CHAPTER SIX

Policy Code: RM-6 Credit Risk

Purpose:

The following policy outlines the specific risk management approach to be implemented by the company in its course of identifying, monitoring, and managing its Credit Risk exposure. The policy will address the specific approach to mitigate Credit Risks arising from the company's investment, takaful, and re-takaful activities.

Scope:

The scope of implementing this policy is within the jurisdiction of RM under the direct supervision of SM, the AC, and the BOD. This policy will be performed taking into consideration the delegation of authority structure in establishing and implementing Credit Risk policies and procedures.

Content:

1. Governance

Governing Body (The BOD

The BOD is responsible for approving and monitoring the Credit RMF. This framework is the core component of the BOD's process to ensure a structure of adequate management controls over Credit Risk.

Managing Director (MD)

The MD is responsible for ensuring that this framework is implemented effectively via policies, procedures, controls, and reports sufficient to control Credit Risk within the company.

Asset and Liability Committee (ALCO)

About Credit Risk, the ALCO is responsible for:

1) Overseeing and providing strategic direction for the management of Credit Risk throughout the company;

2) Establishing and reviewing credit exposure limits regularly according to policy;

3) Reviewing exceptions, if any, from approved risk guidelines and policies and trends in Credit Risk and other risk information; and

4) Providing advice and approval for amendments to the Credit Risk policy and related procedures.

Risk Management

The Risk Management should be responsible for performing the following significant risk management functions regarding Credit Risk:

i) Formulating Credit Risk policies and procedures;
ii) Timely identification of sources of Credit Risks;
iii) Analysis of counterparty risk and internal rating of counterparties;
iv) Compiling regular credit portfolio reports for the MD and the BOD;
v) Monitoring limit excesses and take appropriate action;
vi) Calculating the Credit Risk Component of the minimum Risk-Based Capital Requirement; And
vii) Ensuring that potential credit issues are identified and a watch list is maintained.

Finance

Finance ensures that relevant data – arising from transactions entered into by the company is reported to support the management of Credit Risk.

Core responsibilities of Finance include:

• Aggregation of exposures across all activities of the company.
• Timely reporting of credit exposures to the MD and the BOD.
• Ensuring related exposures are identified for aggregation purposes, i.e. exposures to entities under common ownership or control.

2. Credit Risk Overview

Credit risk is the risk of default by borrowers and transactional counterparties as well as the loss of value of assets due to deterioration in credit quality. Exposure to Credit Risk results from financial transactions with securities issuers, debtors, borrowers, brokers, policyholders, Re-Takaful entities, and guarantors.

Sources of Credit Risks include:

a.) Re-Takaful Credit Risk

The company seeks to limit its liability by ceding part of the assumed risks to the re-takaful market. The risk that the re-takaful entity from which re-takaful has been bought is unable to fulfill its obligations in the event of a claim is an important component of the Credit Risk profile of the company.

b.) Investment Credit Risk

The company invests its contribution proceeds in Shari 'ah compliant fixed income instruments such as Sukuk. The risk that the issuers of instruments held by the company default form another part of the Credit Risk profile of the company.

c.) Takaful Credit Risk

Another component of the Credit Risk exposure of the company would be the contributions receivable from policyholders, brokers, and other third parties. Due to the right of offset (against brokers and third parties), credit exposures arising from these sources are negligible. Nevertheless, the company's BOD shall review these exposures regularly – in line with all other credit exposures - to assess the appropriateness of the current approach.

3. **Credit Risk Appetite**

The Credit Risk Appetite definition is designed to ensure that the company's capital is protected from erosion through credit losses. The applicable matrix is set out below for investment and takaful related Credit Risk exposures.

Credit exposures can increase the risk profile of the company and adversely affect financial viability.

A credit exposure includes both on-financial Position and off-financial Position exposures (including guarantees, Shari 'ah compliant derivative financial instruments, and performance-related obligations) to single counterparties and groups of related counterparties.

The company's Asset and Liability Committee (ALCO) decides and monitors the company's investment and takaful-related credit risk limits.

Credit Risk limits are set and periodically reviewed for both investment and takaful-related credit exposures by counterparty, sector, country, instruments, and currency.

RM will ensure that limits are monitored periodically as deemed appropriate by RM.

If a temporary limit increase is required, the relevant person must submit a proposal detailing the reasons for the change for the review of RM and approval of the AC.

The above set limits will be reviewed on an annual basis by the AC, and revised as and when needed based on the recommendation of RM.

4. **Credit Risk Exposure Measurement Methodologies**

The BOD has the responsibility of monitoring and managing credit concentrations through a review of the following reports which are prepared by Finance:

1) Investment Credit Risk

a) Concentration by line of business;

b) Concentration by credit rating;

c) Concentration by industry;

d) Concentration or regional concentrations;

e) Concentration by tenor.

2) Re-Takaful Credit Risk

a) Amount of exposure;

b) Financial strength rating (external rating);
c) Re-Takaful entity's capital base; and
d) Amount of exposure the Re-Takaful entity has in the same sector/region as the one a takaful company has reinsured with it.

5. Credit Exposure Approval Process

The company has Credit Risk exposure from its takaful, re-takaful, and investment-related activities.

The authorities for approval are defined within the financial approval matrix as adopted by the BOD

6. Large Exposure Policy

All material exposures within the company are referred, to before commitment to the Finance Department to ensure that these can be accommodated within the capital and large exposure framework of the company.

Finance is responsible for monitoring, controlling, and reporting the large exposure positions of the company. A large exposure is defined as an exposure of more than 10% of the company's Capital. All large exposures will then be referred to RM for review and to the Investment/AC for approval within their delegated authority

7. Monitoring and Reporting of Counterparty Credit Exposures

RM has the responsibility of monitoring all the limits set out in this policy and reporting any exceptions to the Risk.

Credit Reports

RM – with the support of Finance- submits the following key reports to AC monthly for monitoring of Credit Risk:

1. Exposures vs. limits, i.e.., limit excesses report;

2. Expired limits, i.e.., expired limits and limits expiring within the next three months;

3. Exposures to single counterparty groups; and

4. Periodic portfolio reports detailing exposures to individual industries, countries, and credit grades.

Nature and Frequency of Credit Reporting to Approval Bodies

The BOD is provided with a quarterly report for review by Finance, supported by RM, detailing:
1. New counterparties approved since the last report by Finance;

2. All excesses on credit lines every quarter with a description of their resolution;
3. The company's largest exposures;
4. Watch list;
5. Quarterly portfolio report detailing the breakdown of counterparty risk in the portfolio by product, rating, and industry classification;
6. The company's credit exposures stemming from premium receivables.

8. Excesses over Established Risk Limits

The company takes unauthorized excesses on credit limits or risk appetite thresholds very seriously. Excesses are investigated promptly and reasons for their existence are ascertained.

Where excesses are not authorized, the HRM will promptly elevate the excess to AC, which can either approve the excess and increase the credit limit under its delegated authority or take action requiring exposure reduction within 30 days of reporting the excess.

9. Frequency of Credit Review

All limits, exposures, and transactions are reviewed, at a minimum, on an annual basis by RM.

Credit Watch List Procedures

The company maintains a watch list of Credit Risk counterparties. This is circulated for review by the AC every month.

The watch list gives details of counterparty exposures that display a degree of stress or weakness, including a rating downgrade potential downgrade, or other events. This includes exposures that, while remaining some distance from posing a risk of loss, require a more closely managed exposure strategy with the active involvement of Finance, relevant department/ unit, and RM.

10. Problem Credit Management

Problem credits are defined as those where the risk of loss is considered high by RM.

These risks are reviewed regularly by the AC based on reports provided by RM.

Strategies to work out individual problem credit exposures will be agreed upon by the AC based on the recommendations of the Head of Finance and RM.

11. Provisioning

The AC Reviews Non-Performing Assets, at a minimum once a year. Non-performing assets are classified according to the length of time overdue.

Monitoring of Non-Performing assets falls under the responsibility of RM.

Non-performing assets overdue for more than 30 days are adequately provisioned, as long as the Risk Committee does not deem such exposures immaterial.