RISK MANAGEMENT
Approach

The Risk Management Framework takes its lead from the Board Approved Risk Appetite Statement (detailed below) which provides the catalyst to setting the risk/reward profile required by the Board, resulting in the development of detailed business strategies, limit frameworks and policies required to enable successful execution.

AmBank Group's Board Approved Risk Appetite Statement:

"The AmBank Group's strategic goals are for top quartile shareholder returns and target Return on Equity which will be progressively developed over a three year period wherein the AmBank Group will further improve the quality and diversification of its Balance Sheet via differentiated growth strategies within its various business lines.

In FY 2009/10, targeted ROE will be 12.0% increasing to 15.0% by FY 2011/12. This will require compounded growth in earnings of approximately 16.0% over the ensuing three-year period.

Growth will come via further diversification of the loan portfolio into less volatile earning streams whilst maintaining a Retail/Non-Retail NPAT split in the order of 60:40.

The AmBank Group's target international external credit rating is in the BBB range over the next three years, supported by its overall loan asset quality and portfolio mix, its traded market risk limits and strategies, its sound management of interest rate risk in the balance sheet and funding and liquidity risk.

Target regulatory capital ratios over the three year period are to be greater than 8.0% for Tier 1 capital and greater than 12.0% for regulatory capital."

Strategic Risk

Strategic risk is the risk of not achieving the Group's corporate strategic goals. The Group's goals correspond with the Group's overall strategic planning to reflect the Group's vision and mission, taking into consideration the Group's internal capabilities and external factors.

The Board is actively involved in setting strategic goals, and is regularly updated on matters affecting corporate strategy implementation and corporate projects/ transactions. There are also formal governance, project management and due diligence and verification processes, including taxation, legal, finance, treasury and regulatory sign-offs.

Capital Risk

The Group has established a Balance Sheet and Capital Management unit within its Finance Department to oversee its capital adequacy position, to ensure compliance with the requirements of Bank Negara Malaysia ("BNM") and to take prompt action to address projected or actual capital deficiency and to ensure the optimal management of balance sheet risks as they relate to asset and liability management.

The Group monitors its capital adequacy position to ensure compliance with the requirement of BNM and to take prompt action to address projected or actual capital deficiency. The capital position is reviewed on a quarterly basis, taking into account the levels and trend of material risks, the assumptions used in the capital assessment measurement system, sufficiency of capital amount against the various risks and its compliance with established adequacy goals as well as future capital requirement based on the Group's reported risk profile.

Market Risk Management

Market Risk is defined as the potential loss arising from changes in interest rates, foreign exchange rates, credit spreads, equity prices and commodity prices. These changes can affect the value of financial instruments and may also affect customer-flow-related revenues and proprietary trading revenues.

The objective of Market Risk Management is to ensure accurate risk recognition, which includes the identification and measurement of market risk factors in line with the Group's risk appetite. The Group regularly reviews its strategies which evolve ever-changing markets and results in dynamic risk exposures (i.e. increasing, maintaining or reducing risk). The Group continues to keep an appropriate equilibrium between risks taken and returns earned to ensure returns to shareholders are optimised.

The Group manages market risk using two approaches; the first being under normal market circumstances where the benchmark standard used is Profit-at-Risk. Profit-at-Risk comprises Value-at-Risk ("VaR") and loss limit thresholds. VaR is a statistical measure of the potential loss that the Group may experience arising from adverse movements under normal market circumstances. The loss limit thresholds are in place to trigger management discussion on appropriate mitigation measures to be taken once certain levels of losses are reached.

The second approach employs the benchmark standard of Capital-at-Risk to ensure that the Group is able to absorb unanticipated market movement based on historical shock scenarios.

To complement the VaR, the Group has a set of scenario analysis that serves as indicators of the change in portfolio value under various potential market conditions such as shifts in currency rates, general equity prices, interest rates, and yield curve shifts.

Risk thresholds are approved by the Board. These risk thresholds align specific risk-taking activities with the overall risk appetite of the Group and of its individual business units.

Market Risk Management continues to significantly invest resources into processes and system improvements, which help define and control inherent risks within the Group.

Market Risk Management Process

Identification	• Identify market risks within existing and new products. • Review market-related information e.g. market trend, economic data, etc.
Assessment/ Measurement	• Value-at-Risk ("VaR"). • Profit-at-Risk. • Capital-at-Risk.
Control/ Mitigation	• Establish market risk limits e.g. loss limits, VaR and sensitivity limits set against business profitability budget and align with the risk appetite approved by the Board.
Monitoring/ Review	• Monitoring of limits. • Periodical review and reporting.

Funding Risk Management

Funding risk is the risk that the Group will not be able to fund its day-to-day operations at a reasonable cost. Liquidity could be affected by inability to access long term or short term deposits, repurchase or security-lending markets or draw under credit facilities, whether due to factors specific to us or to general market conditions.

The primary objective of funding risk management framework is to ensure the availability of sufficient funds at a reasonable cost to honour all financial commitments as they fall due under normal market condition and on contingency basis. It also ensures optimal funding structure and balances the key funding risk management objectives, which include diversification of funding sources, customer base, and maturity periods.

The measures utilised for funding risk management are varied and range from daily to monthly monitoring and reporting. These include weekly cash flows, monitoring of depositors and relevant key ratios and monthly reporting to the Executive Risk Management Committee ("ERMC") on the measures as well as breaches of limits, if any. Scenario testing is performed to assess the adequacy of liquidity to meet obligations due under stressed levels.

Funding Risk Management Process

Identification	• Cash flow maturity mismatch and behavioral maturity of depositors. • Unusual large deposits and/or withdrawals.
Assessment/ Measurement	• Analyse cash flow maturity mismatch and concentration of large depositors. • Funding risk-related ratios, scenario analysis and stress testing.
Control/ Mitigation	• Setting limits and triggers. • Maintenance of adequate cash and liquefiable assets. • Diversification and stabilisation of liabilities and/or funding structure.
Monitoring/ Review	• Periodical review and reporting.

Credit Risk Management

Credit risk is the risk of loss due to the inability or unwillingness of a counterparty to meet its payment obligations. Exposure to credit risk arises from lending, securities and derivative exposures.

The primary objective of credit risk management framework is to maintain accurate risk recognition which ensures that exposure to credit risk is always kept within the Group's risk appetite framework and related credit policies. Lending activities are guided by internal credit policies and risk appetite framework that are approved by the Board. The Group's risk appetite framework is refreshed at least annually and with regard to credit risk, provides direction as to portfolio management strategies and objectives designed to deliver the Group's optimal portfolio mix. Credit Risk portfolio management strategies include, amongst others:

- Concentration limits by exposures to:
  - single customers & related customer groups;
  - industry segments; and
  - countries.
- Asset writing strategies for industry segments and individual customers;
- Loan to Value collateral ratios; and
- Watch-list processes for identifying, monitoring and managing higher risk customers and those with potential to become higher risk.

For non-retail credits, risk recognition begins with an assessment of the financial standing of the borrower or counterparty using an internally developed credit rating model. The model consists of quantitative and qualitative scores that are then translated into a rating grade, ranging from 'AAA' (lowest risk) to 'C' (highest risk). The assigned credit rating grade forms a crucial part of the credit analysis undertaken for each of the Group's credit exposures.

Credit Risk Management Process

Identification	• Risk assessment on the potential impact of internal and external factors on transactions and positions. • Selection of asset and portfolio mix guided by asset writing strategies.
Assessment/ Measurement	• Internal credit rating system to evaluate customer's creditworthiness. • Risk recognition - current methodologies include quantifying expected loss using expected default frequencies with estimated LGD & EAD, and calculating "unexpected loss". In 2010, new refined models will separately quantify PD, LGD, EAD, to enhance pricing models, facilitate loan loss provision calculation, automate stress-testing and enhance portfolio management.
Control/ Mitigation	• Credit risk management policies, guidelines, and Group's risk appetite framework govern selection of assets, control concentration risk by single customer or industry sector, collateral, rehabilitation, etc. • Monitoring of benchmark returns to ensure adequate returns for risk taken, taking into account operating expenses and cost of capital.
Monitoring/ Review	• Monitoring asset growth in line with risk appetite settings, non-performing loan ("NPL") trend, flow rates of loan delinquency buckets, exposures by industry sectors, risk-grades distribution, etc., flowing into monthly risk reporting to executive management and at least quarterly to the Board. • Watchlist committees review credits at risk of deterioration at least monthly. • Post mortem review of loans to extract lessons learned for facilitating credit training and refinement of credit policies or guidelines, towards enhancing risk identification and control.

To support credit risk management's observation of disciplines governed by Basel II framework and International Financial Reporting Standards ("FRS"), new and enhanced rating models are expected to be launched in 2010, to generate obligor's probability-of-default ("PD"), loss-given-default ("LGD") and exposure-at-default ("EAD"). The new rating models will be calibrated to the AmBank portfolio thereby providing enhanced predictive capability and more automation of risk evaluation approaches. These models will:

- enhance pricing models;
- facilitate loan loss provision calculation;
- automate stress-testing; and
- enhance portfolio management.

For retail credits, credit-scoring systems are being used to complement the credit assessment and approval processes. In 2009, new application scorecards will replace first generation scorecards to better differentiate quality of borrowers. Behavioral scoring system will also be developed to facilitate dynamic updating of the Group's retail portfolio quality with resulting impacts on formulation of facility management activities including collection and recovery strategies.

Operational Risk Management

Operational risk is the risk arising from inadequate or failed internal processes, people and systems or from external events on the Group's day-to-day operations that are executed to attain its business objectives, which restrict or prevent such objectives from being achieved.

Operational risk management is the discipline of systematically identifying the critical potential points and causes of failure, assess the potential cost and to minimise the impact of such risk through the initiation of risks mitigating measures and policies.

The primary responsibility for managing operational risk rests with each operating department. Nevertheless, the execution of risk management methodology is supported and guided by the Risk Management Department whose function is to define minimum standards, policies and methodologies, monitor compliance, and identify as well as report on Group-wide risk exposures.

The operating departments are responsible for assessing their operational risks and review controls instituted periodically to ensure that the measures introduced continue to be relevant and appropriate.

The Group has implemented a Product Approval Programme to ensure that all risks inherent in new products/financing packages and related business activities are identified, and measures to minimise these risks are put in place, before the launch of the products. All new products require the sign-off of the respective risk control units, including Risk Management, Legal, Finance and the Internal Audit as well as the Risk Management Committee/ Board.

Operational Risk Management Process

Identification	• Analyse key processes. • Risk self-assessment and review reported incident.
Assessment/ Measurement	• Five risk causal platform (people, process, governance, IT and external) and risk events. • Risk scorecard and incident data management.
Control/ Mitigation	• Policies and integration of related controls into processes/procedures addressing the specific operational risk. • Contingency planning.
Monitoring/ Review	• Review on business/ support operating unit and independent validation by internal audit. • Review feedback from internal reporting. • Periodic reporting on loss incidents and major risk issues.

Business Continuity

Our Business Continuity Management ("BCM") Process, which is an integral part of operational risk management, places importance on ensuring that the required BCM framework is in place to identify events that could potentially threaten the Group's operations and to build resilience and capability to safeguard the interests of its brand and reputation. The BCM process complements the efforts of the disaster recovery team, to ensure that the Group has the required critical capabilities and resources, such as systems, work space and premises, communications, in a business continuity facility for the more critical business operations like Treasury and IT.

Legal And Regulatory Risk Management

The Group is subject to a comprehensive range of legal obligations in all countries in which it operates. Legal risks arise from potential breaches of applicable laws and regulatory requirements, unenforceability of contracts, lawsuits, or adverse judgment which may lead to the incurrence of losses, disrupt or otherwise resulting in financial and reputation risks. Legal risk is managed by internal legal counsel as well as the Operational & Legal Risk Management Committee, and, where necessary, in consultation with external legal counsel to ensure that such risk is minimised.

A proactive regulatory risk monitoring and control process is essential for any financial group to provide assurance that its products and services are offered in a manner consistent with regulatory requirements and industry best practices.

Group Compliance undertakes the task by ensuring that appropriate measures are introduced and applied accordingly, whilst inculcating a compliance culture across all levels of staff. Amongst the measures introduced are monitoring and reporting, training, providing advice and disseminating information. A process is in place to standardise compliance practices across the AmBank Group.

The compliance monitoring and reporting system is essentially a mechanism through which businesses monitor their compliance to rules and regulations as well as provide monthly, quarterly and exception reporting that is carried out on line. This reaffirms our commitment to a centralised compliance infrastructure that embraces regular self-assessment by staff, thus providing management the assurance that staff are aware and comply with internal and external requirements.

Compliance awareness is performed on a regular basis to ensure staff keep abreast of banking, insurance, securities and anti-money laundering law as well as other regulatory developments. In addition to the training provided, the Compliance Repository, an online resource tool, continues to provide staff with easy access to rules and regulations to various search modes.

Basel II Implementation For AmBank Group

Credit Risk

The Group has since January 2008, successfully implemented Basel II Standardised Approach. The Group adopts the comprehensive approach in recognising collateral and guarantee obtained as risk mitigants to reduce credit exposures in computing the regulatory capital.

Operational Risk

For operational risk, the Group is currently applying the Basic Indicator Approach for risk weighted capital charge. This will be supported by an operational risk management system that is under development and targeted to be implemented in the next financial year. A robust operational risk management will enable the Group to meet further advances in Basel II requirements, including the application of The Standardised Approach in a more effective manner which is targeted to be achieved by year 2010. It also allows the Group to proactively monitor operational risk through the modules of incident data, key risk indicators, risk and control self-assessment and stress testing.