RISK MANAGEMENT FRAMEWORK AND POLICY

The Bank formulates Risk Management Policy accordint to POJK No. 65/POJK.03/2016 concerning Risk Management Implementation for Sharia Commercial Bank and Sharia Business Unit.

To undertake the Risk Management function, the Bank establishes the governance of effective risk management, independent Risk Management Unit, sets the risk appetite and risk tolerance, and develops risk management policy and procedures to maintain the determined risk level.

RISK MANAGEMENT ORGANIZATION

1. Risk Management Committee

   Risk Management Committee is responsible for the implementation of the overall risk management framework. This Committee is chaired by the Director in charge of Risk Management Unit, with the members consisting of the majority of the Board of Directors and Executive Officers of business units and/or supporting unit, Compliance and Risk Management Director.

2. Risk Management Unit

   Risk Management Unit manages the coordinating function and conducts the socialization of the whole risk management process of the Bank in order to minimize the potential as well as the impact of various types of risks faced by the Bank. Risk Management Unit develops a comprehensive process to identify, measure, monitor and control the risks and prepare report of risk level and build a reliable internal control system.

3. Operational Unit

   Operational Unit (both in the business unit and/or supporting unit/function) is tasked with the following duties and responsibilities:

   - ✓ Manage the process of identification, measurement, monitoring and control of risks related to the operational activities;
   - ✓ Develop policy, SOP, implementation manual and limit for operational activities, and perform the operational activities according to the prevailing policy, SOP and limit.

- ✓ Inform the risk exposure related to business activities to the Risk Management Unit on periodic basis;
- ✓ Increase the risk awareness of every employee through effective communication.

RISK MANAGEMENT FRAMEWORK

The risk management framework of the Bank is implemented through policy, procedures, transaction limit and authority, risk tolerance and risk management instrument. The implementation of risk management includes:

- ✓ Active supervision by the Board of Commissioners, the Board of Directors and Sharia Supervisory Board;
- ✓ Adequacy of policy, procedure and limit setting;
- ✓ Adequacy of the process of identification, measurement, monitoring and control of risks and risk management information system;
- ✓ Comprehensive internal control.

GENERAL POLICY OF RISK MANAGEMENT

To ensure effective risk control, the policy and procedures must be in accordance to the risk management strategy and includes risk tolerance. Risk Management Policy is established to ensure that the Banks maintain risk exposure that is consistent with the internal policy and procedures and external rules, laws and regulations. In implementing the risk management policy, the Bank shall consider amongst others:

- ✓ The type of business and product in line with the vision, mission and business strategy of the Bank;
- ✓ Risk identification and mitigation that is clear and controlled particularly in relation to the Bank product and transaction;
- ✓ Clear command of responsibility in managing eacy type of risk;
- ✓ The methodology and information management system being utilized is able to measure risk and support business;

- ✓ The setting of authority and limit parameter that keeps the maximum risk of loss within an acceptable level according to the risk tolerance and risk appetite of the Bank;
- ✓ Business Continuity Management;
- ✓ Policy to govern new product and activity;
- ✓ Measurement and setting of the Bank risk level are presented in the form of risk profile.

INTERNAL CONTROL FRAMEWORK

The internal control framework of Bank BTPN Syariah applies the 3 lines of defense that each operates independently.

- ✓ The first line, *Risk Taking Unit* (RTU), is the function of Quality Assurance, to ensure all operational activities are in accordance to the prevailing policy and procedures;
- ✓ The second line, Risk Management Unit with the Compliance Division, is to manage the definition, refinement and maintenance of operational risk management methodology; to ensure the adequacy of risk mitigation, policy and procedures; and to facilitate coordination of the overall risk management activities;
- ✓ The third line, Internal Audit Unit, is to ensure – in an independent manner – that all residual risks are managed according to the approved risk tolerance.

CREDIT RISK

Credit Risk is the risk of default that may arise from a customer or other party failing to fulfil the obligation to the Bank according to the credit agreement. Included in the credit risk are the risk of default of debtor, the risk of financing concentration, counter party credit risk, and settlement risk.

1. **Adequacy of Policy, Procedures and Limit Setting**

   To provide a clear foundation in managing credit risk, the Bank develops the financing policy and procedures as the guidelines in the implementation of financing process which is to be reviewed on periodic basis especially in the situation with changes in the economy and changes in the regulation and/or business approach. The Bank also set the limit to keep the credit risk exposure within the risk appetite of the bank. The limit includes amongst others the limit of authority of decision making on financing according to the competency of the decision maker and the risk level, while keeping it from conflict of interest in the financing process for the customers, setting the Legal Lending Limit according to the prevailing regulation of Bank Indonesia and Financial Services Authority.

2. **Adequacy of Identification, Measurement, Monitoring and Control Process of Risks and the Risk Management Information System**

   The implementation of Credit Risk framework in Bank BTPN Syariah is administered in an integrated process consisting of identification, measurement, monitoring and risk mitigating/controling process. Credit risk identification is the result of the review of credit risk characteristics that are inherent in the financing functional activities and treasury including the financing concentration risk. Credit risk measurement system considers the product characteristics, time period, collateral aspect, potential of default, and the Bank capability to absorb the potential of default. The Bank monitors the actual credit risk expore against the credit risk limit and monitors the management of problem financing and monitors the conformity between the policy and the implementation of credit risk management.

3. **Comprehensive Internal Control System**

   The internal control system is to manage the risks that the endanger the continuity of the business of the Bank, that amongst others includes the implementation of procedures to manage and resolve problem financing effectively, ensure segregation of duties between financing approval function and problem financing settlement function. Controlling credit risk is also administered by means of risk mitigation, actively managing the portfolio position and risk, and setting the target of the concentration risk limit.

MARKET RISK

Market risk is the risk in the balance sheet position and administrative account due to the changes in the market prices, that includes the risk of changes in the value of tradable or rentable assets.

1. **Adequacy of Policy, Procedures and Limit Setting**

   Currently the Bank has already had adequate policy and procedures related to the main principles of market risk management framework. According to the current policy and activity of the Bank, the type of market risk applies for the Bank only includes the measurement and monitoring to the changes in benchmark rate in the portfolio banking book. The management of benchmark rate risk banking book is part of the overall Assets and Liabilities Management of the Bank in accordance to the business condition of the Bank. The setting of the limit and risk tolerance is well documented in the Market Risk Management Policy and SOP Market Risk Management, and is reviewed on periodic basis. The Bank has also had the provisions and mechanism to execute the emergency plan for the possible occurence of crisis.

2. **Adequacy of Identification, Measurement, Monitoring and Control Process of Risks and the Risk Management Information System**

   The market risks arising from the Bank operations are identified, measured, monitored and managed to anticipate the potential changes of the condition both under the normal and crisis circumstances. The measurement and monitoring to the market risk exposure is administred by means of monitoring the changes of the benchmark rate risk banking book. The identification benchmark rate risk starts from the analysis of the sources of benchmark rate risk of the overall rate sensitive instruments of the Bank at the positions of assets, liabilities and off balance sheet that may create a potential loss to the Bank both from the earning side and economic value. The measurement and monitoring process is also conducted to the Mark to Market performed every month as part of the monitoring of the Bank market risk to the value of the securities of the Bank. In addition, monitoring is also applied to counterparty limit.

3. **Comprehensive Internal Control System**

   The Bank has already had adequate internal control process by measuring the Bank resilience to loss under stress market condition and administering escalation of control and review of the market risk policy and limit according to the prevailing policy and procedures.

LIQUIDITY RISK

Liquidity risk is the risk due to the inability of the Bank the fulfil the short term obligation by using its cash flow as the source of fund and/or high quality pledgeable liquid assets without creating any disruption in the Bank activities and financial condition.

1. **Adequacy of Policy, Procedures and Limit Setting**

   The policy implemented by the bank in controlling liquidity risk is by developing the liquidity risk management policy in accordance to the mission, business strategy, capital adequacy, human resources and risk appetite of the Bank.

2. **Adequacy of Identification, Measurement, Monitoring and Control Process of Risks and the Risk Management Information System**

   The instruments to measure and monitor the liquidity risks include: liquidity ratio, maturity profile, cash flow projection and stress testing. The monitoring of liquidity position is also performed on daily basis by observing early warning indicators to the internal and external indicators. In addition, the Bank also prepares reports to the regulator that include the individual maturity profile report and consolidated maturity profile report (LCR, NSFR and risk profile) to the parent bank.

3. **Comprehensive Internal Control System**

   The Bank has set the liquidity risk tolerance according to the level of liquidity risk that is acceptable for the management of the Bank. The Internal Control functions to anticipate the potential of increasing liquidity risk that may create any disruption in the operations or continuity of the business of the Bank by implementing the Contingency Funding Plan approach, that is the operational manual and procedures to prevent, minimize and manage any potential of threats to funding in the event that the Bank is experiencing liquidity crisis.

OPERATIONAL RISK

Operational risk is the risk of loss due to inadequate internal process, failure of internal process, human error, system error, and/or the occurence of external events impacting the Bank operations.

1. **Adequacy of Policy, Procedures and Limit Setting**

   The Bank has had the policy and procedures to manage operational risk, that includes amongst Operational Risk Management Policy, Business Continuity Management Policy, Operational Policy, Human Resources Management Policy, and IT Policy and the related procedures. The setting of operational risk limit to cap the maximum risk to be absorbed by the Bank refers to the exposure of operational risk, past losses, operational risk tolerance, and analysis of the potential operational risk and its future looking risks.

2. **Adequacy of Identification, Measurement, Monitoring and Control Process of Risks and the Risk Management Information System**

   Risk identification is conducted by registering all potential operational risks according to process, products, risk occurence and information assets owned by the Bank. Risk measurement process is performed through periodic self assessment activities, management of risk/loss event database and calculation of capital adequacy operational risk. Risk control process is conducted by Operational Unit and Risk Management Unit by applying effective control mechanism and/or providing adequate assurance to minimize the risk for the Bank. Risk Management Information System is made to provide information in an accurate, timely and updated manner to support the management function in planning and decision making.

3. **Comprehensive Internal Control System**

   Internal control system is performed by doing periodic review to the procedures, documentation, data processing system, contingency plan, contract and agreement between the Bank and other parties; and conducting assurance process to all functional activities and follow up the result of internal/external audit. At the operational level, three lines of defence is established with the Quality Assurance providing support to the Risk Taking Unit in the enforcement of operational risk management on daily basis. In the next layer of defense, Risk and Fraud Management Division in collaboration with Compliance Division are in charge to manage the definition, refinement and maintenance of operational risk management framework, to ensure the adequacy of risk mitigation, policy and procedures, and to facilitate the coordination of operational risk management activities. The next layer of defense is the Internal Audit which independently functions to ensure that the residual risks are managed within the boundaries of risk appetite.

4. **Business Continuity Management**

   Bank BTPN Syariah has developed the Manual of Business Continuity Management that is comprehensive to anticipate operational risk that may occur in the critical/extreme situation due to natural disaster such as flood, earth quake and other factors such as fire, electricity supply disruption, uncondusive business environment – so as to guarantee the continuity of services to customer.

LEGAL RISK

Legal risk is the risk due to law suits and/or weaknesses in juridical aspects.

1. **Adequacy of Policy, Procedures and Limit Setting**

   Overall legal risk management includes company regulations, code of ethics, litigation, legal work agreement, setting of authority and power, and sanction management.

2. **Adequacy of Identification, Measurement, Monitoring and Control Process of Risks and the Risk Management Information System**

   The Bank ensures the adequacy of identification, measurement, monitoring and control process of risks and risk management information system to prevent the potential of law suit. The Bank identify and control legal risks inherent in the new product and activity before it is introduced to the customers and identify legal risks inherent in every functional activity.

3. **Comprehensive Internal Control System**

   Comprehensive internal control system in legal risk management process is conducted by doing periodic review.

COMPLIANCE RISK

Compliance risk is the risk resulting from the Bank incompliance and/or the Bank not implementing the legal regulations, prevailing provisions of the regulators, and/or the Bank not fulfilling the Sharia principles.

1. **Adequacy of Policy, Procedures and Limit Setting**

   The Bank has already had the Compliace Policy and Procedures, including the AML/CTF as the fundamental infrastructure in the governance of compliance function that is used as the reference in the implementation of the compliance function of the Bank.

2. **Adequacy of Identification, Measurement, Monitoring and Control Process of Risks and the Risk Management Information System**

   The Bank conducts the identification, measurement, monitoring and control process of compliance risks in a continuous basis that includes amongst others administering compliance test to the design of policy and product program to be issued by the working unit, including to the plan to lauch new product/activity and its development. The Bank establishes a periodic compliance risk reporting system, minimum once a month.

3. **Comprehensive Internal Control System**

   The Bank applies control to operational risks by doing periodic review to the compliance policy and procedures, implementing periodic compliance checking, conducting quality assurance to all functional activities, and follow up the result of internal/external audit.

STRATEGIC RISK

Strategic risk is the risk resulting from the inaccuracy of decision making and/or implementation of strategic decision and failure in anticipating changes in business environment.

1. **Adequacy of Policy, Procedures and Limit Setting**

   The Bank has already had the procedures governing the formulation and preparation of the Bank Business Plan including the review of strategic direction and key activities to support the stated strategic plan.

2. **Adequacy of Identification, Measurement, Monitoring and Control Process of Risks and the Risk Management Information System**

The Bank, through Corporate Planning Unit, ensures the adequacy of the identification, measurement, monitoring and control process of strategic risks by conducting quarterly review of strategic risks including financial performance. The Bank compares the performance of banking industry to the business plan being implemented in the Bank. Such review of strategic risks is part of the process of reviewing the overall risk of the Bank.

3. **Comprehensive Internal Control System**

   The Bank has already had internal control system for strategic risk management by conducting periodic review to the Bank performance, quantitatively and qualitatively.

REPUTATION RISK

Reputation risk is the risk due to the diminishing confidence level of the stakeholders resulting from the negative perception to the Bank.

1. **Adequacy of Policy, Procedures and Limit Setting**

   The Bank has established the procedures concerning the communication to prevent and manage negative publicity.

2. **Adequacy of Identification, Measurement, Monitoring and Control Process of Risks and the Risk Management Information System**

   Identification of reputation risk is made for each functional activity and the measurement of reputation risk is administered quantitatively. To monitor and control the reputation risk, the Bank has established the Unit with the authority and responsibility to provide comprehensive information to the customers and stakeholders. With regard to the monitoring and control of reputation risk, the Corporate Communication Unit and the unit in charge of Customer Complaint Settlement perform the monitoring to the number of customers' complaints and the success rate in settling the complaints.

3. **Comprehensive Internal Control System**

   The Bank has already had the internal control system for reputation risk management by managing customers complaints, implementing prudent principles and transparency.

RATE OF RETURN RISK

Rate of Return Risk is the risk due to the changes in the rate of return paid by the Bank to the customers resulting from the changes of the rate of return received by the Bank in the provision of fund, that may impact the behavior of the third party fund customers of the Bank.

1. **Adequacy of Policy, Procedures and Limit Setting**

   The provisions on rate of return that amongst others govern the determination of inherent rate of return risk, the measurement of rate of return risk profile with the prevailing risk level and policy and procedures. Such provision is an integrated part of the Bank Market and Liquidity Risk Management Policy.

2. **Adequacy of Identification, Measurement, Monitoring and Control Process of Risks and the Risk Management Information System**

   The measurement of the rate of return risk profile that amongst others include the risk of declining rate of return paid by the Bank to the customers due to the declining performance of the Bank. The monitoring is conducted through the information management that provides periodic and timely reports.

3. **Comprehensive Internal Control System**

   Is conducted according to the prevailing policy and procedures.

INVESTMENT RISK

Equity investment risk is the risk due to the Bank partaking losses of the customers' business financed under profit and loss sharing basis. This risk arises when the Bank provides financing under profit sharing agreement to the customers where the Bank will bear the risk of losess and share the profits of the customer's business being financed by the Bank. In this case, the calculation of profit sharing is not only based on the revenue or sales generated by the customers but calculated from the profit earned from the business of the customer. In the event that the customer's business goes banckrupt, the principal amount of the financing provided by the Bank to the customers will not be paid back.

1. **Adequacy of Policy, Procedures and Limit Setting**

   The provision that governs investment including amongst others the estimated rate of return of various sharia banking products in the Bank refers to the generally accepted rate of return in the financial market as the benchmark in planning the pricing or rate of return. This is stipulated in the Marke and Liquitdity Risk Management Policy of the Bank.

2. **Adequacy of Identification, Measurement, Monitoring and Control Process of Risks and the Risk Management Information System**

   Identification of risk is conducted by assessing the proforma of the Bank financing products under profit sharing basis and by analyzing the sensitivity of such products to the market changes that may impact the financial performance of the Bank. Measurement is conducted to assess the resilience of the customer's business in generating revenue under the circumstances with the changes in economic condition, changes in regulation or changes in other external factors that may impact the customer's business. Monitoring is performed through information system that provides periodic and timely reports.

3. **Comprehensive Internal Control System**

   Is conducted according to the prevailing policy and procedures.