Risk Management

This section forms an integral part of OCBC’s audited financial statements

DEVELOPMENTS IN 2013

2013 was marked by increased efforts of regulators in Asian emerging economies to manage the impact of unprecedented global liquidity on asset prices, including new restrictions in property lending in Singapore. Even as the US and Eurozone economies recovered and raised the prospects for regional exporting countries, capital flows, exacerbated by fears over premature US Fed tapering, remained volatile during much of 2013. Rotating capital flows highlighted the risks faced by regional economies when they deferred structural economic reforms. Meanwhile, China, as the key driver of intra-Asian trade in recent years, started to reposition and restructure itself from an export investment-led economy to a more sustainable consumption model that would likely result in lower growth rates and reshape the opportunities for Asia.

The financial sector in Singapore remained resilient, as confirmed by the International Monetary Fund in their 2013 Financial Sector Assessment Program (“FSAP”) review. OCBC has already met prevailing Basel III expectations, and continued to be well poised to deal with the shifting economic landscapes and heightened regulatory expectations. To ensure an effective and robust liquidity management profile, we proactively managed and optimised the mix of our funding sources to support our liquidity needs in key locations. OCBC’s asset quality remained sound as our underwriting discipline emphasised admitting established firms in our core markets of Singapore, Malaysia, Indonesia and Greater China, with sound risk ratings within our defined risk appetite limits. Our non-performing loan ratio and credit losses remained, and continue to be, one of the lowest within the domestic financial sector.

Looking forward, we believe that regional governments are taking prudent actions to manage the impact caused by the withdrawal of US Quantitative Easing (“QE”). We remain watchful of China’s plans and ability to transition its economy to a more sustainable consumption model that would likely result in lower growth rates and reshape the opportunities for Asia.

OCBC remains committed to its prudent lending posture with customer-centric and mitigating strategies over emerging risks. Our sound asset quality and capital ratios put us in a strong position to capitalise on new and emerging business opportunities as the global economy recovers and as China continues to expand the use of Renminbi in international trade.

RISK MANAGEMENT IN OCBC GROUP

The OCBC Group believes that sound risk management is paramount to the success of our risk-taking activities. Our philosophy is to ensure that risks and returns remain consistent with our risk appetite. To achieve this, we proactively identify any emerging portfolio threats and credit concentrations at an early stage in order to develop timely risk-response strategies.

The key elements of OCBC Group’s enterprise-wide risk management strategy are:

- **Risk appetite** – The Board of Directors approves the Group’s risk appetite, and that all risks are managed in alignment with the risk appetite. Risk-taking decisions must be consistent with strategic business goals and returns should compensate for the risk taken.
- **Risk frameworks** – The Group’s risk management frameworks for all risk types are documented, comprehensive, and consistent.
- **Holistic risk management** – Risks are managed holistically, with a view to understand the potential interactions among risk types.
- **Qualitative and quantitative evaluations** – Risks are evaluated both qualitatively and with appropriate quantitative analyses and robust stress testing. Risk models are regularly reviewed to ensure they are appropriate and effective.

The Board of Directors and senior management provide the direction to the Group’s effective risk management that emphasises well-considered risk-taking and proactive risk management. This is reinforced with appropriate risk management staff, ongoing investments in risk infrastructure, regular review and enhancement of risk management policies and procedures, overlaid with a strong internal control environment throughout the Group. Accountability for managing risks is jointly owned among customer-facing and product business units, dedicated functional risk management units, as well as other support units such as Operations and Technology. Group Audit also provides independent assurance that the Group’s risk management system, control and governance processes are adequate and effective. Rigorous portfolio
management tools such as stress testing and scenario analyses identify possible events or market conditions that could adversely affect the Group. These results are taken into account in the Group's capital adequacy assessment and setting of risk limits.

This risk management chapter discusses the risk management practices, policies, and frameworks of OCBC Group, excluding Great Eastern Holdings (“GEH”) and PT Bank OCBC NISP Tbk (“NISP”). GEH and NISP are listed companies that publish their own annual reports that contain information on their risk management frameworks and practices (refer to Note 39 in the Group’s Financial Statements for information on GEH’s risk management). Group management collaborates with GEH and NISP on aligning their risk management practices to Group risk standards through knowledge sharing and training.

All other banking subsidiaries are required to implement risk management policies that conform to Group standards including the adoption of stricter local regulations where necessary. Approving authority and limit structures are consistent with the Group to ensure proper ownership and accountability.

**RISK GOVERNANCE AND ORGANISATION**

The Board of Directors establishes the Group’s risk appetite and risk principles. The Board Risk Management Committee (“BRMC”) is the principal Board committee that oversees the Group’s risk management. It reviews and approves the Group’s overall risk management philosophy, risk management frameworks, major risk policies, and risk models. The BRMC also oversees the establishment and operation of the risk management systems, and receives regular reviews as to their effectiveness. The Group’s various risk exposures, risk profiles, risk concentrations, and trends are regularly reported to the Board of Directors and senior management for review and action.

The BRMC is supported by Group Risk Management Division (“GRM”), headed by the Group Chief Risk Officer. GRM has functional responsibility on a day-to-day basis for providing independent risk control and managing credit, market, operational, liquidity, and other key risks. Dedicated GRM officers establish Group-wide policies, risk measurement and methodology. They also monitor the Group’s risk profiles and portfolio concentrations. The Group’s risk management and reporting systems are designed to ensure that risks are comprehensively identified and evaluated to support risk decisions.

Compensation of risk officers is determined independently of other business areas and is reviewed regularly to ensure compensation remains market competitive.

Senior management actively manages risks through various risk management committees, such as the Credit Risk Management Committee, the Market Risk Management Committee, the Asset and Liability Management Committee, the Operational Risk and Information Security Committee, as well as the Risk Capital Committee. Both risk-taking and risk control units are represented in these committees, emphasising shared risk management responsibilities.

Credit officers’ personal approval authority limits are based off internal risk ratings and set according to their relevant experience and qualifications. GRM officers also provide expertise during the design and approval of new products to ensure existing systems and processes are able to adequately support any new product risks.

**BASEL REQUIREMENTS**

OCBC Group has implemented Monetary Authority of Singapore (“MAS”) Notice 637 on Risk Based Capital Adequacy Requirements for banks incorporated in Singapore. MAS 637 has been revised to further raise the quality of regulatory capital base and to enhance risk coverage under Basel III. As part of enhanced public disclosures on risk profile and capital adequacy, we commenced publishing mid-year disclosures on our investor relations website in 2013 (Please refer to the Pillar 3 Disclosures section for information as at 31 December 2013).

For credit risk, the Group has adopted the Foundation Internal Ratings-Based (“F-IRB”) approach and supervisory slotting criteria to calculate credit risk-weighted assets for major non-retail portfolios, and the Advanced Internal Ratings-Based (“A-IRB”) approach for major retail and small business lending portfolios. Other credit portfolios are on the standardised approach (“SA”) and they will be progressively migrated to the internal ratings-based approaches. The regulatory capital to be set aside for credit risk-weighted assets depends on various factors, including internal risk grades, product type, counterparty type, and maturity.

For market and operational risk, the Group has adopted the standardised approach. Market risk-weighted assets are marked to market and are risk weighted according to the instrument category, maturity period, credit quality grade, and other factors. Operational risk-weighted assets are derived
by applying specified beta factors or percentages to the annual gross income for the prescribed business lines in accordance with regulatory guidelines. Initiatives are in place to move towards Internal Model Approach for market risk.

The Group performs an Internal Capital Adequacy Assessment Process (“ICAAP”) assessment annually to ensure the Group is able to maintain sound capital levels after consideration of material risks under various stress scenarios. Combined with the Board approved Risk Appetite Statement, the ICAAP process provides a high-level of assurance the Group will remain financially sound and prudently managed at all times.

Implementing the Basel framework is an integral part of our efforts to refine and strengthen, as well as to ensure our management of risks is appropriate for the risks we undertake. Group management remains vigilant to ongoing industry and regulatory developments, including risk-adjusted compensation and higher liquidity and capital requirements.

**CREDIT RISK MANAGEMENT**

Credit risk arises from the risk of loss of principal or income on the failure of an obligor or counterparty to meet their contractual obligations. As our primary business is commercial banking, the Group is exposed to credit risks from loans to retail, corporate, and institutional customers. Trading and investment banking activities, such as trading of derivatives, debt securities, foreign exchange, commodities, securities underwriting, and settlement of transactions, also expose the Group to counterparty and issuer credit risks.

**CREDIT RISK MANAGEMENT OVERSIGHT AND ORGANISATION**

The Credit Risk Management Committee (“CRMC”) is the senior management group that supports the CEO and the BRMC in proactively managing credit risk, including reshaping the credit portfolios. It reviews the Group’s credit risk philosophy, framework, and policies, and aligns credit risk taking with business strategy and planning. In addition, the CRMC recommends credit approval authority limits, reviews the risk profile of material portfolios, and highlights any concentration concerns to higher management.

Credit Risk Management (“CRM”) departments manage credit risk within pre-determined risk appetite, customer targets, limits and monitor compliance with standards set in risk policies. Dedicated risk functions are responsible for risk portfolio monitoring, risk measurement methodology, risk reporting, and remedial loan management.

Regular risk reporting is made to the Board of Directors, BRMC and the CRMC in a timely, objective, and transparent manner. These reports include detailed profiles on portfolio quality, credit migration, expected losses, and concentration risk exposures by business portfolio and geography. Such reporting allows senior management to identify adverse credit trends early, formulate and implement timely corrective action, and ensure optimal use of capital resources.

**CREDIT RISK MANAGEMENT APPROACH**

OCBC’s credit risk management framework covers the entire credit risk cycle, underpinned by comprehensive credit risk processes, as well as using models to efficiently quantify and manage risks in a consistent manner.

The Group seeks to take only credit risks that meet our underwriting standards, and risks that are commensurate with adequate returns to enhance shareholder value. As Fair Dealing remains an integral part of OCBC’s core corporate values, credit extensions are only offered after a comprehensive assessment of the borrower’s creditworthiness, as well as the suitability and appropriateness of the product offering. In addition, the key to our risk management success lies in the sound judgement of our experienced credit officers.

**Lending to Consumers and Small Businesses**

Credit risks for the consumer and small business sectors are managed on a portfolio basis with credit programmes for mortgages, credit cards, auto loans, commercial property loans, and business term loans. Loans are underwritten that conform to clearly defined target markets, terms of lending and maximum loan sizes. Credit origination source analysis and independent verification of documentation are in place to prevent fraud. The portfolios are closely monitored monthly using MIS analytics. Scoring models are also used in the credit decision process for some products to enable objective, consistent decisions and efficient processing. Behavioural scores are used to identify potential problem credits early to proactively manage the start of collection efforts.

**Lending to Corporate and Institutional Customers**

Loans to corporate and institutional customers are individually assessed and approved by experienced risk officers. They identify and assess the credit risks of large corporate or institutional customers, or customer groups, taking into consideration management quality, financial and business competitive profiles against industry and economic threats. Collateral or other credit support are also assessed to mitigate and reduce risks.
Credit extensions are guided by pre-defined target market and risk acceptance criteria. To ensure objectivity in credit extensions, co-grantor approvals and shared risk ownership are required from both the business unit as well as credit risk functions.

**Lending to Private Banking Customers**
Credit extensions to our wealth management clients in the Bank of Singapore are subject to comprehensive credit assessment and compliance to loan ratios and margin requirements. Joint approvals from the business and risk units also ensure objectivity. Loan advance rates are dependent on the liquidity, volatility and diversification of the collateral portfolio. Credit exposures that are secured by marketable securities are subject to daily valuation and independent price verification controls.

**Credit Risk from Investment or Trading Activities**
Counterparty credit risks from our trading, derivative, and debt securities activities are closely monitored and actively managed to protect against potential losses in replacing a contract if a counterparty defaults. Counterparty credit limits are established for each counterparty following an assessment of the counterparty’s creditworthiness in accordance with internal policies, as well as the suitability and appropriateness of the product offering. Credit exposures are also controlled through independent monitoring and prompt reporting of excesses and breaches against approved limits and risk mitigation thresholds.

The Group has limited exposure to asset-backed securities and collateralised debt obligations and is not active in securitisation activities.

**INTERNAL CREDIT RATING MODELS**
Internal credit rating models are an integral part of OCBC Group's credit risk management, decision-making process, and capital assessment. These internal rating models and the parameters – probability of default (“PD”), loss given default (“LGD”), and exposure at default (“EAD”) – are factors used in limit setting, credit approval, monitoring, reporting, remedial management, stress testing, and internal assessment of the adequacy of capital and provisions.

Model risk is managed under an internal Model Risk Management framework, including an internal ratings framework, to govern the development and validation of rating models and the application of these models. Approval for material models and annual validation results rests with the BRMC. All models are subject to independent validation before implementation to ensure that all aspects of the model development process have met internal standards. The models are developed with active participation by credit experts from risk taking and risk control units. In addition, the models are also subject to annual review (or more frequently, where necessary) and independent validation to ensure the models are performing as expected, and that the assumptions used in model development remain appropriate. All rating models are assessed against regulatory requirements to ensure compliance.

The Group's internal risk grades are not explicitly mapped to external credit agency ratings. Nevertheless, our internal risk grades may correlate to external ratings in terms of the probability of default ranges as factors used to rate obligors would be similar; an obligor rated poorly by an external rating agency is likely to have a weaker internal risk rating.

**A-IRB for Major Retail Portfolios**
The Group has adopted the Advanced Internal Ratings-Based (“A-IRB”) approach for major retail portfolios, including residential mortgages, credit cards, auto loans, as well as small business lending. Internal rating models, developed from internal data, are used to estimate PD, LGD, and EAD parameters for each of these portfolios. Application and behaviour scorecards are used as key inputs for several retail PD models. Product, collateral, and geographical characteristics are major factors used in the LGD and EAD models.

**F-IRB for Major Non-Retail Portfolios**
The Group's major non-retail portfolios are on the Foundation Internal Ratings-Based (“F-IRB”) approach. Under this approach, internal models are used to estimate the PD for each obligor, while LGD and EAD parameters are prescribed by MAS. These PD models are statistically-based or expert judgement models that use both quantitative and qualitative factors to assess an obligor's repayment capacity and are calibrated to expected long-term average one-year default rate over an economic cycle. Expert judgement models are typically used for portfolios with low defaults following inputs from relevant internal credit experts. The models also comply with the regulatory criteria for parameterisation. For major specialised lending portfolios, risk grades derived from internal models are mapped to the five supervisory slotting categories as prescribed in MAS Notice 637. The risk weights prescribed for these slotting categories are used to determine the regulatory capital requirements for such exposures.
IRB Approach for Securitisation Exposures
The credit risk weighted assets for securitisation exposures are computed using the ratings-based method for such exposures as prescribed by MAS Notice 637.

Standardised Approach for Other Portfolios
Other credit portfolios, such as private banking and exposures to sovereigns are under the standardised approach, and will be progressively migrated to the ratings-based approaches. Regulatory prescribed risk weights based on asset class and external ratings from approved credit rating agencies, where available, are used to determine regulatory capital. Approved external rating agencies include Standard & Poor’s, Moody’s, and Fitch.

CREDIT RISK CONTROL
Credit Risk Mitigation
Transactions are entered into primarily on the strength of a borrower’s creditworthiness and ability to repay. To mitigate credit risk, the Group accepts collateral as security, subject to Group policies on collateral eligibility. Collateral include both physical and financial assets. The value of collateral is prudently assessed on a regular basis, and valuations are performed by independent qualified appraisers. Appropriate discounts are applied to the market value of collateral, reflecting the quality, liquidity, volatility, and collateral type. The loan-to-value ratio is a main factor in secured lending decision. OCBC Group also accepts guarantees from individuals, corporates, and institutions as a form of support.

For derivative contracts, the total credit exposure of the contract is the mark-to-market value plus the estimate of the potential credit exposure over the remaining term of the contract. The Group calculates such exposures and uses statistical modelling tools to estimate the potential worst-case scenario risk. To manage counterparty credit risk, financial collateral may be taken to partially or fully cover mark-to-market exposures on outstanding positions. A discount is normally applied on the collateral to cover potential adverse market volatility and currency risk. The collateral agreement typically includes a minimum threshold amount where additional collateral is to be posted by either party if the mark-to-market exposures exceed an agreed threshold. Master agreements, such as those from International Swaps and Derivatives Agreement (“ISDA”), are also used and these allow for close out netting if either counterparty defaults. Some of our netting and collateral agreements may contain rating triggers, mostly in the event of a one-notch rating downgrade. Given the Group’s investment grade rating, there is minimal increase in collateral required to be provided to our counterparties under a one-notch downgrade occurrence.

Managing Credit Risk Concentrations
Credit risk concentrations may arise from lending to single customer groups, borrowers who are in similar activities, or diverse groups of borrowers being affected by similar economic or market conditions. To manage such concentrations, limits are established for single borrowing groups, products, industry segments, and cross-border transfer risks. These limits are aligned with the Group’s business strategy, capacity and expertise. Impact on earnings and capital are also considered during the setting of limits.

The Group continues to diversify its country exposure as it expands its presence and activities in Greater China and Indonesia. As a key player at home, we have significant exposure to the real estate market in Singapore. Dedicated specialist real estate teams manage this risk with focus on client selection, collateral quality, project viability, and real estate cycle trends. Regular stress tests are also made to identify potential vulnerabilities on the real estate portfolio.

The Bank is in compliance with Section 35 of the Banking Act, which limits its exposure to real estate in Singapore to not more than 35% of its total eligible loan assets.

REMEDIAL MANAGEMENT
The Group constantly strives to anticipate early problem credits and proactively manage such credits as they start to deteriorate and/or restore to good health. As we value long-term customer relationships, we prefer to work closely with them at the onset of their difficulties. We recognise the opportunity to promote customer loyalty and retention, where appropriate, even as we enforce strict discipline on remedial management.

Loans are categorised as “Pass” or “Special Mention”, while non-performing loans (“NPLs”) are categorised as “Substandard”, “Doubtful”, or “Loss” in accordance with MAS Notice 612.

OCBC Group has dedicated specialist workout teams to manage problem exposures. Time, risk-based, and discounted cash flow approaches are used to develop collection and asset recovery strategies. The Group uses information and analytical data such as delinquency buckets and adverse status tags for delinquent consumer loans, to constantly fine-tune recovery efforts to gain optimal effectiveness, and to identify customer retention opportunities.
Impairment Allowances for Loans
The Group maintains loan allowances that are sufficient to absorb credit losses inherent in its loan portfolio. Total loan loss reserves comprise specific allowances against each NPL and a portfolio allowance for all loans to cover any losses that are not yet evident. The Group’s policy for loan allowances is guided by Financial Reporting Standard 39 (“FRS 39”), as modified by MAS Notice 612.
Specific allowance is established when the present value of future recoverable cash flows of the impaired loan is lower than the carrying value of the loan. Assessment for impairment is conducted on a loan-by-loan basis. The exceptions are homogenous loans (such as housing loans, consumer loans, and credit card receivables) that fall below a certain materiality threshold. Such loans may be pooled together according to their risk characteristics and collectively assessed according to the degree of impairment severity, taking into account historical loss experience.
Portfolio allowances are set aside based on management’s credit experiences and judgement for estimated inherent losses that may exist but have not been identified to any specific financial asset. Credit experiences are based on historical loss rates that take into account geographic and industry factors. A minimum 1% portfolio allowance is set aside under the transitional arrangement in MAS Notice 612.

Write-offs
Loans are written off against impairment allowances when the loss can be reasonably determined; i.e. after recovery action has been exhausted or when recovery prospects are deemed remote.

Ceasing of Interest Accrual on Loans
When a loan is classified “Substandard”, “Doubtful”, or “Loss”, interest income ceases to be recognised in the income statement on an accrual basis. However, this non-accrual of interest does not preclude the Group’s entitlement to the interest income as it merely reflects the uncertainty in the collectability of such interest income.

Collateral Held Against NPLs
Real estate in Singapore forms the main type of collateral for the Group’s NPLs. The realisable value of the real estate collateral is used to determine the adequacy of the collateral coverage. Cross collateralisation will only apply when exposures are supported by proper legal documentation.

Market Risk Management
Market risk is the risk of loss of income or market value due to fluctuations in factors such as interest rates, foreign exchange rates, equity and commodity prices, or changes in volatility or correlations of such factors. OCBC Group is exposed to market risks from its trading and client servicing activities.

Our market risk management strategy and market risk limits are established within the Group’s risk appetite and business strategies, taking into account macroeconomic and market conditions. Market risk limits are subject to regular review.

Market Risk Management Oversight and Organisation
The Market Risk Management Committee (“MRMC”) is the senior management committee that supports the BRMC and the CEO in market risk oversight. The MRMC establishes the market risk management objectives, framework, and policies governing prudent market risk taking, which are backed by risk methodologies, measurement systems, and internal controls.

The MRMC is supported at the working level by Market Risk Management (“MRM”) within GRM. MRM is the independent risk control unit responsible for operationalising the market risk management framework to support business growth while ensuring adequate risk control and oversight.

Market Risk Management Approach
Market risk management is a shared responsibility. Business units are responsible for undertaking proactive risk management within their approved trading strategies and investment mandates, whilst MRM acts as the independent monitoring unit to ensure sound governance. Key risk management activities of identification, measurement, monitoring, control, and reporting are regularly reviewed to ensure effective risk management.

Market Risk Identification
Risk identification is addressed via the Group’s new product approval process at product inception. Market risks are also identified by our risk managers from their other ongoing interactions with the business units.

Market Risk Measurements
Value-at-Risk
Value-at-risk (“VaR”) is a key market risk measure for the Group’s trading activities. The BRMC agrees on an aggregate market risk appetite based on VaR. VaR is measured and monitored by its individual market risk components, namely interest rate risk, foreign exchange risk, equity risk and credit spread risk,
as well as at the aggregate level. VaR is based on a historical simulation approach and is applied against a one-day holding period at a 99% confidence level. As VaR is a statistical measure based on historical market fluctuations, it might not accurately predict forward-looking market conditions all the time. As such, losses on a single trading day may exceed VaR, on average, once every 100 days.

Other Risk Measures
As the Group’s main market risk is interest rate fluctuations, Present Value of a Basis Point ("PV01"), which measures the change in value of interest rate sensitive exposures resulting from one basis point increase across the entire yield curve, is an additional measure monitored on a daily basis. Other than VaR and PV01, the Group also utilises notional amounts, CS01 (1 Basis Point move in Credit Spreads) and derivative greeks for specific exposure types, where appropriate, to supplement its risk measurements.

Stress Testing and Scenario Analyses
The Group also performs stress testing and scenario analyses to better quantify and assess potential losses arising from low probability but plausible extreme market conditions. The stress scenarios are regularly reviewed and fine-tuned to ensure that they remain relevant to the Group’s trading activities, risk profile, and prevailing and forecast economic conditions. These analyses determine if potential losses from such extreme market conditions are within the Group’s risk tolerance.

The table below provides a summary of the Group’s trading VaR profile by risk types as at 31 December 2013 and 31 December 2012.

<table>
<thead>
<tr>
<th>Risk Type</th>
<th>2013</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Year End</td>
<td>Average</td>
</tr>
<tr>
<td>Interest Rate Risk VaR</td>
<td>7.85</td>
<td>8.33</td>
</tr>
<tr>
<td>Foreign Exchange Risk VaR</td>
<td>7.50</td>
<td>5.05</td>
</tr>
<tr>
<td>Equity Risk VaR</td>
<td>1.01</td>
<td>1.26</td>
</tr>
<tr>
<td>Credit Spread Risk VaR</td>
<td>1.59</td>
<td>3.01</td>
</tr>
<tr>
<td>Diversification Effect (1)</td>
<td>-0.40</td>
<td>-7.79</td>
</tr>
<tr>
<td>Aggregate VaR</td>
<td>17.56</td>
<td>9.84</td>
</tr>
</tbody>
</table>

(1) Diversification effect is computed as the difference between Aggregate VaR and sum of asset class VaRs.
(2) Not meaningful as the minimum and maximum VaR may have occurred on different days for different asset classes.

RISK MONITORING AND CONTROL

Limits
Only authorised trading activities for approved products may be undertaken by the various trading units. All trading risk positions are monitored on a daily basis against approved and allocated limits by independent support units. Limits are approved to reflect available and anticipated trading opportunities, with clearly defined exception escalation procedures. Exceptions, including any temporary breaches, are promptly reported and escalated to senior management for resolution. Multiple risk limits (VaR and risk sensitivities), profit/loss, and other measures allow for more holistic analysis and management of market risk exposures.

Model Validation
Model validation is also an integral part of the Group’s risk control process. Risk models are used to price financial instruments and to calculate VaR. The Group ensures that the models used are fit for their intended purpose, through internal verification and assessment. Market rates used for risk measurements and valuation are sourced independently, thereby adding further to the integrity of the trading profits and losses ("P&L"), risk and limit control measurements.

To ensure the continued integrity of the VaR model, the Group conducts back-testing to confirm the consistency of actual daily trading P&L, as well as theoretical P&L against the model’s statistical assumptions.
Risk Management
(This section forms an integral part of OCBC’s audited financial statements)

Frequency distribution of Group Trading Book Daily Total VaR
(One Day Holding Period) for FY 2013

Number of Trading Days

Frequency distribution of Group Trading Daily Revenue
for FY 2013

Number of Trading Days
ASSET LIABILITY MANAGEMENT
Asset liability management is the strategic management of the balance sheet structure and liquidity needs, covering liquidity sourcing and diversification, structural interest rate and structural foreign exchange management.

ASSET LIABILITY MANAGEMENT OVERSIGHT AND ORGANISATION
The Asset Liability Management Committee ("ALCO") is responsible for the oversight of our Group liquidity and balance sheet risks. The ALCO is chaired by the CEO and includes senior management from the business, risk and support units. The ALCO is supported by the Corporate Treasury within the Group Finance Division. Asset Liability Management within GRM provides liquidity and balance sheet risk/limit monitoring.

ASSET LIABILITY MANAGEMENT APPROACH
The Asset Liability Management framework comprises liquidity risk management, structural interest rate risk management and structural foreign exchange risk management.

Liquidity Risk
The objective of liquidity risk management is to ensure that there are sufficient funds to meet contractual and regulatory financial obligations and to undertake new transactions.

Our liquidity management process involves establishing liquidity management policies and limits, regular monitoring against liquidity risk limits, regular stress testing, and establishing contingency funding plans. These processes are subject to regular reviews to ensure that they remain relevant in the context of prevailing market conditions.

Liquidity monitoring is performed daily within a framework for projecting cash flows on a contractual and behavioural basis. Simulations of liquidity exposures under stressed market scenarios are performed and the results are taken into account in the risk management processes. Structural liquidity indicators such as liquidity and deposit concentration ratios are employed to maintain an optimal funding mix and asset composition. Funding strategies are in place to provide effective diversification and stability in funding sources across tenors, products and geographies. In addition, liquid assets in excess of regulatory requirements are maintained for contingent use in the event of a liquidity crisis. These liquid assets comprise statutory reserve eligible securities as well as marketable shares and debt securities.

Structural Interest Rate Risk
The primary goal of interest rate risk management is to ensure that interest rate risk exposures are maintained within defined risk tolerances.

Interest rate risk is the risk to earnings and capital arising from exposure to adverse movements in interest rates. The material sources of interest rate risk are repricing risk, yield curve risk, basis risk and optionality risk. A range of techniques are employed to measure these risks from an earnings and economic value perspective. One method involves the simulation of the impact of a variety of interest rate scenarios on the net interest income and the economic value of the Group's equity. Other measures include interest rate sensitivity measures such as PV01 as well as repricing gap profile analysis.

Limits and policies to manage interest rate exposures are established in line with the Group's strategy and risk appetite. Thresholds and policies are appropriately approved, and reviewed regularly to ensure they remain relevant against the external environment. Control systems are in place to monitor the risk profile against the approved risk thresholds.

Structural Foreign Exchange Risk
Structural foreign exchange exposure arises primarily from net investment in overseas branches, subsidiaries, strategic as well as property assets. The objective is to protect the capital through identifying, measuring, and managing the potential adverse impact of structural foreign exchange risk on capital deployed. OCBC actively manages this risk through hedges and match funding for foreign currency investments, in order to minimise impact.
Risk Management
(This section forms an integral part of OCBC’s audited financial statements)

OPERATIONAL RISK MANAGEMENT
Operational risk is the risk of loss resulting from inadequate or failed internal processes, people, systems and management, or from external events. Operational risk management also covers fiduciary, legal and reputational risks.

The Group’s operational risk management aims to both manage expected and unexpected losses, including those caused by catastrophic events. The twin goals enable new business opportunities to be pursued in a risk-conscious and controlled manner.

OPERATIONAL RISK MANAGEMENT OVERSIGHT AND ORGANISATION
The Operational Risk and Information Security Committee (“ORISC”) is the senior management committee that oversees the execution of the Group’s operational risk management, information security and technology risk practices. ORISC ensures that various risk management programmes that are in place are appropriate, effective, and support the Group’s business strategy.

The Operational Risk Management (“ORM”) department within GRM establishes the ORM framework, including supporting policies and methodologies. The ORM department also provides independent oversight of operational risk monitoring and control that reside within business, products and process owners. The ORM programmes are actively implemented through the respective Operational Risk Co-ordinators or managers in the business units and subsidiaries. Self-assessment declarations are subject to risk-based independent reviews.

OPERATIONAL RISK MANAGEMENT APPROACH
OCBC Group adopts a framework that ensures operational risks are properly identified, managed, monitored, mitigated, and reported in a structured and consistent manner. The framework is underpinned by an internal control system that reinforces the Group’s control culture by establishing clear roles and responsibilities for staff and preserving their rights in executing control functions without fear of intimidation or reprisal.

Each business unit undertakes regular self-assessment on the robustness of its own risk and control environment, including meeting all regulatory and legal requirements. Performance metrics are also used to detect early warning signals and to drive appropriate management actions before risks become material losses.

Senior management attests annually to the CEO, Audit Committee and BRMC on the adequacy and effectiveness of the internal control system, as well as report key control deficiencies and accompanying remedial plans. Operational risk losses and incidents data trends are also analysed and regularly reported.

The Group Corporate Security function, set up since 2012, brought together Physical and People Security, Business Continuity Management, and Fraud Risk Management under one umbrella. New capabilities and initiatives have been implemented to further strengthen the Group’s resiliency and protection of its assets against unexpected events.

Physical and People Security
The Group recognises that as it expands its regional footprint, its personnel and assets may be exposed to more external threats. The Group Physical Security Policy and Standards provide the baseline safeguard requirements for the Group.

Busines Continuity Management
The programme aims to reduce the interruption of essential business activities and services during times of crisis. Review and testing of its business recovery strategies and plans are carried out on an annual basis. Every year, senior management also provides an attestation to the BRMC. The attestation includes a measurement of the programme’s maturity, extent of alignment to MAS guidelines, and a declaration of acceptable residual risk.

Fraud Risk Management
The Group’s Fraud Risk Management and Whistle-Blowing programmes help prevent and detect fraud or misconduct. Fraud incident reports, including root cause analysis, extent of damage, supporting remedial actions and recovery steps of major incidents, are regularly reported to ORISC and BRMC. Group Audit independently reviews all fraud and whistle-blowing cases, with regular reporting to the Audit Committee.

Reputational Risk Management
Reputational risk is the current or prospective risk to earnings and capital arising from adverse perception of the image of the Group by customers, counterparties, shareholders, investors and regulators. We have a reputational risk management programme which focuses on understanding and managing our responsibilities towards our different stakeholders, and protecting our reputation. A key emphasis of the programme is effective information sharing and engagement with stakeholders.
Fiduciary Risk Management
The Group has a fiduciary risk management programme to manage risks associated with fiduciary relationships from managing funds or providing other agency services. The programme provides guidelines on regular identification, assessment, mitigation, and monitoring of fiduciary risk exposures, to ensure the Group’s compliance with applicable corporate standards.

Regulatory and Legal Risks
Each business unit is responsible for the adequacy and effectiveness of controls in managing both regulatory and legal risks. An annual Regulatory Compliance Certification is provided by senior management to the CEO and BRMC on the state of regulatory compliance.

INFORMATION SECURITY AND TECHNOLOGY RISK MANAGEMENT APPROACH
The Group protects and ensures the confidentiality, integrity, and availability of its information assets through implementing appropriate security controls to protect against the misuse or compromise of information assets.

Enhanced Technology Risk Management Programme
New and appropriate security technologies are regularly identified and implemented as part of OCBC’s holistic approach to managing technology risk. In 2013, we enhanced our Technology Risk Management programmes by implementing clearly defined risk appetite statements and ongoing monitoring of risks related to compliance, availability and information security.

Cyber Security
With the rise in cyber threats, OCBC has remained an active participant in cyber security initiatives within the banking sector. As chairman of the Association of Banks in Singapore (“ABS”) Standing Committee’s cyber security awareness programmes, we take a leading role in collaborating with industry participants and key government agencies to formulate cyber security awareness programmes. Amongst the Standing Committee’s key objectives are to influence technology risk management strategies, practices and to recommend solutions to counter cyber threats.