



Moving To a Centralised Risk Management Framework

CENTRAL BANK OF SRI LANKA

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CENTRAL BANK OF SRI LANKA

TOWARDS PROSPERITY



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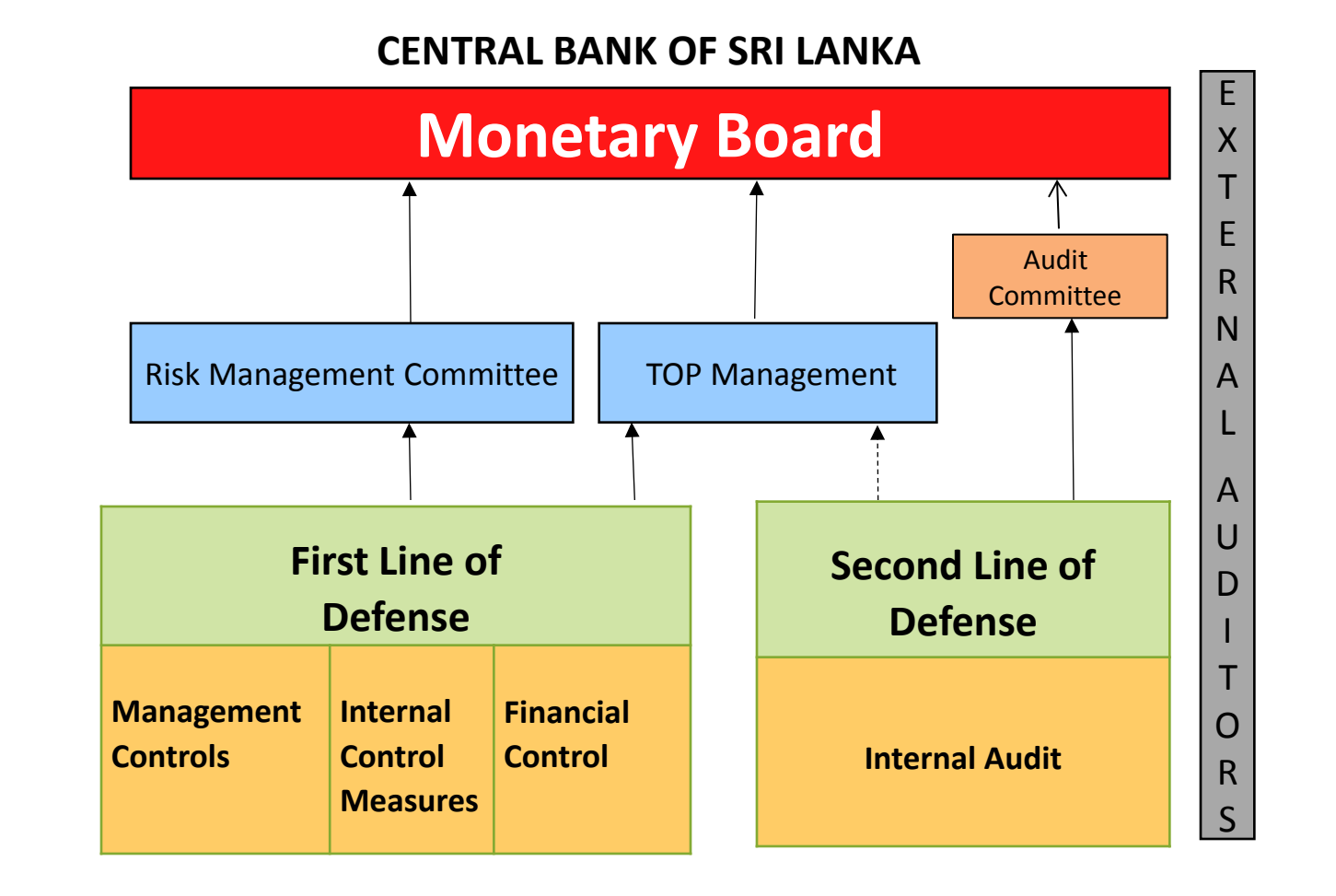


Risk Management Function at the CBSL evolved with.....

- Learning lessons from global risk governance failures
- The CBSL adhered to widely accepted standards, guidelines and best practices
- Introduced a systematic risk management framework in 2010
 - Setting up of a Risk Management Committee (RMC) to oversee overall risk of the Bank
 - 03 Deputy Governors were to act as Chief Risk Officers in their respective Clusters
 - Strategic Plan and Business Continuity Plan



2-Lines of Defense – Risk Management Structure (2010-2015).....

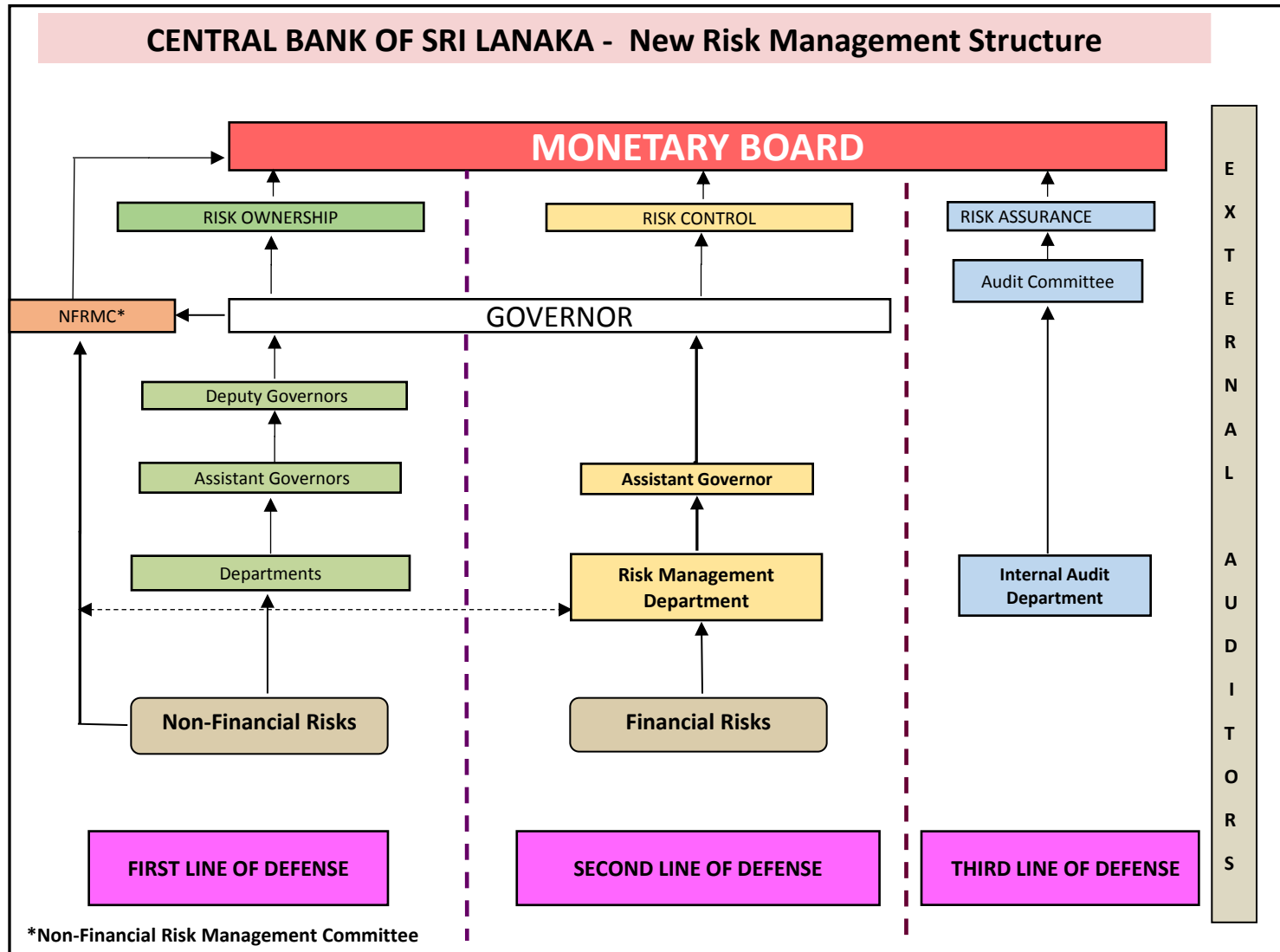


Moving to Centralised Financial Risk of the Bank at the RMD.....

- Moved away from 2-Lines of Defense Framework to 3-Lines of Defense framework.
- Moved towards a more Centralised Risk Management System in 2015 from a decentralized system.
- Established Risk Management Department (RMD), as an independent reporting line.
- Managing other risks continue under respective Departments in a decentralised manner.
- Setting up of Non-Financial Risk Management Committee to oversee non-financial risk of the Central Bank.



3-Lines of Defense Structure.....



Financial Risk Management of the Bank is centralised at RMD

Risk Management Department	Other Departments
<ul style="list-style-type: none">• Financial Risks<ul style="list-style-type: none">- Market Risk- Credit Risk	<ul style="list-style-type: none">• Non Financial Risks<ul style="list-style-type: none">- Policy risk- HR Risk- Legal Risk- Cyber Risk- Other Operational risks
Reputational Risk	



RMD presently monitors Financial Risk in the Lines of

- International Reserves Management
(US\$ 6 billion)
- Investments of Rupee funds of the Central Bank
(LKR 75 billion)



International Reserves Investments - Formation of Policies and Guidelines

- Strategic Asset Allocation Process –SAA (a combined task of the IOD and RMD)
- Preparation and review of Guidelines
 - International Reserves Investment Policy Statement (IPS)
 - Investment Guidelines (IG)
 - Counterparty Credit Risk Management Guidelines (CCRMG)



IPS, IG and CCRMG to provide guidance for SAA.....

- IPS set out to basic principle and guidance for formulating SAA
- IG specifies broad parameter on the eligible assets classes, asset allocation, risk tolerance, benchmark and rebalancing strategy etc.
- CCRMG to monitor the credit risk
- Prepared by the RMD and approved by the Monetary Board



Strategic Asset Allocation(SAA) is the most important Risk Management Tool.....

- A Structured and Scientific Methodology
- An Asset Allocation with a long term objectives of;
 - Capital Preservation (SAFETY)
 - Liquidity Requirements (LIQUIDITY)
 - Income Generation (RETURN)



In line with Reserves Management Objectives, the Reserve Portfolio is tranced into.....

- Working capital (to meet daily liquidity needs).
- Liquidity (to replenish the working capital tranche and to meet short term debt obligations).
- Investment (to earn a return).



Decision making process of SAA

- Monetary Board (MB) responsible for setting the overall parameter for SAA and providing the oversight.
- Approve by the MB with the recommendation of Foreign Reserves Management Committee (FRMC).
- Preparation and periodical reviews carried out by IOD and RMD jointly.



SAA Structure.....

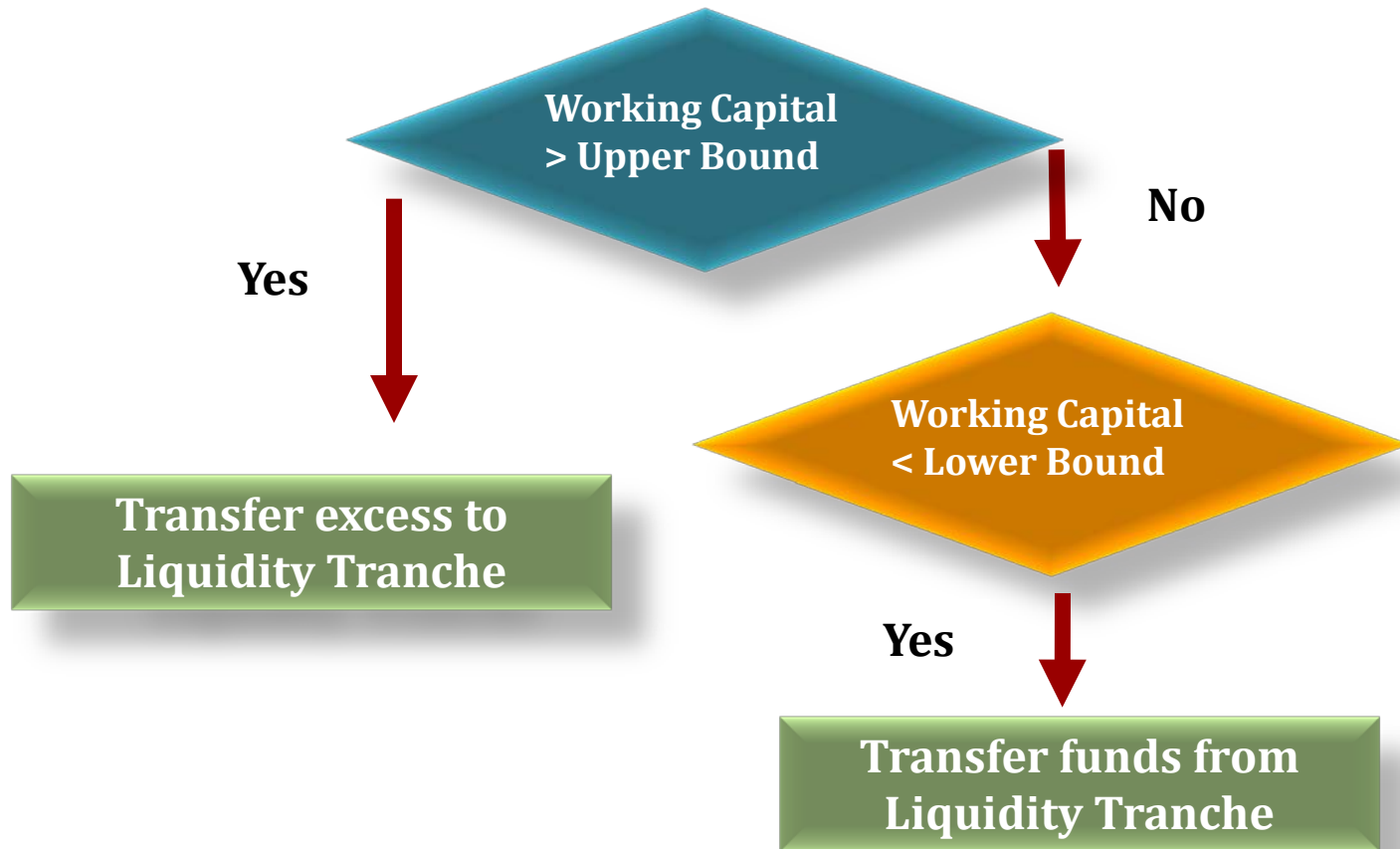
Tranches	Objectives	Investment Horizon	Risk Tolerance	Eligible Asset Classes
Working Capital	Daily Liquidity Requirement	1 Month	No negative return	Nostro Accounts, Short Term Deposits, Treasury Bills
Liquidity	Precautionary Needs	1 Year	No negative return over 1 year with 95% confidence	Nostro Accounts, Deposits, Liquid Bonds*
Investment	To Earn a Return	2 Years	No negative return over 2 years with 95% confidence	Longer Tenor Bonds*
Gold	As per Monetary Law Act**			

*Bonds = Issued by Sovereigns, Government Guaranteed Agencies and Supranational Institutions

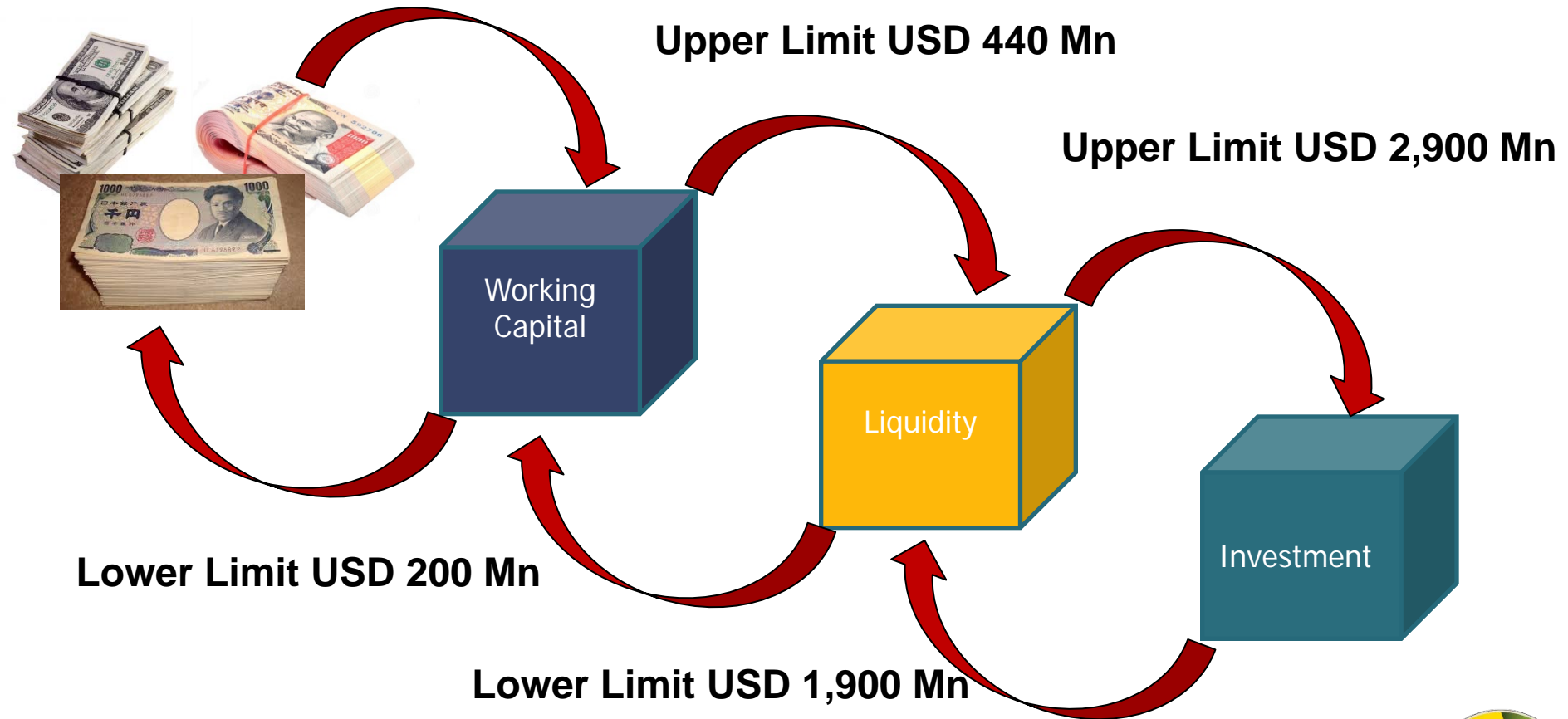
** The Central Bank may import, export, buy, sell, hold, or otherwise deal in Gold in any form.



Key considerations in SAA Process Rebalancing Working Capital.....



Fund Movements between Tranches



Risk Assessment Process - Management of International Reserves.....

- **Risk Measures**

- (i) Market Risk**

- Value at Risk (VaR)

- Modified Duration

- Scenario Analysis

- Stress Testing

- Tracking Error

- Back Testing

- (ii) Credit Risk (Based on counterparty credit Risk Management)**

- Setting up Counterparty overall & product limits based on credit ratings and financial soundness.

- Regular review of financial soundness of counterparties.

- Monitoring of adherence to set limits.

- Credit default swaps and equity price movements.



Risk Reporting to the Management.....

- Daily reports to Governor on volatility of reserves, asset classes, market liquidity and yield curve behaviour etc. as an early warning system.
- Reporting line is independent from the operations.
- Directly reports to the Governor through Assistant Governor in charge of Risk Management.
- Risk Escalation Reports in the event of unanticipated changes in markets that could have a significant impact on the balance sheet.
- Reporting Breaches.



Reporting Financial Risk.....

Market Risk and Credit Risk

- Monthly reporting to Assistant Governor (AG) in charge of Risk Management.
- Monthly presentation to the Foreign Reserves Management Committee (FRMC).
- Quarterly reporting to Governor/Monetary Board.
- Counterparty assessments and monitoring are made on continuous basis.
- Changes to counterparty limits as and when rating revisions - report to Governor through AG



Non Financial Risk Management Committee (NFRMC).....

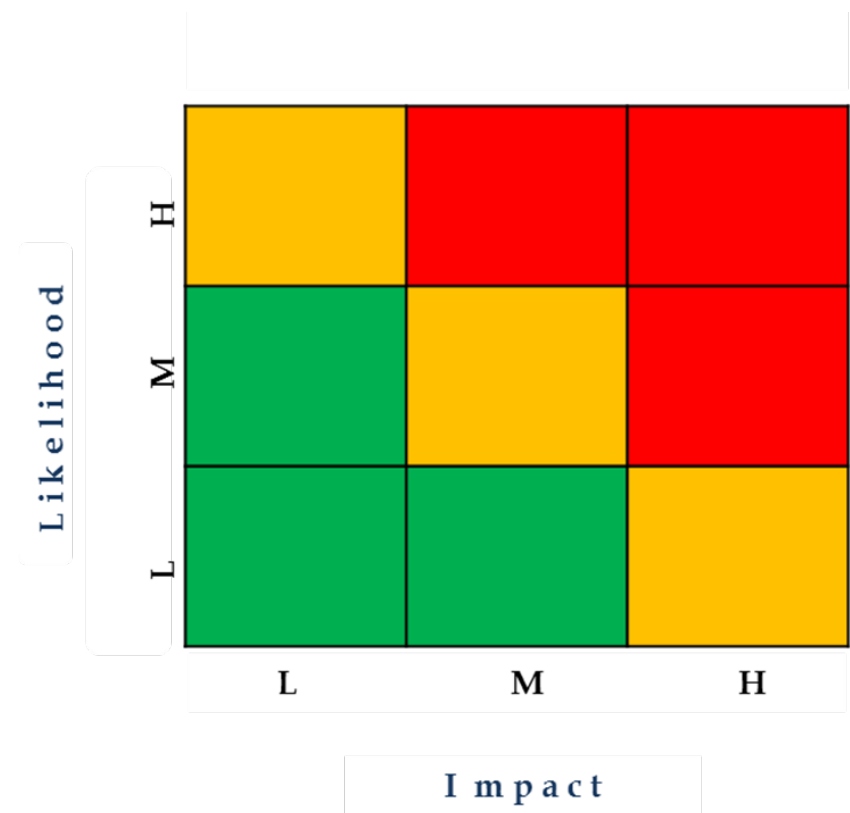
- Most Departments are exposed to wide array of non-financial risks arising from internal and external factors.
- NFRMC - as a framework for overseeing non financial risk of the Bank
- Chaired by Governor
- Quarterly Meetings
- All DGG, AGG and Directors of key (14) Departments which have relatively high exposure in operational risks are members of the Committee.
- High risk factors together with precautionary measures are reviewed and discussed at the NFRMC.



Analysis of Departmental Risk

Event Category	Impact, if occurred	Likelihood of occurrence
High	High	High
	Medium	High
	High	Medium
Medium	High	Low
	Medium	Medium
	Low	High
Low	Medium	Low
	Low	Medium
	Low	Low

Risk Matrix



Risk Reporting – (Non Financial Risk).....

- Non- financial risks of a critical nature are directly and immediately reported to the management by the risk owner (Head of the Department).
- Member Departments report their respective risk profiles to NFRMC on quarterly basis to discuss remedial actions at the committee level.
- RMD engages in risk mapping exercise and categorise high, medium and low risk factors.



Current Risk Governance Structure.....

Monetary Board - Overall Responsibility

Chief Risk Officer - Oversee Overall Risk of the Bank

Head of Dept - Chief Risk Officer of the respective Dept

Director of Risk Management –

Responsible for assessing, analyzing and reporting financial risks

Risk Officer (Dept Level) - Risk reporting and coordination with RMD

All Employees - Risk Officers of the CBSL

NFRMC - To oversee non-financial risk of the Bank

NEW RISK MANAGEMENT CULTURE TO THE BANK



The Way Forward: Medium Term Strategy.....

- Adopt Enterprise-wide Risk Management (ERM) Framework
- Appointment of Chief Risk Officer (CRO) and Chief Compliance Officer (CCO) as an initial move to ERM framework
- Overall Risk Policy Statement for the Bank
- High Level Committee Structure to oversee overall risk of the Bank
- Pilot Project started with two departments
- Preparation of Risk Registers for each department
- Starting Risk Mapping Process
- Planning to complete by 2021



Our special thanks are due to Risk Management Teams of



Hong Kong Monetary Authority



Thank you!

