



## **MATERIAL RISK FACTORS & MEASURES TO MANAGE RISKS**

Driven by its desire to improve business processes, increase operation efficiency, improved repayment rate, optimize earning potential and embed a culture of risk management, LLFC adopted the Enterprise Risk Management (ERM) Approach in 2019 through the guidance of ISO 31000 Risk Management Implementation Process and BSP Circular 971, s. 2017 or the Guidelines on Risk Governance. ERM is a process effected by an entity's board of directors, management, and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity and manage risk to be within its risk appetite. It provides reasonable assurance regarding the achievement of the entity's objectives.

As a Non-Bank Supervised Financial Institution (NBSFI), the core operations of LLFC are leasing and financing, which income is highly dependent on its lending operations. Its exposure to various types of borrowers is something to crow about, not only because of the economic benefits derived by its clients but also since it has substantially elevated LLFC's status. In its almost forty-years of existence, LLFC's clientele continuously grow, and diversity of products and services impart complexity to an otherwise simple lending operation, a situation that compels LLFC to consider a more effective way of managing the various risks it is confronted with. It recognizes the fact that risks could arise not only from its lending activities but also from other internal and external factors, such as the stringent regulatory requirement and stiff market competition, which could impact on its operations, income, and capital. This realization prompted the LLFC to adopt the ERM Approach that encompass all possible risks it encounters that enables LLFC to continuously carry out risk mitigating measures in an evolving process.

LLFC adopted the ERM Approach to strengthen its initiative to retain its ISO 9001:2015 Certification without necessarily leaving out the RM foundations it has established. It complements the Silo Approach, which focus on those risks it considers important such as credit, liquidity, operational and compliance risks at managed individually. With the ERM Approach it empowers LLFC to see the inter-relationship of the risks and digress from compartmentalized way of addressing risks and overlaps in formulation of risk management strategies.

LLFC also recognizes material risk factors and mitigating measures, to wit:

- **Strategic Risk Management**

Strategic risk is defined as the failure to develop, implement, and monitor institutional strategies/direction may threaten LLFC's overall viability and growth prospects. To address such risk, LLFC formulates a medium-term plan and closely monitors institutional goals and commitment to Governance Commission for Government Owned-and-Controlled Corporation (GCG). LLFC also conducts an annual Internal Capital Adequacy Assessment Process through the Risk and Control Self-Assessment Map.

- **Credit Risks**

Being a financial institution the primary risks in LLFC's operations is Credit Risk. Credit Risk Management is defined as the inability to review and analyze requests for credit to determine likelihood of repayment. This include the failure to manage the risk that loss is incurred if counterparty does not fulfill its financial obligations in a timely manner. Credit risk arises from all activities dependent on customer performance and when funds are committed, invested, or otherwise exposed through actual or implied contractual agreement (whether reflected on or off the balance sheet). It comprises primarily of default risk; settlement risk; concentration risk; and



collateral/recovery risk among others. To manage such risk, LLFC has a rigorous credit evaluation and approval process in place. It requires credit enhancement/collaterals as a secondary measure to protect the institution, monitoring of credit exposures, observance of limits and risk distribution to maintain an acceptable level of risk.

- **Liquidity Risk**

Liquidity risk is the failure to properly manage cash flows could affect LLFC's ability to settle its obligations as they come due and could lead to insolvency and regulatory sanctions. LLFC recognizes the need to identify, measure, monitor and mitigate liquidity risk. Thus, it implements effective strategy for a sound and prudent liquidity risk management strategy. Among the strategies used by LLFC are setting liquidity risks limits; regular review of the liquidity position; and a projection of cash needs for future periods, as well as the diversification of the funding sources.

- **Interest Rate Risk**

LLFC's is also exposed to interest rate risk or the vulnerability to movements in interest rates. The inability to appropriately plan for and react to fluctuations in interest rates will lead to cash flow shortfalls resulting from re-pricing of loans or obligations. It is the risk that the LLFC will experience deterioration in its financial position as interest rate moves over time. To mitigate the impact, it monitors and assess fund sources and fund usage.

- **Operational Risks**

LLFC also actively monitors its operational risks attributed to its operations. Operational risk refers to loss resulting from inadequate or failed internal processes, people, and systems, or from external events. This definition includes legal risk but excludes strategic and reputational risks. It is inherent in all activities, products and services, and cuts across multiple activities and business lines within the financial institution. As part of LLFC's Operational Risk Management processes, the following are being utilized:

- Risk and Control Self-Assessment
- Business Impact Analysis
- Business Continuity Risk Assessment
- Information Security Risk Assessment
- Risk Event Monitoring Report
- Operational Risk Management Audit

- **Compliance Risk Management**

Compliance risk is defined as the failure to comply with laws, rules, related self-regulatory organization standards, and codes of conduct applicable to its activities that results in eroding of LLFC's franchise value. It may also arise from failure to manage conflict of interest, treat customers fairly, or effectively manage risks arising from money laundering and terrorist financing activities. To address this risk LLFC and LBP has established and implemented the LBP Group Centralized Compliance Management (CCM) Framework, which lay down the standards for the compliance management function. Under the CCM Framework, the compliance management function of LBP Group shall be handled by LBP-Compliance Management Group.