected to the rating system which includes the following:

i. Thrifty banks (TBs – Private Development Banks, Savings and Loan Associations, Savings and Mortgage banks)

ii. Rural Banks (RBs) including Cooperative Rural Banks (CRBs)

The system will only be used for new and existing FI accounts. Accounts that are already undergoing remedial management are excluded.

The rating system is composed of two parts:

i. Quantitative – places numerical weight on the following risk factors:  
   - **Capital Adequacy**
The results of quantitative part are discounted by the results of the qualitative part. The resulting numerical figure is translated into a qualitative rating for the account.

ii. Qualitative – reflects the borrower’s character and the FI’s rating given by the regulatory and rating agencies. The benchmarks used in the quantitative part are based on the industry figures and the pronouncements from government regulatory agencies. As such, the benchmarks are subject to periodic change/adjustments.

4.4. Credit Pricing

Setting the price on the basis of the borrower’s credit standing and the effect on the portfolio risk represents an important control measure for the Account Management Group of the Corporation. Thus, LBP Lease implements systems necessary to set prices that reflect risks adequately.

- Components Determining the Price
  Among other things, the margin of a loan is determined by the following factors:
  i. cost of processing the loan
  ii. cost arising from a possible default of the loan
  iii. cost of capital requirements

A rate fixing premium is also added to cover the risk assumed by LBP Lease in fixing a longer term rate that cannot be matched exactly from available facilities of LBP Lease from its lenders. The fixing premium is normally increments of ¼ (.25) percent to ½ (.50) percent for every year depending on the interest rate yield curve. Re-pricing of accounts at regular intervals is also encouraged to ensure that pricing is adjusted based on the existing market condition.

4.5. Credit Enhancement

Credit enhancements provide an effective means of mitigating the size of a client’s credit exposure. However, credit enhancements are regarded as a secondary consideration. LBP Lease will utilize enhancements as necessary and will not forgo its initial credit requirements in exchange for a credit enhancement.

4.5.1. Parent Company Guarantees
Guarantees may take many different forms, including full or partial guarantees. A parent guaranty for a subsidiary would not be accepted for an amount beyond the credit worthiness of the parent alone. The guaranty of a subsidiary’s exposure is to be included within the parent company’s total exposure amount. A parent company guaranty must be reviewed by the Legal Servicing Unit. The Corporation’s risk rating for the parent is assigned when the parent guaranties or assumes subsidiary debt.

In some instances, counterparties may require an assurance or corporate guaranty when relying on the client’s repayment ability. When granted, these will be aggregated and reviewed periodically by the LBP Lease.

4.5.2. Pledged Collateral

The Corporation requires hard collaterals to some of its clients to strengthen the credit position of LBP Lease. However, for lease facility hard collaterals are not required in as much as the leased asset is owned by the Corporation and can stand on its own. Other acceptable collaterals are as follows:

a. Real Estate Mortgage (REM) on acceptable residential commercial properties
b. Assets pertaining to the project, both existing or to be acquired
c. Other assets owned by the borrower not necessarily related or pertaining to the project
d. Other assets not owned by the borrower but legally acceptable by virtue of a 3rd Party Mortgage

4.5.3. Enhancement/Collateral Monitoring, Maintenance and Release

The Account Management Group (AMG) in coordination with the Credit Investigation and Appraisal Unit (CIAD) under Account Servicing Group (ASG) is responsible for assuring the existence and availability of the enhancement/collateral to be accessed in the event the customer fails to fulfill its obligations. However, the maintenance and release of the documentation related to the enhancements/collaterals shall be the responsibility of Account Administrative Unit under ASG.

4.6. Collection

The collection process is initiated with priority given on delinquent accounts. In the later stages of delinquency, the Management decides whether to place accounts for third-party collection, file suit, or seek a settlement. Regular monitoring of delinquent receivables before they become a serious repayment problem develops can greatly reduce the need for extensive recovery proceedings. A
procedure is in place to age receivables so those potential problems are spotted quickly and acted upon efficiently.

Experience indicates that the sooner a collection activity is implemented on a delinquent account, the better the chances for recovery. Not every customer that becomes delinquent will ultimately become un-collectable. LBP Lease maximizes recoveries by using different strategies for each account. Collection efforts are concentrated on accounts with a higher probability of payment and size of the outstanding balance.

Deciding when to dispose of a delinquent receivable is crucial to the collection process. Settling for less than the full amount by placing a delinquent customer with a third-party collection agency saves time but costs money. Filing suit is the last resort as it extends the collection cycle, and could send a debtor into bankruptcy or yield an un-collectable judgment. The key to efficient collection is recognizing the situations in which settling for less than the full value of the balance is the best option.

4.7. Credit Classification and Provisioning

Credit reserves are established to help mitigate the effects of customer default on income volatility. Credit losses from the two primary types of credit exposures, current and potential exposure, are covered in part by credit reserves. Current credit exposure describes the amount of any outstanding receivable (billed and unbilled) that would be uncollected in the event of customer default. Potential credit exposure is the risk associated with possible future increases in the value of an open contract that would be lost if a customer fails to honor its commitments.

LBP Lease classifies its loans pursuant to BSP Circular 247 Series 2000 according to perceived levels of risk and in order to maintain loss reserves which are in aggregate adequate to absorb probable losses arising from its loan portfolio. These classifications are not solely dependent on the number of days the relevant loan is overdue and are as follows:

a. **Unclassified (including miscellaneous exceptions):** These are loans which do not have a greater-than-normal risk and for which no loss on ultimate collections is expected. An allowance of 1% is prescribed for loans in this category.

b. **Loans Especially Mentioned (LEM):** These are loans which are potentially weak because of matters such as technical defects in the supporting collateral or insufficient credit information about the borrower. An allowance of 5% is prescribed to be set up for loans in this category. Substandard loans: These are loans which appear to involve a substantial and unreasonable degree of risk and
which have a weakness that jeopardizes their liquidation. Such weakness may include adverse trends of a financial, managerial, economic or political nature, or a significant weakness in collateral. The prescribed allowance is 25% to be set up immediately for unsecured substandard loans and 10% for secured substandard loans.

c. **Doubtful loans:** These are substandard loans which have the added characteristics of existing facts which will make collection in full highly improbable and on which substantial losses are probable. An allowance of 50% is prescribed to be set up in full immediately for loans in this category.

d. **Loss loans:** These are loans which are considered uncollectible or of insufficient value to warrant being classified as bankable assets. A full allowance is prescribed to be set up in full immediately for loans in this category.

The Account Servicing Group shall review the classification of classified accounts coursed through it and on a monthly basis, reports the adversely classified accounts and reviews the required reserves for these accounts.

The realizable value of collateral is taken into account in the classification of loans with collateral. The greater the realizable value of the collateral, the lower the risk classification of the loan. Allowance for loan losses on classified accounts with confirmed and identifiable collateral is based on the principal balance of the loan. Loans classified as "loss" assets are generally written off by the Corporation in accordance with BSP guidelines. These guidelines stipulates that such loans are only to be written off, and therefore removed from the LBP Lease’s balance sheet, after they have been fully provided for and the Corporation is satisfied that there is no prospect of any recovery.

In addition, LBP Lease also establishes a general allowance for probable loan losses at a level considered adequate to provide for potential losses on its loan portfolio, based on Management’s evaluations of the collectibles of interest and principal, after considering the prevailing and anticipated economic climate, prior loss experience and BSP requirements. The adequacy of the LBP Lease’s allowance for probable loan losses is reviewed regularly based on reports from Account Officers. Any addition to the allowance will be made at the end of the relevant fiscal period to the extent it is deemed deficient.

**4.8. Loan Impairment Testing**

BSP Circular No. 494, Series of 2005 requires that for prudential reporting, valuation reserves shall be booked and the impairment loss on loans/leases shall be computed for the purpose of annual audited financial statements. As required under the Philippine...
Financial Reporting Standards (PFRS), the Corporation assesses any impairment on loans/lease receivables each year to establish whether there is any objective evidence that a financial asset or group of financial assets is impaired.

A loan/receivable or a group of loans/receivables is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the loan/receivable and that loss event has impact on the estimated future cash flows of the loan/receivable or group of loans/receivables that can be reliably estimated. The Corporation assesses loan impairment in two ways, namely:

- Individual or specific assessment for individually significant loans; and
- Collective assessment

All accounts assessed individually but with no impairment losses are determined after comparing carrying value of receivable and the present value of the estimated future cash flows shall be included in collective assessment for impairment loss.

4.9. Credit Limit and Concentration

The limits are necessary to control the risks associated with LBP Lease’s activities. When limits are exceeded, risk must be reduced by taking risk mitigation measures.

A consistent limit management system shall be installed to define, monitor, and control the limits. Such system has to meet the following requirements:

a. The parameters used to determine the risks and define the limits should be taken from existing systems.

b. The defined indicators should be used consistently throughout the organization.

c. Employees should be able to understand how and why the indicators are determined and interpreted. This is intended to ensure acceptance of the data and the required measures, e.g. when limits are exceeded.

d. In order to guarantee effective risk management, risks shall be monitored continuously and clear control processes will also be initiated in time. Therefore, credit decision and credit portfolio management shall be closely linked to limit monitoring.

The limit system shall be developed bearing in mind the requirements of risk controlling and the Corporation’s capacities.

a. Limit Structure

The Corporation has designed the following limits based on existing corporate and regulatory policies:

i. **Single Borrower’s Limit**
The Corporation’s Single Borrower Limit shall be pursuant to the Implementing Rules and Regulation of Republic Act No. 8556 (The Financing Company Act of 1998, amending Republic Act 5980) which states that "The total credit that a financing company may extend to any person, company, corporation or firm shall not exceed thirty (30%) percent of its net worth."

ii. DOSRI Limit

LBP Lease shall also follow the DOSRI limit in the Implementing Rules and Regulation of Republic Act No. 8556 (The Financing Company Act of 1998, amending Republic Act 5980) which states that "The total credit that a financing company may extend to its directors, officers and stockholders shall not exceed fifteen (15%) percent of its net worth."

iii. Industry Limit

The Corporation shall provide preference in lending to priority sectors as identified by its mother bank Land Bank of the Philippines (LBP). Exposures on an industry should not exceed 20% of the total portfolio. Lending to industries included in the negative list provided by LBP shall also be minimized.

iv. Asset Type Limit

<table>
<thead>
<tr>
<th>ASSET TYPE</th>
<th>LIMIT</th>
</tr>
</thead>
<tbody>
<tr>
<td>IT Related</td>
<td>15% of the Total Portfolio</td>
</tr>
<tr>
<td>Non-IT Related</td>
<td>20% of the Total Portfolio</td>
</tr>
<tr>
<td>Real Property</td>
<td>50% of the Total Portfolio</td>
</tr>
</tbody>
</table>

v. Exposures to Government

Risk on exposures to government is addressed by requiring government clients to secure facility exposures through assignment of annual budget allocation for repayment of the financed projects, assignment of deposits, guarantee, and mortgage of financed object/property.

b. Rigidity of Limits

The rigidity of limits varies in terms of their impact on the LBP Lease’s business activities.

i. Certain limits are defined rigidly and must never be exceeded; otherwise the viability of the Corporation as a whole would be endangered.

ii. In addition, there are limits that serve as an early warning indicators that indicate the risk of exceeding limits ahead of time.

This differentiation ensures that control signals are sent out not
only after the limits has been exceeded, but that early warning indicators point out the risk of exceeding a rigid limit in time to make sure that appropriate countermeasures can be taken immediately.

c. Limit Monitoring
Limit shall be monitored on a regular basis by the Risk Management Unit. Limit monitoring is the task of examining if the defined limits are complied with at the level of the individual account as well as at the portfolio and the overall level. The decision makers shall be informed timely depending on the extent to which the limits are exceeded and the approach taken to remedy the situation.

d. Limit Exception Approval and Monitoring
It is anticipated that demand, unanticipated market movements, and economic reasons will result in exposures nearing or exceeding the prescribed limits. The approving authorities, depending on the credit exposure amount may grant exceptions to these limits, but only after an assessment and approval.

4.10. Legal Review
The Legal Counsel of the Corporation will review contracts and documentation associated with client transactions. Generally, LBP Lease will utilize standardized agreements to help assure that transactions are properly documented and legally enforceable.

4.11. Internal Audit
Internal Audit responsibilities will include testing of the accuracy of LBP Lease internal credit risk exposure records and credit files relative to the supporting legal documentation on business transactions. Internal audit may also assess the accuracy and completeness of financial statement analyses and evaluations used to develop credit quality ratings. In addition, responsibilities may include testing of compliance with established limits and other policy guidelines.

4.12. Documentation and Credit File Maintenance
Credit file documentation requirements are generally referred to as the documents needed to legally enforce the loan agreement and properly analyze the borrower's financial capacity. Presented below are the standard loan and collateral documents. On the other hand the standard evaluation requirements are presented in Annex “D” of this manual.

<table>
<thead>
<tr>
<th>STANDARD DOCUMENTARY REQUIREMENT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Principal Lending/Credit Documents</td>
</tr>
<tr>
<td>- Master Lease Agreement</td>
</tr>
</tbody>
</table>
### STANDARD DOCUMENTARY REQUIREMENT

<table>
<thead>
<tr>
<th>Category</th>
<th>Documents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lon/Line Agreement</td>
<td>Receivable Financing/Discounting Line Agreement</td>
</tr>
<tr>
<td>Restructuring Agreement</td>
<td></td>
</tr>
<tr>
<td><strong>Availment Documents</strong></td>
<td></td>
</tr>
<tr>
<td>Lease Schedule</td>
<td>Promissory Note</td>
</tr>
<tr>
<td>Disclosure Statement</td>
<td></td>
</tr>
<tr>
<td><strong>Collateral/Security Documents</strong></td>
<td></td>
</tr>
<tr>
<td>Real Estate Mortgage</td>
<td>Chattel Mortgage</td>
</tr>
<tr>
<td>Mortgage Trust Indenture</td>
<td>Assignment of Receivables</td>
</tr>
<tr>
<td>Joint and Several Signatures/Comprehensive Surety Agreement</td>
<td></td>
</tr>
</tbody>
</table>

The Account Management Group (AMG) is responsible for assuring that the documentation is properly maintained and monitored. Account Administration Unit under the Account Servicing group shall keep copies of the Security Files and ensure that missing, deficient, or improperly executed documents are considered exceptions for it not to aggravate problem loans and seriously hamper workout efforts. A tickler system will be maintained within the organization to track and report deficiencies.

### 5. Credit Risk Monitoring and Reporting

Detailed information about the risk at the portfolio level will be reported to the Risk Management Committee on a regular basis by the Risk Management Unit of LBP Lease in order to manage risk effectively. The Risk Management Unit shall consolidate and process information related to risk controlling and to aggregate it into a risk report covering the following areas:

- The report shall show the development of the total portfolio and the sub-portfolios in terms of risk;
- The need for action, that is mainly risk mitigation measures, results from assessment of market trends, the coordination with risk bearing capacity and risk strategy
- It also has to show how the measures shall affect the Corporation’s risk situation, which is responsible and deadline for implementation of the measures.
- The effectiveness of the processes and measures should also be discussed

Monthly portfolio quality (past due) report is prepared by the Risk Management Unit and presented to the Board of Directors. It shows the
level of past due, the amount of total portfolio, non-performing loans and assets as well as status and actions taken on existing past due accounts.

Below is an outline of indicators in terms of their relevance and benefit which may be incorporated in the risk reports:

<table>
<thead>
<tr>
<th>PERSPECTIVE</th>
<th>INPUT PARAMETERS</th>
<th>OUTPUT</th>
<th>BENEFIT</th>
</tr>
</thead>
<tbody>
<tr>
<td>BOARD OF DIRECTORS/ RISK MANAGEMENT COMMITTEE</td>
<td>Return on equity</td>
<td>Ratio of profit to equity</td>
<td>Necessary to monitor benefit reaching target profitability</td>
</tr>
<tr>
<td></td>
<td>Overview of limit utilization/ utilization of coverage capital</td>
<td>Comparison of limits defines in the risk strategy/ risk capital with risks</td>
<td>Creates input parameters for risk reduction if limits are at risk of being exceeded</td>
</tr>
<tr>
<td></td>
<td>Concentrations</td>
<td>Volumes of loan with identical characteristics</td>
<td>Makes it possible to observe and manage cluster risks</td>
</tr>
<tr>
<td></td>
<td>Specific loan loss provisions vs. Actual and expected defaults</td>
<td>Ratio of provisions for expected losses</td>
<td>Shows if losses can be absorbed by provisions or have to be deducted from coverage capital</td>
</tr>
<tr>
<td></td>
<td>Liquidity Status</td>
<td>Analysis of residual maturities of the credit portfolios and comparison with refinancing funds</td>
<td>Serves to secure LBP Lease’s liquidity</td>
</tr>
<tr>
<td></td>
<td>Composition of sub-portfolios in terms of ratings, industries</td>
<td>Detailed depiction of risks in the sub-portfolio</td>
<td>Allows the comparison with limits to determine specific controlling impulses</td>
</tr>
<tr>
<td>MANAGEMENT</td>
<td>Concentrations</td>
<td>Volumes of loans with identical characteristics</td>
<td>Make it possible to observe and manage cluster risks</td>
</tr>
<tr>
<td></td>
<td>Unsecured portions</td>
<td>Share of unsecured exposures (or parts thereof) in the overall credit exposures</td>
<td>Serves to determine the maximum default risk in case of total loss</td>
</tr>
<tr>
<td></td>
<td>Overview of</td>
<td>Ratio of</td>
<td>Shows if losses can</td>
</tr>
<tr>
<td>PERSPECTIVE</td>
<td>INPUT PARAMETERS</td>
<td>OUTPUT</td>
<td>BENEFIT</td>
</tr>
<tr>
<td>------------------------------</td>
<td>-----------------------------------------------------------------------------------</td>
<td>---------------------------------------------------------------------------------------------</td>
<td>------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td></td>
<td>specific loan loss provisions versus Actual defaults</td>
<td>provisions for expected losses</td>
<td>be absorbed by provisions or have to be deducted from coverage capital</td>
</tr>
<tr>
<td></td>
<td>Development of the individual borrower’s credit standing over time</td>
<td>Comparison of the borrower’s ratings throughout the lifetime of the exposure</td>
<td>Serves to recognize early warning signals and set-up or modify provisions</td>
</tr>
<tr>
<td>ACCOUNT MANAGER/ OFFICER</td>
<td>Development of Industry risk</td>
<td>Shows risk premium for borrowers based on industry</td>
<td>Offers input parameters on marketing</td>
</tr>
<tr>
<td></td>
<td>Development of collateral valuation</td>
<td>Assessment of proceeds that can be realized if collateral is sold</td>
<td>Serves to recognize early warning signals and may lead to a rerating of the borrower</td>
</tr>
</tbody>
</table>
B. MARKET RISK AND LIQUIDITY RISK MANAGEMENT

LBP Lease recognizes the need to identify, measure, monitor and control liquidity and market risks thus it shall adopt an effective strategy for a sound and prudent market and liquidity risk management strategies. The Corporation shall also implement policies and procedures to execute the strategy at an operational level. The following are classified as major market and liquidity risks that LBP Lease manages in the course of its business.

- **Interest Rate Risk**
  Interest rate risk is the vulnerability of LBP Lease’s financial condition to adverse movements in interest rates. It corresponds to the potential effects of interest rate changes on the institution’s profitability, in particular net interest income.

- **Liquidity Risk**
  Liquidity risk is the risk that the Corporation will be unable to make a timely payment of any its financial obligations to customers or counterparties in any currency. Liquidity risk can also extend to a financial institution’s inability to take advantage of business opportunities and sustain the growth forecast in its strategic plan due to lack of liquidity or difficulty in obtaining funding at a reasonable cost.

1. **Market and Liquidity Risks Exposure**

   **Interest Risk Exposure**
   LBP Lease’s interest rates may be fixed or repriceable depending on the nature of the asset or liability. In addition, certain assets or liabilities may not be considered as interest bearing such as those classified as non-performing loans.

   LBP Lease shall identify the principal sources of interest rate risk associated with the positions resulting from financial activities. The main factors that could affect the Corporation’s interest rate risk exposure are:
   - Rate changes
   - Changes in yield curve
   - Nature of financial product
   - Sources of funding and product volume

   **Sources of Interest Rate Risk**
   - Re-pricing Risk
     The most common type of interest rate risk and arises from differences in the maturity and re-pricing of the Corporation’s assets, liabilities and off-balance sheet positions. While such re-pricing and mismatches are fundamental to the business of financial intermediation, they also expose the Corporation’s earning and underlying economic value to changes based on fluctuations in market interest rates.
• Yield Curve Risk
  Yield curve risk is the risk that rates of different maturities may change by a different magnitude. It arises from variations in the movement of interest rates across the maturity spectrum of the same index or market. Yield curves can steepen, flatten or even invert. Unanticipated shifts of the yield curve may have adverse effects on the Corporation’s earnings and underlying economic value.

The Corporation is exposed to interest rate risk in different ways. It is therefore essential that LBP Lease shall be fully aware of the factors that could influence the management of this risk, as well as interest changes and volatility. Some of these factors are:
  • The nature and complexity of the structure of assets and liabilities affecting interest rate sensitivity of earnings and net value;
  • The importance of loan risk premiums and the frequency of repricing dates;
  • Changes in monetary policies;
  • The principal components of the economic environment, including inflation rates and possible declines in return generated by certain financial products.

Foreign Exchange Risk Exposure
Although limited, the Corporation to a certain extent is also exposed to Foreign Exchange risk for transactions involving opening of Letter of Credit (LC). LBP Lease allows its clients to use the existing LC line of the Corporation with LBP for their requirements. Letter of Credit is an undertaking issued by the bank for importer's account in favor of the supplier authorizing them to claim payments provided all LC terms and conditions are complied with. It ensures that payment of goods or services are delivered on the part of the shipper while on the part of the buyer it ensures that the terms and condition of the credit are complied with before payment is made.

Liquidity Risk Exposure
The Corporation’s primary liquidity risk exposure is from the funding liquidity. Funding Liquidity Risk refers to current and prospective risk arising from the inability to meet funding requirements arising from cash flow mismatches without incurring unacceptable losses. It occurs from mismatch of asset and liability.

Liquidity risk is a consequence of exposures to a combination of various risks such as market risk, credit risk and operational risks. The Corporation's overall risk management strategy shall consider correlation between liquidity risks and other risks to which LBP Lease is exposed.

Among the early warning indicators that may indicate liquidity problems are:
  • A negative trend or significantly increased risk in any area or product and services
2. **Measuring and Managing Market and Liquidity Risks**

Changes in interest rates affect both earnings and the economic value of the Corporation by changing net interest income and other interest sensitive income and expenses. Changes in interest rates also affect the Corporation’s underlying economic value. The value of assets, liabilities and interest-rate related, off-balance sheet contracts is affected by a change in rates because the present value of future cash flows, and in some cases the cash flows themselves, is changed.

Management decisions concerning interest rate risk exposure of the Corporation shall take into account the risk/reward trade-off of interest rate risk positions. Management shall compare the potential risk of an interest rate risk position against the potential reward.

Liquidity risk management requires a solid understanding of the cost, availability and maturity of the instruments used as well as the risks represented by the Corporation’s various sources of liquidity, both under normal circumstances and crisis situations. It involves balancing the trade-off between profitability and the risk of illiquidity. Management must ensure that sufficient funds are available at reasonable cost to meet potential demands from both fund providers and borrowers.

### 2.1. Market and Liquidity Risks Limits

The Corporation’s Board of Directors shall set the tolerance for market and liquidity risks and communicate that tolerance to Management. Based on the market risk tolerance, the Management thru the Asset and Liability Committee (ALCO) shall establish the appropriate limits that will be duly approved by the Board of Directors. In setting the market and liquidity risk limits, the nature of the strategies and activities as well as past performance of the Corporation shall be considered. Likewise, the level of earnings and capital shall also be considered to ensure that both are sufficient to absorb losses based on the proposed limits.

ALCO shall periodically review and approve all risks exposure limits from new or existing activities, ensuring these are consistent with and within risk tolerance of business strategy. Market and liquidity risks limits shall be reviewed by ALCO at least annually to account for changes in strategies, size and composition of the Corporation's balance sheet and off-balance sheet positions, market conditions and regulatory issuances.

### 2.2. Market and Liquidity Risk Analysis

The Corporation’s market and liquidity risk analysis process shall commensurate to its size, complexity and risk profile.
**Interest Rate Risks**

The Corporation shall monitor the gap between its rate sensitive assets and rate sensitive liabilities in order to determine the impact of interest rate risk on the net interest margin. Assets and Liabilities are to be broken down in different time intervals based on their maturities to analyze and calculate potential mismatch between the two and the potential effect of the shifts on interest rates. Mismatch in the Corporation’s asset and liability structure/position which would potentially impact the revenues (positive or negative) shall be the basis in determining whether LBP Lease’s exposure to interest rate risk is minimal, large or excessive and warrants immediate action to reduce it.

Scenario Analysis particularly on the sensitivity of interest rates to movements in the market that will affect the Corporation’s financial position shall also be done. This shall include stress scenarios that will be identified by the Corporation.

**Foreign Exchange Risk**

Account Officers are encouraged to be well aware of the impact of changes in foreign exchange whenever they process Letter of Credit transactions. Prudence and careful analysis of the terms should be undertaken at all times.

**Liquidity Risks**

A comprehensive and forward looking liquidity risk analysis shall be utilized by the Corporation. It shall incorporate all the cash flows and liquidity implications of all material assets, liabilities, off-balance sheet positions and other activities of the Corporation. The analysis, at the minimum, should address the following:

a. The Corporation’s sources and uses of cash and their relevant trends.
b. Pro-forma cash flow statements and funding mismatch gaps over different time horizons.
c. Financial ratio analysis
d. Projected liquidity analysis
e. Liquidity gap analysis
f. New products/programs and their effect on liquidity.
g. Trends in the relative cost of funds required by existing and alternative funds providers and the impact on net interest income and margin.
h. The diversification of funding sources and trends in funding concentrations.
i. Asset quality trends.
j. The sensitivity of funds providers to both financial market and institutional trends and events.

The Corporation shall likewise measure prospective liquidity risk by projecting the institution’s cash flows under alternative scenarios. These projections will include usual business scenarios that will
incorporate growth assumptions, or alternative business plans as well as various adverse stress scenarios. The Management’s analysis of the trends in the Corporation's funding sources and balance-sheet structure shall be used to develop the cash flow projections.

2.3. Funding and Liquidity Plan
A minimum operating liquidity requirement shall be established to maintain a comfortable cushion in order to meet cash needs. The liquidity needs of the Corporation shall be reviewed on a regular basis. The review will encompass a detailed forecast of imminent liquidity requirements and a projection of cash needs for the next period.

To determine immediate cash flow needs, a cash flow statement shall be used to develop projections. Regular projections can predict whether excess or deficient liquidity levels will be experienced by the Corporation in the future.

2.4. Contingency Funding Plan
Contingency Funding Plan shall be created using extreme scenarios of adverse liquidity and evaluating the Corporation’s ability to withstand these prolonged scenarios. Contingency funding plans shall incorporate events that could rapidly affect the Corporation’s liquidity, including a sudden inability to securitize assets, tightening of collateral requirements or other restrictive terms associated with secured borrowings.

2.5. Diversification of Liquidity Providers
LBP Lease shall ensure diversification of its funding sources. Currently, LBP Lease has an existing loan and credit line agreement with different banks.

2.6. Market and Liquidity Risks Controls and Audit
Adequate internal controls shall also be in place to ensure the integrity of the Corporation’s market and liquidity risks management process. These internal controls shall be an integral part of the Corporation’s overall system of internal control and should promote effective and efficient operations, reliable financial and regulatory reporting, and compliance with relevant laws, regulations, and institutional policies. An effective system of internal control for market and liquidity risk shall include:

a. A strong control environment;
b. An adequate process for identifying and evaluating risk;
c. The establishment of control activities such as policies, procedures, and methodologies;
d. Adequate information systems;
e. Continual review of adherence to established policies and procedures; and
f. An effective internal audit and independent validation process.

Policies and procedures shall specify the approval processes, exposure limits, reconciliations, reviews, and other control mechanisms designed to provide a reasonable assurance that the Corporation's market and liquidity risk management objectives are achieved.

Internal Audit Unit (IAU) shall provide another layer for independent check and balance to further strengthen market and liquidity risk controls. IAU shall perform a post-audit of entire treasury operations at least once a year and recommend corrective measures for possible infractions in the management of market and liquidity risks.

3. Market and Liquidity Risks Monitoring and Reporting

Reporting of market and liquidity risk measures shall be done regularly and shall clearly compare current exposures to policy limits. In addition, past forecasts or risk estimates should be compared with actual results to identify any modeling shortcomings.

To ensure effective market and liquidity risk monitoring frequent routine reviews and more in-depth and comprehensive reviews on a periodic basis shall be done. Comprehensive and accurate internal reports analyzing LBP Lease’s liquidity and market risks shall be regularly prepared and reviewed by Management and submitted to the Board of Directors.
C. OPERATIONAL RISK MANAGEMENT

LBP Leasing Corporation shall actively monitor the operational risks attributed to the company’s operations. Under Basel II, operational risk covers risks or losses attributed directly or indirectly from operational failures, including financial or non-financial damages from failed or inadequate internal process, systems, people and external events. Hence, drivers of operational risk can be attributed to management, people, systems, processes, new initiatives/activities, and external factors.

Operational risk management is an overall effort to deliver quality, taking into account the organization’s business strategy and customer satisfaction standards. The management of operational risk is directed towards:

- Protection of earnings and capital from losses caused by operational failures;
- Reduction of risk of disruption to operations and limitations of business/strategic losses from operational failures.

1. Operational Risk Management Framework

The operation risk management framework provides an overall operational strategic direction and ensures that an effective operational risk management and measurement process is adopted throughout the organization. Operational Risk Management Framework is shown below:

The Operational Risk Management Framework presents that operational risk management is a continuous process of managing the four sources or cause of operational risks. It also depicts that an effective Operational
Risk Management is founded on four elements: (1) Organization; (2) Strategy/Policy; (3) Operations/Systems; and (4) Measurement.

2. **Basic Operational Risk Management Principles**

2.1. **Developing an Appropriate Risk Management Environment**

a. The Board of Directors is aware of the major aspects of the LBP Lease’s operational risks is a distinct risk category that should be managed. They approve and periodically review LBP Lease’s operational risk management framework.

b. The Board of Directors ensures that the Corporation’s operational risk management framework is subject to effective and comprehensive internal audit by operationally independent, appropriately trained and competent staff.

c. Management has the responsibility for implementing operational risk management framework approved by the Board of Directors.

2.2. **Managing Risk Through Identification, Assessment, Monitoring and Mitigation/Control**

a. The different organizational units identify and assess the operational risks inherent in all material products, activities, processes and systems of the Corporation.

b. The Corporation implements a process to regularly monitor operational risk profiles and material exposure to losses. Regular reporting of pertinent information to Management and Board of Directors that supports the proactive management of operational risk shall be in place.

c. The Corporation has policies, processes and procedures to control or mitigate material operational risks.

2.3. **Managing Risk Through Business Continuity Planning**

a. The Corporation has in place contingency and business continuity plans to ensure its ability to operate as ongoing concern and minimize losses in event of a severe business disruption.

3. **Operational Risk Sources**

The Basel Committee defined operational risk as “the risk of loss resulting from inadequate or failed internal processes, people, and systems or from external events.” The legal risk is included among the sources of operational risk however it will be discussed as a separate item in this manual.

The four operational risk sources are discussed below:

3.1. **Process**

This pertains to losses that may be incurred due to deficiency in an existing procedure of the absence of a procedure. Losses in this category can result from human error or failure to follow an existing procedure. Process related losses are unintentional. These risks may
stem from breakdowns in established processes, or inadequate process mapping within business lines.

Complex or poorly designed processes and systems can give rise to operational losses, either because the systems are unfit for the purposes or due to system malfunctions.

3.2. **People**

This refers to losses associated with intentional violation of internal policies by current or past employees. People risk may also be referred to the risk of management failure, organizational structure or other human resource failures. These risks may be exacerbated by poor training, inadequate controls, poor staffing resources, or other factors.

The way in which the Corporation manages its employees can be a major source of operational risk. Poorly trained or overworked employees may inadvertently expose the Corporation to operational risk. People can refer to a range of issues such as mismanaged or poorly trained employees or the potential for people to perpetrate fraud and so on. The Corporation may find that the availability of its employees or its ability to replace them can influence its ability to recover from interruptions to the continuity of its operations.

3.3. **Systems**

This refers to losses that are caused by breakdowns in existing systems or technology. Losses in this category are unintentional. These cover instances of both disruptions and outright system failures.

Careless handling of passwords or inappropriate administration of access rights facilitates the “work” of external attackers to bring down the systems causing business disruptions or stoppage. Likewise the hazards resulting from malwares or computer viruses are considerably higher if the Corporation does not have up-to-date protective software and anti-virus systems.

3.4. **External Events**

This pertains to losses occurring as a result of natural or man-made forces or the direct result of a third party’s action. These can include natural disasters, terrorism and vandalism.

Included in this risk are natural disasters, political risks, risks related to external crimes among others.

4. **Classification of Operational Risks**

4.1. **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.
4.2. External Fraud
Losses due to acts of a type intended to defraud, misappropriate property or circumvent the law, by a third party

4.3. Employment Practices and Workplace Safety
Losses arising from acts inconsistent with employment, health or safety laws or agreements, from payment of personal injury claims, or from diversity/discrimination events.

4.4. Clients, Products and Business Practices
Losses arising from an unintentional or negligent failure to meet a professional obligation to specific clients (including fiduciary and suitability requirements) or from the nature or design of a product.

4.5. Damage to Physical Assets
Losses arising from loss or damage to physical assets from natural disaster or other events.

4.6. Business Disruption and System Failures
Losses arising from disruption of business or system failures

4.7. Execution, Delivery and Process Management
Losses from failed transaction processing or process management, from relations with trade counterparties and vendors.

5. Measuring and Managing Operational Risk

5.1. Operational Risk Identification and Assessment Tools
In order to control and limit operational risks, LBP Lease ensures that it is aware of the potential risks. The Corporation utilizes the following tools to identify and make a sound assessment on the operational risks of LBP Lease:

a. Risk Control Self-Assessment Matrix
Self-assessments aim at raising awareness of operational risks and at creating a systematic inventory as a starting point for further risk management processes as well as process improvements towards better performance.

The Corporation shall assess its operations and activities against a menu of potential operational risk vulnerabilities. This process is internally driven and often incorporates checklists and/or workshops to identify the strengths and weaknesses of the operational risk environment.

The Corporation submits on a periodic basis the Risk Control Self-Assessment (RCSA) Matrix to LBP-Business Risk Management Department (BRMD) as part of the Bank’s oversight function among its subsidiaries. Thus, the procedures adopted by the Corporation are consistent with the LBP procedures on the accomplishment of the RCSA Matrix. LBP-BRMD validates the
content of LBP Lease’s RCSA Matrix and the results of such validation are considered by the Corporation to continually improve its risk assessment process.

RCSA Matrix shall be accomplished by Authorized Risk takers (ARTs). The accomplished RCSA Matrix shall also be monitored and reviewed by the Risk Management Officer and is presented to the Risk Management Committee for discussion. Copy of the RCSA Matrix is also provided to the Internal Audit Unit (IAU) of the LBP Leasing Corporation for validation.

Detailed guidelines on the accomplishment of the RCSA Matrix are presented as Annex “E” of this manual.

b. High level exposure analysis
Focus on risks that could endanger the organization, its strategic objectives and core activities

c. Organizational reviews

d. Key Process Analysis
Key process are identified by interviewing management and key individuals, by analyzing business strategies, reviewing eventual internal audit documentation, etc. and documented using example flowcharts for further analysis

e. Risk Mapping
Process of identifying the operating units tasked with the execution/implementation of operational risk management systems related to specific business lines and activities

f. Key Risk Indicators
Risk indicators are statistics and/or metrics, often financial, which can provide insight into a LBP Lease’s risk position. These indicators are reviewed on a periodic basis to alert the Corporation to changes that may be indicative of risk concerns. Such indicators may include staff turnover rates and the frequency and/or severity of errors and omissions.

g. Diagram Techniques
This is used to uncover risks that aren't readily apparent in verbal descriptions. This would include preparations of systems or process flow charts which illustrate how elements and processes interrelate.

5.2. Testing and Verification of Internal Operational Risk Controls
The Corporation’s operational risk management framework provides for regular and independent testing and verification of the internal operational risk control. Regular review of existing controls shall be conducted to ascertain if:
- Controls are effective and remain in place;
- Changes in the operation that require further operational risk management and control are identified; and
5.3. Operational Risk Management Audit

There are also separate audit conducted by internal and external entities to LBP Lease. Forward-looking and diligent audit reports form an excellent basis for operational improvements and reduction or elimination of operational risks. A follow-up mechanism for internal and external audit findings is in place to ensure that deficiencies found are eliminated and agreed measures and recommendations are implemented on time. Factors essential for effective monitoring are the adequate support of internal audit and an active interest in external audit findings by the Management and Board of Directors.

5.4. Institutionalization of Risk Management Culture

Institutionalizing the risk management culture emphasizes at all levels the importance of managing risk as part of each person’s daily activities. The goal of creating a risk management culture is to create a situation where staffs and Group/Unit Heads instinctively look for the risks and consider their impacts when making effective operational decisions.

5.5. Business Continuity Management

Business Continuity Management (BCM) is a strategic management process geared to identify potential incidents and to develop effective response plans, increase resiliency in organizational processes in case of business disruption and to minimize the impact of disasters on the organization and its assets. In line with this, LBP Lease shall put in place a Business Continuity Plan which is a crucial aspect of operational risk management to ensure that the business can function even following a breakdown or a major system or business premises becoming unavailable. Business continuity is concerned with:

a. Loss Prevention
b. Loss Reduction
c. Loss Survival

Details of processes involve in the Corporation’s Business Continuity Management is presented in the Business Continuity Plan Manual. As a subsidiary of LBP, the guidance of the Bank is also secured for Business Continuity Management particularly in the preparation of Business Impact Analysis.

5.6. Adoption of Instruments for Risk Sharing

Being a primary risk mitigant for operational risk, insurance shall be secured by the Corporation for all its assets. It is a valuable instrument to transfer risks and to also complement operational risk management. Insurance shall be used to cover the losses initiated from high-impact and low-probability operational risks. The Corporation also considers outsourcing of activities and/or functions as a way to manage operational risks and remain competitive.
6. **Specific Measures of Operational Risk Management**

The monitoring of the entire risk cycle considerably contributes to its effectiveness. This is to reveal weaknesses and improvement measures. Ongoing controls shall be embedded in business processes within the Corporation that should be performed by all employees within the framework of their tasks. Presented below are some of the operational risks of the Corporation including the existing controls to address such:

<table>
<thead>
<tr>
<th>SOURCE</th>
<th>RISKS</th>
<th>CONTROL MEASURES</th>
</tr>
</thead>
<tbody>
<tr>
<td>SYSTEMS/ INFRASTRUCTURE</td>
<td>Outdated measures and facilities</td>
<td>Ongoing analysis of risks and threats</td>
</tr>
<tr>
<td></td>
<td>Insufficient maintenance and repair</td>
<td>Continuous inspections</td>
</tr>
<tr>
<td></td>
<td>Unclear responsibilities</td>
<td>Organization and Documentation</td>
</tr>
<tr>
<td>INFORMATION TECHNOLOGY</td>
<td>Inadequate software quality</td>
<td>Software quality management; Risk Awareness; IT Audit</td>
</tr>
<tr>
<td></td>
<td>IT security</td>
<td>IT security policy/ standards; Risk Awareness; IT Audit</td>
</tr>
<tr>
<td></td>
<td>Interruption of day-to-day operation</td>
<td>Active Monitoring; Risk Awareness; IT Audit</td>
</tr>
<tr>
<td></td>
<td>Outsourcing</td>
<td>IT Organization and Strategy; Risk Awareness; IT Audit</td>
</tr>
<tr>
<td>BUSINESS PROCESSES</td>
<td>Incorrect processes</td>
<td>Documentation; Employee involvement; Control processes; General quality standards of process organization</td>
</tr>
<tr>
<td></td>
<td>Bottlenecks; Redundancies</td>
<td>Process analysis; Employee involvement; Control processes; General quality standards of process organization</td>
</tr>
<tr>
<td></td>
<td>Project Risk</td>
<td>Project Management; Control processes; General quality standards of process organization</td>
</tr>
<tr>
<td>PERSONNEL</td>
<td>Criminal acts</td>
<td>Principles of business ethics; Control mechanism; Internal audit; Corporate culture</td>
</tr>
<tr>
<td></td>
<td>Errors</td>
<td>Error culture; Control mechanism; Internal audit; Training measures; Corporate culture</td>
</tr>
<tr>
<td></td>
<td>Management Risk</td>
<td>Incentive system; Control mechanism; Internal audit; Training measures; Corporate culture</td>
</tr>
<tr>
<td></td>
<td>Insufficient human resources</td>
<td>Resource planning; Corporate culture</td>
</tr>
</tbody>
</table>
7. **People Risk Management**

People Risk is defined as the risk of loss caused intentional or unintentionally by an employee or involving employees such as in the area of employment disputes. The following risks are associated with the employment of people and may cause business disruptions:

- Employee errors or mistakes
- Employee misdeeds
- Employee unavailability
- Employment practices

The Administrative Unit under the Corporate Support Services Group shall be primarily responsible in adopting strategies for management of people risk.

### 7.1. Classification of People Risk

People risk is generally classified into:

#### 7.1.1. Recruitment and Retention Risk

The following table presents the risk drivers associated with Recruitment and Retention Risk and some of the proposed strategies to manage these risks:

<table>
<thead>
<tr>
<th>Risk Driver</th>
<th>Risk Management Strategies</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Compensation and Benefit</td>
<td>• Ongoing review of compensation package</td>
</tr>
<tr>
<td><strong>Inability to provide monetary and other benefits that align with employee expectations</strong></td>
<td>• Communication of the Corporation’s compensation program</td>
</tr>
<tr>
<td>2. Career Pathing/Growth</td>
<td>• Review/development/communication of policies on hiring and promotions</td>
</tr>
<tr>
<td><strong>Lack of a definite path for career development and growth</strong></td>
<td>• Establishment of promotional guidelines</td>
</tr>
</tbody>
</table>
### 7.1.2. People Development and Performance Risk

The following table presents the risk drivers associated with People Development and Performance Risk and some of the proposed strategies to manage these risks:

<table>
<thead>
<tr>
<th>Risk Driver</th>
<th>Risk Management Strategies</th>
</tr>
</thead>
</table>
| 1. Appropriateness/Effectiveness of training program<br>
*Inability to come up with appropriate training programs and to measure their effectiveness may not result in the achievement of desired objectives and business goals* | • Identification of employee training needs<br>• Course and resource person’s evaluation |
| 2. Performance Management System<br>
*Ineffectiveness of the PMS may result to inability to achieve desired results and lead to employee dissatisfaction or grievances* | • Review of performance Management Program |

### 7.1.3. Succession Planning

<table>
<thead>
<tr>
<th>Risk Driver</th>
<th>Risk Management Strategies</th>
</tr>
</thead>
</table>
| 1. Quantity and quality of the candidates<br>
*Inadequate competent and qualified candidates may constrain the ability of the Corporation to fill up critical positions* | • Selection and Promotions deliberations<br>• Sending key management officers to Management Development Program<br>• Familiarity of other officer/s with the functions of another officer |
8. Technology/Information Technology (IT) Risk Management

Technology/IT developments have transformed how business operates. It enables key processes that the Corporation uses to develop, deliver, and manage its products, services and support operations. While these technology developments provide business benefits, they also present new and complex risks, such as information security, data integrity, cyber-crime, cyber-terrorism, systems availability, and model risk. Within the context of IT operations, risk is the probability, not the certainty, of suffering a loss, and the vulnerability or likelihood that threat will occur. The loss could be anything from diminished quality of a service to increased cost, missed deadlines, or complete service failure. These risks require operational risk controls for day-to-day operations, as well as disaster recovery planning for unlikely but potentially disastrous events.

8.1. Technology/IT Risk Elements

a. Management Processes
   Management processes involve planning, investment, development, execution, and staffing or information technology functions.

b. Architecture
   Architecture refers to the underlying design of an information system and its individual components.

c. Integrity
   Integrity refers to reliability, accuracy, and completeness of information delivered to users.

d. Security
   Security refers to safety afforded in information assets and information processing environments.

e. Availability
   Availability refers to the delivery of information to end-users, counter-parties. The delivery of information is effective when information is consistently delivered on a timely basis in support of business and decision-making processes. Measures of availability include capacity of information systems and appropriate business continuity planning processes.

8.2. Technology/IT Risk Management Process

The Technology Risk Management process shall help LBP Lease to identify, measure, monitor and control its risk exposure. It is the responsibility of the Board of Directors and a Senior Management to ensure that an effective planning process exists, that technology is implemented properly with appropriate controls and that measurement and monitoring efforts effectively identifying ways to manage risk exposure. The process involves three (3) essential elements, namely:

8.2.1. Planning
   Technology planning often involves strategic, business and project planning.
• Strategic plan established the overall role of technology as it relates to the Corporation’s mission and assesses the type of technology that it needs to fulfill that role.

• Business plan integrates the new technology into existing lines of business and determines the level of technology best suited to meet the needs of particular business lines.

• Project plan establishes resource needs, time lines, benchmarks and other information necessary to convert the business plan into operation.

Proper planning minimizes the likelihood of computer hardware and software systems incompatibilities and failures and maximizes the likelihood that the Corporation’s technology is flexible enough to adapt to future needs of LBP Lease and its clients. Because technology is constantly changing, the Management should periodically assess its uses of technology as part of its overall business planning. Planning should consider issues such as:

• Cost of designing, developing, testing and operating the systems whether internally or externally;

• Ability to resume operations swiftly and with all data intact in the event of system failure or unauthorized intrusions;

• Adequacy of internal controls, including controls for third party providers; and

• Ability to determine when a specific risk exposure exceeds the ability of an institution to manage and control that risk.

8.2.2. Implementation

Proper implementation of projects and initiatives is needed to convert plans into better products and services, delivery channels and processes. The Corporation shall establish the necessary controls to avoid operational failures and unauthorized intrusions which could result in increased losses and damaged reputation.

8.2.3. Measurement and Monitoring

As part of both planning and monitoring, the Corporation must establish clearly defined measurement objectives and conduct periodic reviews to ensure that goals and standards established are met. Goals and standards should include an emphasis on data integrity, which is essential to any effective use of technology. Information should be complete and accurate before and after it is proposed. Ultimately, the success of technology depends on whether it delivers the intended results.

8.3. IT Risk Identification

IT risk is determined by tracing it to adverse business impact as shown in the following table:

<table>
<thead>
<tr>
<th>Identified IT Risk</th>
<th>Definition</th>
<th>Adverse Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. IT Management</td>
<td>Failure to effectively manage technology</td>
<td>Missed business</td>
</tr>
</tbody>
</table>

Initial Issue Date  October 2009
Revision No. 2
Revision Date April 2014
<table>
<thead>
<tr>
<th>Identified IT Risk</th>
<th>Definition</th>
<th>Adverse Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk</td>
<td>prioritize IT initiatives and administer IT resources may lead to lost business and hinder the achievement of the Corporation’s goals and objectives</td>
<td>opportunities</td>
</tr>
<tr>
<td>2. IT Confidentiality Risk</td>
<td>Failure of information system to adequately protect both IT data and IT infrastructure leads to or allows unauthorized access, or leads to destruction of information and information system of the Corporation</td>
<td>Unauthorized disclosure; sanctions; unrecoverable financial loss</td>
</tr>
<tr>
<td>3. IT Availability and Continuity Risk</td>
<td>Failure to ensure uninterrupted operations and immediate recovery from systems and implementation failures leads to lost business and losses for the Corporation</td>
<td>Long recovery period; Undue business process operations disruptions or stoppage</td>
</tr>
<tr>
<td>4. IT Integrity Risk</td>
<td>Failure of information systems to provide accurate, reliable and timely financial and non-financial information when needed leads to operational inefficiencies or lost business opportunities</td>
<td>Operational inefficiencies; lost business opportunities</td>
</tr>
<tr>
<td>5. Technology Implementation Risk</td>
<td>Failure to adopt and implement the appropriate system and technology to support business processes or major initiatives may lead to costly investments and may compromise product or service</td>
<td>Costly investments; poor service delivery</td>
</tr>
</tbody>
</table>
IT risk analysis is done to determine the probable cause which are generally in the form of threats and vulnerabilities. Threats and vulnerabilities may be classified as natural disasters, environmental and people-based.

8.4. IT Risk Control
IT risk control shall be established to prevent or eliminate the threats or potential causes of IT risk which are inherent to IT functions and processes. The Corporation shall develop an IT Risk Management Framework to ensure that there is sufficient control in place to manage IT risks.

8.5. IT Risk Action Plan
IT risk pre-emptive response is aimed at minimizing the damaging impact of uncontrolled IT risk occurrence. This involves IT Risk Containment to forestall the adverse impact of IT risk to the Corporation while troubleshooting and recovery actions are being pursued (e.g. back-up arrangement; disaster recovery and IT continuity plan management) and IT Risk Mitigation which is aimed at softening the impact of residual IT risk (e.g. securing insurance, outsourcing).

9. Operational Risk Monitoring and Reporting
High-level operational risk reports will be produced periodically to be reviewed by the Board of Directors and Management. These reports will provide information regarding the operational risk profile of the organization, including the sources of operational risks both from an organization-wide and line-of-business perspective, versus established management expectations.

Operational Risk Monitoring and reporting will include continuous review and updating of the Corporation’s Risk Control Self-Assessment Matrix, timely and continuous information management and reporting, monitoring of audit issues and creation of loss event database.
D. LEGAL RISK MANAGEMENT

LBP Leasing Corporation established a legal risk management system with the following objectives:

- To organize unified management of legal risks.
- To ensure legitimacy of the Corporation’s activities.
- To ensure that the Corporation’s legitimate interests at the time of signing and execution of agreements are met.
- To establish a legitimate framework for relationships between the Corporation and its employees, to ensure that labor laws, business and corporate ethics are observed by the Corporation and its employees.

1. Legal Risk Management Framework

The following fundamental principles are adopted by the Corporation for the organization of a system on the management of legal risks:

- Determine a procedure for identifying, evaluating, establishing an acceptable level of legal risks and monitoring of the level of legal risks;
- Develop a set of measures towards maintaining an acceptable level of legal risks, including control and/or minimization of risks;
- Specify a procedure for information support on issues of legal risk;
- Establish a procedure for reporting and exercising control over the effectiveness of management of legal risks.

2. Legal Risk Exposures

Legal risk management involves the management of legal risk and the legal management of risk. It shall cover compliance risk management,
contractual risk management and litigation risk management among others. Legal mechanisms are part of the dealings of the Corporation. These include the master agreements, loan/lease agreements, collateral agreements and other agreements which contain important legal provisions that are designed to protect the Corporation in the event of default or disputes. Failure to ensure that proper documentation and to obtain necessary protection in the signed agreements can lead to losses for the Corporation.

Legal risks are classified into three (3) categories which are as follows:

2.1. Defective Contracts

This would include defective and unenforceable contracts that are contrary to law, with technical defects or with lack of capacity on either parties.

2.2. Lawsuits

This would include carrying interpretations of contractual obligations/procedural rules/legal provisions, possibility that the claim may fail due to unforeseen events, non-filing/submission of required pleadings/documents in court, failure to appear during crucial stages in the litigation process and possibility that legal proceedings will have an adverse consequence greater than expected.

2.3. Adverse Judgments

This would include unfavorable judgments against the Corporation and favorable judgments to the Corporation but with the risk that the enforcement of judgment award is subject to potential difficulties of procedures, failure or refusal of judgment obligor to honor obligations and judgment award not capable of satisfaction or execution.

3. Measuring and Managing Legal Risks

Primarily, the Legal Servicing Unit (LSU) develops legal risk management strategies to protect the interest of the Corporation. They shall work closely with the Office of the Government Corporate Counsel (OGCC) to act on and monitor legal cases that are endorsed for appropriate legal action.

Further, the Corporation utilizes the following methods to minimize the level of legal risks:

3.1. Legal Review

Conduct of legal review by LSU shall ensure that all documentation requirements such as master agreements and contracts are complete and enforceable and that contracting parties have legal capacity or are duly empowered to contract with the Corporation.
3.2. **Standardization of Legal Documents**

Organize a system on developing, endorsing and approving standard agreements and transactions that would meet the requirements of legal protection of the Corporation’s interests.

3.3. **Legal Consultations**

The Corporation shall establish requirements for coordinating operations with the LSU in specific cases. Authorized risk takers may seek advice to LSU regarding the legal constitution of enforceable commitments during the negotiation process, appropriate governing law and jurisdiction for agreements, development and documentation of terms of transactions and documentation of waivers, amendments and cancellations to the original documents.

3.4. **Other Legal Risk Control**

The Corporation particularly the LSU shall adopt the following additional processes to manage legal risks:

a. Analyze impact of legal risks on the Corporation’s Key Results Areas (KRAs);

b. Monitor regulatory issuances and its effect in the Corporation’s operation;

c. Coordinate activities towards identifying, classifying and evaluating legal risks; and

d. Adopt and use the principles “know your customer” and “know your employee”.

4. **Specific Measures of Legal Risk Management**

Presented below are some of the specific legal risk exposures of the Corporation and the corresponding control measures undertaken to minimize the identified risks:

<table>
<thead>
<tr>
<th>SOURCE</th>
<th>RISKS</th>
<th>CONTROL MEASURES</th>
</tr>
</thead>
<tbody>
<tr>
<td>LEGAL</td>
<td>Mistakes in drafting contracts</td>
<td>General management of legal risk; Consideration of special risk issues; Involvement of the legal department into day-to-day business</td>
</tr>
<tr>
<td></td>
<td>Lack of evidence</td>
<td>General management of legal risk; Consideration of special risk issues; Involvement of the legal department into day-to-day business</td>
</tr>
<tr>
<td></td>
<td>Non-compliance with contractual or legal duties</td>
<td>General management of legal risk; Consideration of special risk issues; Involvement of the legal department into day-to-day business</td>
</tr>
<tr>
<td></td>
<td>Problems in enforcing</td>
<td>General management of legal risk</td>
</tr>
<tr>
<td>SOURCE</td>
<td>RISKS</td>
<td>CONTROL MEASURES</td>
</tr>
<tr>
<td>----------------</td>
<td>--------------------------------------------</td>
<td>-------------------------------------------------------</td>
</tr>
<tr>
<td></td>
<td>claims</td>
<td>risk; Consideration of special risk issues; Involvement of the legal department into day-to-day business</td>
</tr>
<tr>
<td></td>
<td>External legal risks</td>
<td>Strategic and contingency planning</td>
</tr>
</tbody>
</table>

5. **Legal Risk Monitoring and Reporting**

The Legal Serving Unit shall ensure that a periodic reporting of total legal risk exposures/profile of the Corporation to the Risk Management Committee and the Board of Directors is done. Quarterly updates on accounts endorsed to legal should also be provided to the Board of Directors.
E. COMPLIANCE RISK MANAGEMENT

Compliance risk management is covered by the Compliance Unit of LBP Leasing Corporation. The Compliance Unit shall enhance compliance risk management, provide comprehensive compliance risk coverage and take into account the RCSA’s and priority risk in its compliance risk assessment & prioritizing compliance risk.

A Compliance Risk Assessment is integrated in the compliance procedures with the following objectives:

- To evaluate and quantify compliance as well as assess and mitigate business risks specific to the Corporation’s current operations, products and services and provide basis for risk prioritization.
- To establish a basis for business risk mitigation plans, corporate policies and controls, including improvement of compliance programs.

Presented below are the activities covered by the Compliance Risk Assessment:
Annex “A” – BSP Circular No. 510 Series of 2006

OFFICE OF THE GOVERNOR

Circular No. 510
Series of 2006

Subject: Guidelines on Supervision by Risk

The Monetary Board in its Resolution No. 88 dated 19 January 2006 approved the attached guidelines on supervision by risk to provide guidance on how financial institutions (FIs) should identify, measure, monitor and control risks.

The guidelines set forth the expectations of the Bangko Sentral ng Pilipinas (BSP) with respect to the management of risks and are intended to provide more consistency in how the risk-focused supervision function is applied to these risks. The BSP will review the risks to ensure that an FIs internal risk management processes are integrated and comprehensive. All FIs should follow the guidance in their risk management efforts.

This Circular shall take effect fifteen (15) calendar days after publication in the Official Gazette or in a newspaper of general circulation.

FOR THE MONETARY BOARD:

AMANDO M. TETANGCO, JR.
Governor

2 February 2006

PANANGIPANING MATATAG, BANSANG PANATAG

Initial Issue Date: October 2009
Revision No.: 2
Revision Date: April 2014

Bунghà Sentrûng Filipînès

OFFICE OF THE GOVERNOR

Circular No. 247
Series of 2000

The Monetary Board, in its Resolution No. 753 dated May 12, 2000 approved the amendment of Circular No. 210 dated September 9, 1998 on the guidelines in the classification of loans, and the provisioning requirements for classified loan accounts.

SECTION 1. As a general policy, banks must observe the provisions of Section 76 of R.A. No. 337 as amended to wit:

"Before granting a loan, banks must exercise proper caution to ascertain that the debtor is capable of fulfilling his commitments to the bank.

NEW"

SECTION 2. Classification of Loans. In addition to classifying loans as either current or past due, the same should be qualitatively appraised and grouped as Unclassified or Classified.

A. Unclassified Loans. These are loans that do not have a greater-than-normal risk and do not possess the characteristics of classified loans as defined in item B of this Section. The borrower has the apparent ability to satisfy his obligations in full and therefore no accelerated collection is anticipated. The following loans, among others, may be considered subject to classification:

1. Loans or portions thereof secured by immovable or movables/immoveable substitutes remaining in the lending institution, and margin deposits, or government supported securities,

2. Loans with technical defects, and uncertainties in documentation and collateral requirements. These deficiencies are isolated cases where the exceptions involved are not material nor is the bank’s chance to be repaid or the borrower’s ability to liquidate the loan in an orderly manner undermined. These exceptions should be brought to Management’s attention for corrective action during the examination and those not corrected shall be

ITAGUYOD AMG PHILIPPINES 2000

IMAG-HIPOK SA BANGKO
Annex “C” – BSP Circular No. 494 Series of 2005

Bangko Sentral ng Pilipinas

OFFICE OF THE GOVERNOR

Circular No. 594
Series of 2005

Subject: Guidelines on the Adoption of Philippine Financial Reporting Standards and Philippine Accounting Standards

The Monetary Board in its Resolution Nos. 1116 and 1184 dated 18 August 2003 and 8 September 2005, respectively, approved the following guidelines in adopting the provisions of the Philippine Financial Reporting Standards (PFRS) and Philippine Accounting Standards (PAS) effective the annual financial reporting period beginning 1 January 2006, both for purposes of prudential reporting and audited financial statements.

Section 1. Statement of Policy. It is the policy of the Bangko Sentral ng Pilipinas to promote fairness, transparency and accuracy in financial reporting. It is in this light that the BSP deems it necessary to adopt all Philippine Financial Reporting Standards (PFRS) and Philippine Accounting Standards (PAS) issued by the Accounting Standards Council (ASC) to the greatest extent possible.

Section 2. Accounting Treatment for Prudential Reporting. For prudential reporting, financial institutions shall adopt in all respect the PFRS and PAS except as follows:

(a) In preparing consolidated financial statements, only investments in financial allied subsidiaries except insurance subsidiaries shall be consolidated on a line-by-line basis; while insurance and non-financial allied subsidiaries shall be accounted for using the equity method. Financial non-financial allied/non-allied associates shall be accounted for using the equity method in accordance with the provisions of PAS 28 “Investments in Associates”. For purposes of preparing separate financial statements, financial/non-financial allied/non-allied subsidiaries/associates, including insurance subsidiaries/associates, shall also be accounted for using the equity method, and

(b) Financial institutions shall be required to meet the BSP recommended valuation reserves.

PANANALAPIING MATATAG, BANSANG PANAYTAG

A. Mabini St., Malate 1014, Manila, Philippines • Telephone (02) 524-70-11 • URL: www.bsp.gov.ph • e-mail: bspmail@bsp.gov.ph
Annex "D" – Standard Evaluation Requirements

LBP LEASING CORPORATION
STANDARD EVALUATION REQUIREMENTS

1. Single Proprietorship
   • Filled-up Business Information Sheet
   • Certificate of Business Name Registration with the ETI
   • Income Tax Return (last two years)
   • Financial Statements (last two years; audited and in-house)
   • Latest Interim Financial Statements
   • Statement of Assets & Liabilities
   • Photograph of principal/owner

2. Partnership/Corporation
   • Filled-up Business Information Sheet
   • Copy of Registration with the SEC
   • Articles of Incorporation and By-Laws (for corporation)/Articles of Co-Partnership and
     Partner’s Resolution (for partnership)
   • List of Officers and Directors certified by the Corporate Secretary
   • Bio-data/Personal Information of Officers and Directors
   • Alien Registration Certificate of foreign officers
   • Board Resolutions to: 1) borrow or enter into the requested facility in the amount of; and
     2) designate authorized representative to negotiate and sign in behalf of the company
   • Financial Statements (last 2 years; audited and in-house)
   • Latest Interim Financial Statements

3. Financial Institutions
   • Filled-up Letter of Application
   • 3-year Audited Financial Statements
   • Latest Annual Report
   • Interim Financial Statements
   • Financial statements for the last two years submitted to BSP-CBP stamped received by
     the BSP or certified by the bank’s manager/account as true copies submitted to the BSP
     (for banks)
   • Latest BSP Report of Examination and the corresponding reply thereof (for banks)
   • List of directors and senior officers certified by the Corporate Secretary with bio-data
   • List of existing principal stockholders and their stockholdings (with 10% or more of total
     shares)
   • Organizational chart/actual set-up
   • One year company plans

4. Cooperatives
   • Articles of Cooperation and By-Laws
   • Bio-data of officers and Board of Directors with ID pictures
   • Cooperative Board of Resolution authorizing the cooperative to borrow (stating the
     amount and purpose of loan) and designating at least two officers to negotiate and sign
     loan documents.
   • Audited financial statements for the last two years along with interim financial
     statements
   • Master list of registered members with name of spouse, address, area of farm, farm
     location, amount of subscribed and paid-up capital and specimen signature prepared by
     the Secretary and attested to by the Chairman

5. Individuals
   • Filled-up Application Form with ID pictures
   • Latest Income Tax Return with W-2
   • Marriage Contract (if married)
   • Photograph
Annex “E” – Steps on the Accomplishment of Risk Control Self-Assessment (RCSA) Matrix

Below are the components of the revised RCSA template. Color-code for the columns are:

- **Green Columns**: Input field
- **Yellow Columns**: With drop-down menu for selection
- **Orange Columns**: Data automatically computed by the RCSA template

1. **Row 4 – Name of Unit**
   Indicate the complete name of the Department or Office.

2. **Row 8 – Mega Process & Row 9 – Major Process**
   Select from the menu the applicable mega and major process of the Unit or Group. This is a mandated field and cannot proceed to the next step without any entry on this field. Below is the Mega/Major Processes:

<table>
<thead>
<tr>
<th>MEGA PROCESSES</th>
<th>MAJOR PROCESSES</th>
</tr>
</thead>
</table>
| Core Business          | 1. Lending and Leasing Operations  
                          |   • Marketing and Loan/Lease Evaluation  
                          |   • Documentation, Availments and Disbursement  
                          |   • Account Monitoring and Administration  
                          |   • Remedial Management  
                          |   • ROPA Management, Utilization and Disposal |
| Resource Management    | 1. Operations Support/Ancillary Services  
                          |   • Documentation, Review, Billing and Recording  
                          |   • Credit Investigation and Appraisal  
                          |   • Accounting  
                          |   • Human Resource Management  
                          |   • General Services and Technology Management  
                          | 2. Asset and Liability Management/Fund Sourcing |
| Strategic Management   | 1. Executive and Other Supervisory Services  
                          |   • Corporate Governance  
                          |   • Risk Management  
                          |   • Legal Services  
                          |   • Compliance Management  
                          |   • Internal Audit |
3. **Row 10 – Sub-Process and Row 11 – Activities**
   Specify the sub-process and activity where the risk assessment will be focused on. Please refer to the detailed procedures on Operations Manual and/or actual processes in audit’s SIPOC (Source-Input-Process-Output-Customer) form.

A. **RISK IDENTIFICATION**

4. **Column A – Risk Reference**
   In assigning the Risk Reference, please use the following configuration:
   Example:
   
   **RMU-2014-RM-001**
   
   - **RMU** = Unit/Groups Name
   - **2014** = Year of Assessment
   - **RM** = Initial of Sub-Process (e.g., Risk Measurement)
   - **001** = Count per Risk

5. **Column B – Risk**
   Select from the drop-down menu the identified operational risk (business process) to be assessed. The selection is based on the Risk Dictionary.

6. **Column C – Risk Driver**
   Select from the drop-down menu the applicable Risk Driver (i.e. the causes of risk). If not included in the selection, click "Others (please specify)" and type the appropriate Risk Driver.

7. **Column D,E,F – Basel II Risk Event Categories**
   **Column D – Level I, Column E – Level II, Column F – Level III**
   To map the risk events with the Basel Event Categories for future reference, select from the drop-down menu the appropriate risk event category. This is a mandated field and cannot proceed to the next step without any entry on this field. (*Annex B in RCSA Template Workbook or Annex D of this Risk Management Manual*).

B. **RISK ASSESSMENT**

8. **Column G – Inherent Loss**
   Indicate the estimated amount of loss (in absolute Peso amount) in case the risk event will happen without considering any control. It may be:
   
   **Hard Loss**
   - Costs due to actual loss of equipment (acquisition cost)
   - Costs due to re-work (normalization)
   - Costs due to resolution of disaster/emergency
   - Costs due to consultant’s time, parts and repair costs, replacement cost
   - Hourly costs of downtime to production, production capacity per hour versus non-productive use of staff time

   **Soft Loss**
   - Costs due to opportunity loss (forgone income)
   - Contingency costs (not budgeted, additional cost due to inflation, etc.)
9. **Column H – Basis of Computation**
   Indicate the basis of computation for each estimated amount assigned in inherent loss.

   Example: actual loss, penalties/sanctions, cost of recovery, cost of rework, overtime pay/additional manhours, opportunity loss, etc.

10. **Column I – Impact Level & Column J – Impact Score**
    Impact is the level of severity or damage to be incurred in case the risk will happen. Impact Score is the score corresponding to the amount of severity or damage. The RCSA template shall automatically compute the Impact Level and Impact Score.

<table>
<thead>
<tr>
<th>Impact Level</th>
<th>Amount of Estimated Damages (in Million)</th>
<th>Impact Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very Low</td>
<td>0 to 6.9</td>
<td>1</td>
</tr>
<tr>
<td>Low</td>
<td>7.0 to 13.9</td>
<td>2</td>
</tr>
<tr>
<td>Moderate</td>
<td>14.0 to 20.9</td>
<td>3</td>
</tr>
<tr>
<td>Major</td>
<td>21.0 to 27.90</td>
<td>4</td>
</tr>
<tr>
<td>Severe</td>
<td>28.0 and above</td>
<td>5</td>
</tr>
</tbody>
</table>

The initial basis for the estimated amount of damages is Php 28 million which is the set threshold per BU.

11. **Column K – Existing Controls**
    Existing Controls are measures (i.e. set-up, systems, policies and procedures) in place to control the occurrence of identified risks (preventive) or mitigate the impact (corrective). Type the applicable existing controls (e.g. EO number and corresponding topics, actual practices, etc.).

12. **Column L – Control Adequacy Description & Column M – Control Adequacy Score**
    Select from the drop-down menu the applicable Control Adequacy Description guided by the table below. The RCSA template shall automatically provide the Control Adequacy Score on Column M.

<table>
<thead>
<tr>
<th>Description</th>
<th>Control Adequacy Score</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Completely Under Control</td>
<td>1</td>
<td>• Existing policy and procedures are in place</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Effectively implemented</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• No BSP and IAG exception related to the risk</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Zero historical risk event</td>
</tr>
<tr>
<td>Description</td>
<td>Control Adequacy Score</td>
<td>Definition</td>
</tr>
<tr>
<td>---------------------------</td>
<td>------------------------</td>
<td>-----------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Tight Control in Place</td>
<td>2</td>
<td>• Existing policy and procedures are in place</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Effectively implemented</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• With minor BSP and Audit exception related to the risk</td>
</tr>
<tr>
<td>Moderate Control in Place</td>
<td>3</td>
<td>• Existing policy and procedures are in place</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• With some flaws on the implementation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• With moderate BSP and IAG exception related to the risk</td>
</tr>
<tr>
<td>Some Control in Place</td>
<td>4</td>
<td>• Some existing policy and procedures are in place</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Not effectively implemented</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• With major BSP and IAG exception related to the risk</td>
</tr>
<tr>
<td>No Control in Place</td>
<td>5</td>
<td>• No existing policy and procedures</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Below acceptable in IAG rating</td>
</tr>
</tbody>
</table>

13. **Column N – Frequency of Occurrence & Column O – Historical Frequency Score**

Select from the drop-down menu the applicable frequency of occurrence, the template will automatically compute for the Historical Frequency Score as illustrated below:

<table>
<thead>
<tr>
<th>Frequency of Occurrence</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 event in a year</td>
<td>1</td>
</tr>
<tr>
<td>1 to 2 event/s in a year</td>
<td>2</td>
</tr>
<tr>
<td>3 to 4 events in a year</td>
<td>3</td>
</tr>
<tr>
<td>5 to 6 events in a year</td>
<td>4</td>
</tr>
<tr>
<td>more than 6 events in a year</td>
<td>5</td>
</tr>
</tbody>
</table>

This is a mandated field and cannot proceed to the next step without any entry on this field.

14. **Column P – Probability Score & Column Q – Probability Level**

Probability is the degree of likelihood that a risk event will happen in the future. It is a function of control and historical frequency. The template automatically computes the Probability Score and Level as illustrated below.
<table>
<thead>
<tr>
<th>Probability Score</th>
<th>Probability Level</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1</td>
<td>Unlikely to Happen</td>
</tr>
<tr>
<td>2 to 4</td>
<td>2</td>
<td>Rare/Seldom</td>
</tr>
<tr>
<td>5 to 9</td>
<td>3</td>
<td>Occasional</td>
</tr>
<tr>
<td>10 to 16</td>
<td>4</td>
<td>Likely to Happen</td>
</tr>
<tr>
<td>17 to 25</td>
<td>5</td>
<td>Almost Certain</td>
</tr>
</tbody>
</table>

Formula: Probability Score = Control Score x Historical Frequency Score

15. Column R – Risk Score

Risk Score is the quantified level of risk after considering the future impact and probability of an event. The template automatically computes the Risk Score.

Formula: Risk Score = Impact Score x Probability Level

<table>
<thead>
<tr>
<th>Risk Score</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 to 5</td>
<td>Very Low</td>
</tr>
<tr>
<td>6 to 10</td>
<td>Low</td>
</tr>
<tr>
<td>11 to 15</td>
<td>Moderate</td>
</tr>
<tr>
<td>16 to 20</td>
<td>Major</td>
</tr>
<tr>
<td>21 to 25</td>
<td>Severe</td>
</tr>
</tbody>
</table>

16. Column S – Risk Weight

Risk Weight is the assigned percentage corresponding to the Risk Score used to compute for the Potential Loss expressed in absolute Peso amount. High Risk Weight indicates high impact and high probability. The RCSA template automatically computes the Risk Weight as illustrated below:

<table>
<thead>
<tr>
<th>Risk Score</th>
<th>Description</th>
<th>Risk Weight</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 to 5</td>
<td>Very Low</td>
<td>0%</td>
</tr>
<tr>
<td>6 to 10</td>
<td>Low</td>
<td>25%</td>
</tr>
<tr>
<td>11 to 15</td>
<td>Moderate</td>
<td>50%</td>
</tr>
<tr>
<td>16 to 20</td>
<td>Major</td>
<td>75%</td>
</tr>
<tr>
<td>21 to 25</td>
<td>Severe</td>
<td>100%</td>
</tr>
</tbody>
</table>

17. Column T – Potential Loss

Potential Loss is the residual loss after applying the controls in place (absolute amount in Peso) that unit will incur in case a risk event will happen. The template automatically computes the Potential Loss value.

Formula:

Potential Loss (Peso) = Inherent Loss (absolute amount in Peso) x Risk Weight (%)

18. Summary

The RCSA template shall automatically computes the following:
The RCSA template shall automatically compute the Overall Risk Level for Process Risk based on the table below:

<table>
<thead>
<tr>
<th>Risk Level</th>
<th>Total Potential Loss (in Million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very Low</td>
<td>0 to 6.9</td>
</tr>
<tr>
<td>Low</td>
<td>7.0 to 13.9</td>
</tr>
<tr>
<td>Moderate</td>
<td>14.0 to 20.9</td>
</tr>
<tr>
<td>Major</td>
<td>21.0 to 27.9</td>
</tr>
<tr>
<td>Severe</td>
<td>28.0 and above</td>
</tr>
</tbody>
</table>

19. Signatories
After the RCSA matrix is accomplished, reviewed and finalized, the following shall be the signatories:

Prepared by: Staff
Reviewed by: Unit Head
Conforme by: Group Head/President

C. RISK MITIGATION (under Risk Mitigation Worksheet)

Risk Prioritization is the process of short-listing the risks which require immediate attention of the Management. All risk events with Risk Score equal to "11 and above" or with Potential Loss amounting to "P14M and above" shall require close monitoring and automatically be included in Risk Mitigation Template.

20. Column A – Risk Reference
Risk Reference shall automatically appear on “Column A of Risk Mitigation Worksheet” if Risk Score equal to “11 and above” or with Potential Loss amounting to “P14M and above”.

21. Column B – Risk Treatment
Select from the drop-down menu the applicable Risk Treatment based on the following description:

<table>
<thead>
<tr>
<th>Risk Treatment</th>
<th>Description</th>
</tr>
</thead>
</table>
| Reduce Risk    | RM strategy or response or technique through systematic reduction in the extent of exposure to risk and/or the likelihood of its occurrence (e.g., disperse or control)
Strategy: "Intelligently minimizing risks in their development" |
<p>| Transfer Risk  | RM strategy or response or technique, in which a risk is shifted to another party (e.g., insurance, outsourcing, warranty or indemnity) |</p>
<table>
<thead>
<tr>
<th>Risk Treatment</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Accept Risk</strong></td>
<td>RM strategy or response or technique where the cost of managing is acceptable because risk avoidance would entail higher cost than the impact of risk. (e.g., reprice, self-insure, offset craft guidelines or plan of action) <em>Strategy: &quot;Intelligently passing on risks to third parties&quot;</em></td>
</tr>
<tr>
<td><strong>Avoid Risk</strong></td>
<td>RM strategy or response or technique that involves taking steps to remove the hazard or engage in other activity or otherwise end a specific exposure (e.g., divest, prohibit, stop or eliminate) <em>Strategy: &quot;Deliberately taking certain risks in a targeted way&quot;</em></td>
</tr>
</tbody>
</table>

**22. Column C – Action Plan**
List down the tangible or specific action plan/s to implement or materialize Risk Treatment selected in Column B.

**23. Column D – Timeline**
Select from the drop-down menu the target time or completion of the committed action plan/s (i.e. Daily, Monthly, Quarterly, Semi-Annually, Annually). If target date is not included in the selection, please click “Others (please specify)” and encode the applicable specific timeline.

**D. SUMMARY**

The summary will present an overall risk profile (covering all the sub-processes) of the unit and will also serve as the sign-off sheet.
### Annex “F” – Basel II Operational Risk Events Categories

<table>
<thead>
<tr>
<th>Event Type Category (Level I)</th>
<th>Definition</th>
<th>Categories (Level II)</th>
<th>Activities Example (Level III)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Internal Fraud</td>
<td>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</td>
<td>Unauthorized Activity</td>
<td>Transactions not reported (intentional)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Transaction type unauthorized (with monetary loss)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Mismarking of position (intentional)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Theft &amp; Fraud</td>
<td>Theft / Extortion / embezzlement / robbery</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Misappropriation of assets</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Check kiting</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Bribe / kickback</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Account take-over / impersonation, etc.</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Fraud / credit fraud / worthless deposits</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Forgery</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Smuggling</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Tax non-compliance / evasion (willful)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Insider trading (not on firm's account)</td>
<td></td>
</tr>
<tr>
<td>2. External Fraud</td>
<td>Losses due to acts of a type intended to defraud, misappropriate property or circumvent the law, by a third party</td>
<td>Theft &amp; Fraud</td>
<td>Theft / robbery</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Forgery</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Account take-over / impersonation, etc.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Check kiting</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Bribe / kickback</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Fraud / credit fraud / worthless deposits</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Smuggling</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Tax non-compliance / evasion (willful)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Insider trading (not on firm's account)</td>
</tr>
<tr>
<td>3. Employment Practices and Workplace Safety</td>
<td>Losses arising from acts inconsistent with employment, health or safety laws or agreements, from payment of personal injury claims, or from diversity/discrimination events</td>
<td>Employee Relations</td>
<td>Compensation, benefit termination issues</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Organized labor activities</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Safety Environment</td>
<td>Employee health &amp; safety rules and events</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>General liability (slips and falls, etc.)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Workers compensation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Diversity and Discrimination</td>
<td>All discrimination types</td>
</tr>
<tr>
<td>4. Clients, Products and Business Practices</td>
<td>Losses arising from an unintentional or negligent failure to meet a professional obligation to specific clients (including fiduciary and suitability requirements), or from the nature or design of a product</td>
<td>Advisory Activities</td>
<td>Disputes over performance or advisory activities</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Suitability, Disclosure &amp; Fiduciary</td>
<td>Fiduciary breaches / guideline violations</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Suitability / disclosure issues</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Retail consumer disclosure violations</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Breach of privacy</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Aggressive sales</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Account churning</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Misuse of confidential information</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Gender liability</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Product Flaws</td>
<td>Product defects (unauthorized, etc.)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Model errors</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Selection, Sponsorship &amp; Exposure</td>
<td>Failure to investigate client per guidelines</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Exceeding client exposure limits</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Improper Business or Market Practices</td>
<td>Antitrust</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Improper trade / market practice</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Market manipulation</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Insider trading (on firm's account)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Unintended activity</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Money laundering</td>
</tr>
<tr>
<td>5. Damage to Physical Assets</td>
<td>Losses arising from loss or damage to physical assets from natural disaster or other causes</td>
<td>Disasters and Other Events</td>
<td>Natural disaster losses</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Losses from external sources (terrorism, vandalism)</td>
</tr>
<tr>
<td>6. Business Disruption and Systems Failures</td>
<td>Losses arising from disruption of business or system failures</td>
<td>Systems</td>
<td>Software</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Utility outage / disruptions</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Hardware</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Telecommunications</td>
</tr>
<tr>
<td>7. Execution, Delivery &amp; Process Management</td>
<td>Losses from failed transaction processing or process management, from relations with trade counterparties and vendors</td>
<td>Transaction Capture, Execution &amp; Maintenance</td>
<td>Data entry, maintenance or loading error</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Missed deadline or responsibility</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Other task misperformance</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Delivery failure</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Miscommunication</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Model / system misoperation</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Accounting error / entity attribution error</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Collateral management failure</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Reference data maintenance</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Customer / Client Account Management</td>
<td>Incorrect client records (loss incurred)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Negligent loss or damage of client assets</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Unapproved access given to accounts</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Monitoring &amp; Reporting</td>
<td>Failed mandatory reporting obligation</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Inaccurate external report (loss incurred)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Customer Intake &amp; Documentation</td>
<td>Client permissions / disclaimers missed</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Legal documents missing / incomplete</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Trade Counterparties</td>
<td>Non-client counterparty misperformance</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Miscellaneous non-client counterparty disputes</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Vendors &amp; Suppliers</td>
<td>Outsourcing</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Vendor disputes</td>
</tr>
</tbody>
</table>
## Annex "G" – List of Risk Management Reports

<table>
<thead>
<tr>
<th>REPORTS</th>
<th>FREQUENCY</th>
<th>SUBMITTED TO/RECIPIENT</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. RCSA Matrix</td>
<td>Annually</td>
<td>RISK MANAGEMENT COMMITTEE, LBP-RMG</td>
</tr>
<tr>
<td>2. Information Risk Asset Register</td>
<td>Annually</td>
<td>RISK MANAGEMENT COMMITTEE, LBP-RMG</td>
</tr>
<tr>
<td>3. Industry Standing</td>
<td>Annually</td>
<td>BOARD OF DIRECTORS, RISK MANAGEMENT COMMITTEE</td>
</tr>
<tr>
<td>4. Concentration of Risks</td>
<td>Annually</td>
<td>RISK MANAGEMENT COMMITTEE</td>
</tr>
<tr>
<td>5. Ratio of Provisions as against Expected Losses</td>
<td>Annually</td>
<td>RISK MANAGEMENT COMMITTEE</td>
</tr>
<tr>
<td>6. Assessment of Collaterals</td>
<td>Annually</td>
<td>RISK MANAGEMENT COMMITTEE</td>
</tr>
<tr>
<td>7. Sources and Uses of Fund</td>
<td>Semi-annually</td>
<td>RISK MANAGEMENT COMMITTEE</td>
</tr>
<tr>
<td>8. Legal Risk Exposures</td>
<td>Quarterly</td>
<td>BOARD OF DIRECTORS, RISK MANAGEMENT COMMITTEE</td>
</tr>
</tbody>
</table>