Financial Risk Management

The nature of HDMF's operations inevitably involves financial risks that must be measured, monitored and managed through an effective risk management system. This is to ensure that financial risks exposures are properly identified, assessed, measured and managed. This requires the development of a risk culture that will influence daily business activities and decision-making.

The Fund formulated risk management policies and procedures that address specific financial risks and monitors strict compliance thereto through its internal audit functions.

The Fund has significant exposures to the following risks:

- Credit risk
- Market risk
- Liquidity risk
- Operational risk

<u>Credit risk</u>

Credit risk is the risk of loss arising from the borrowers' failure to discharge their contractual obligations.

To mitigate credit risk, the Fund has adopted the following initiatives:

a. Implementation of Borrower's Evaluation System (BES)

   The Fund has formulated the Borrower's Evaluation System (BES), a credit quality assessment process for the determination of the creditworthiness of housing loan borrowers including borrower's equity adjustments,

b. The amendment of the Single Borrower's Limit (SBL) for Wholesale Loans (WL) (Circular No. 306 dated April 10, 2012) – aims to further mitigate risks and limit the losses in the event of a default by the borrower/s and avoid a situation where a single loss will adversely affect the profitability/financial condition of the Fund.

   The total amount of loans, credit accommodations and guarantees that may be extended to any person, partnership, association, corporation or other entity shall at any point in time not exceed 25 per cent of the Free Retained Earnings of the Fund.

   Free Retained Earnings refers to the Retained Earnings after declaration of dividends for the preceding year and net of the total capital valuation accounts.

<u>Market Risk</u>

Market risk is brought about by adverse movements in factors that affect the market value of instruments, products, and transactions in an institutions' overall portfolio. It arises from market making, dealing, and position taking in interest rate, foreign exchange and equity markets.

The Fund has adopted risk based pricing for housing loans – a market based pricing framework covering the Fund's costs and its risks with a reasonable spread. Under this framework the interest rates are re-priced periodically at the option of the borrowers, i.e. 3, 5, 10, or 15 years. However, the borrowers may choose a fixed rate for 20, 25, or 30 years.

Liquidity Risk

Liquidity risk is the risk that the Fund will be unable to meet its payment obligations when they fall due under normal and stressful circumstances.

The Fund ensures liquidity through active asset liability management and combination of strategies, namely: maintenance of highly liquid investment portfolio, active monitoring of funding requirements for operations, programs/projects, maturing liabilities and obligations to members. It has a credit facility to address unexpected liquidity requirements.

Liquidity risk is being monitored and managed by the Risk and Capital Management Committee through the Asset-Liability/ Market Risk Sub-committee.

The Board Risk and Capital Committee (BRCC) approved, upon the recommendation of the Asset-Liability/ Market Risk Sub-committee, the use of Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) Standards under Basel III as additional monitoring tools to strengthen its liquidity framework. These ratios are computed on a quarterly basis and presented alongside the Capital Adequacy Ratio (CAR).

The LCR is intended to promote resilience to liquidity disruptions over a thirty-day horizon. This will help ensure that the Fund has sufficient unencumbered, high quality liquid assets to offset the net cash outflows it could encounter in an acute short term stress scenario.

Operational Risk

Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risk can cause damage to reputation, have legal or regulatory implications, or lead to financial loss.

The Fund cannot be expected to avoid all operational risks, but it endeavors to manage these risks by monitoring through a control framework and managing potential risks.

Controls include levels of signing authority, effective segregation of duties, access-authorization, reconciliation procedures, staff training and assessment process.

The Internal Audit Department determines the extent of the Fund’s compliance to laws, rules and regulations and assesses the adequacy of controls embedded in operating and support systems/units, as well as evaluates the performance of its programs, projects and activities.