RISK MANAGEMENT

I. Risk Management Policy

The Small Business Corporation (SB Corporation) pursues adequate and effective risk management systems commensurate to its risk-taking activities. Towards this end, SB Corporation aims to implement best practices in Enterprise Risk Management (ERM) across its systems and processes.

II. Enterprise Risk Management Framework

The ERM Framework of SB Corporation was formally established with the approval by the Governing Board of the ERM Manual through Board Resolution No. 2282, s. 2016 dated 10 March 2016.

Financial institutions are in the business of taking risks. SB Corporation – as the organization charged primarily with the responsibility of implementing comprehensive policies and programs to assist micro, small and medium enterprises (MSMEs) by way of providing access to finance, among others – has risk taking as an integral part of its business. Its ability to manage risks thus allows the institution to live up to its mandate as provided for under Republic Act No. 9501, otherwise known as the Magna Carta for Micro, Small and Medium Enterprises.

As a Government-Owned and Controlled Corporation (GOCC) administratively attached to the Department of Trade and Industry (DTI), SB Corporation aligns itself to national goals and objectives for MSME development as outlined in the MSME Development Plan 2023-2028. This provides the context by which the Corporation's ERM Framework operates.

SB Corporation's Governing Board and Senior Management effectively drives its ERM, with the former being charged with approving and overseeing the implementation of the institution's strategic objectives, risk strategies and corporate governance while the latter manages day-to-day affairs. Together, they set the tone for managing risks across its systems and processes which is shared at all levels of the institution.

The engine driving SB Corporation's ERM vehicle is the linkage between its Strategic Planning, Risk Management and Capital Management Processes. This is anchored on four (4) key components, namely: 1) Risk Organization and Governance; 2) Processes and Policies; 3) Data and System Infrastructure; and 4) Risk Measurements.

These components undergo a continuous cycle of improvement where design translates to implementation and is regularly monitored for enhancement. Thus, ERM is subject of an iterative process and takes on a dynamic form that adjusts to the dynamic risk environment and responds to both internal and external factors and changes in its business model.

III. Enterprise Risk Management Roles and Responsibilities

The following key principles guide SB Corporation's approach to ERM:

Finance and Risk Oversight Committee (Board-level)

The role of the Finance and Risk Oversight Committee (FROC) is to set the direction and overall risk strategies. It provides oversight to the Management of SB Corporation, led by the President and CEO (P/CEO), ensuring that risks are managed across the Corporation in a timely and appropriate manner.

President and CEO

The President and CEO maintains ultimate accountability for the management of the institution's risks, including issuing directives for their management. The P/CEO likewise authorizes and owns the ERM Policy and issues final approval of the ERM risk appetite statements.

Risk Management Committee (Management-level)

The Risk Management Committee (RMC) refers to the existing Management Committee, with the participation of the Chief Risk Officer (CRO). It is a management-level committee chaired by the P/CEO. It is tasked to oversee the development and implementation of processes used to analyze, prioritize, and address risks across the institution.

These risks include the typical risks faced by a financial institution (e.g., credit, market, and operational risks), along with emerging risks that could impede SB Corporation's ability to achieve its strategic objectives. The RMC is broadly responsible for ensuring that risks are managed to create value and, in a manner, consistent with established risk appetite and risk tolerance levels.

Group Heads

Group Heads (GHs), collectively called as Middle Management, serve as the ultimate risk owners. Groups will adopt and follow the ERM Framework and the ERM Policy and participate in enterprise-wide risk management efforts and perform risk management activities within their respective offices. GHs are responsible for implementing consistentrisk management practices in alignment with this policy.

It is the responsibility of the GHs to disaggregate the enterprise-level risk appetite statements into unit-specific risk limits, where applicable. They will also assist the ERM Unit in creating ad hoc risk analysis teams to serve as subject matter experts during the risk identification and analysis process.

Chief Risk Officer

The Chief Risk Officer (CRO) serves as the principal advisor to the P/CEO on all risk matters that could impact the institution's ability to perform its mission. The CRO is responsible for the design, development and implementation of the ERM program of SB Corporation. The CRO, in conjunction with the ERM Unit, will lead the institution in conducting regular enterprise risk assessments of business processes or programs at least annually and will oversee the identification, assessment, prioritization, response, and monitoring of enterprise risks. The CRO will take an active role in strategic planning and integration of risk management principles across the enterprise.

ERM Unit

This refers to the existing Enterprise Risk Management (ERM) Group. The Unit leads ERM activities under the supervision of the CRO. Such activities include developing and maintaining ERM policies, processes, procedures, tools, and information systems; leading efforts to perform enterprise risk identification, assessment, prioritization, reporting, and monitoring; and, establishing ERM communication at all levels and for gathering data and developing risk reports.

IV. Management of Material Financial Risks

SB Corporation is exposed to a variety of financial risks such as market risk (including currency risk, interest rate risk and price risk), credit risk, and liquidity risk. The financial risks are identified, measured and monitored through various control mechanisms. This is to adequately assess market circumstances, thereby help avoid adverse financial consequences to the institution.

This is to likewise ensure that SB Corporation performs its developmental mandate as a Non-Bank Financial Institution (NBFI) and not merely duplicates what the mainstream players in MSME finance (e.g., private banks and financial institutions, government financial institution, etc.) are already doing. SB Corporation develops and operates its financing programs along these lines, to optimize the utilization of National Government investments by not contributing to the cycle of poverty and debt for small business owners.

Over the years, SB Corporation's understanding of the nature of our unique role in MSME finance has deepened, which can be seen in its innovative and countercyclical product offerings as well as in how it evaluates risks and allocate limited resources.

The Corporation's risk management policies for each financial risk factor are summarized below:

Credit Risk

In view of its mandate to safeguard the interest of the public and contribute to the promotion of stability in the economy, SB Corporation manages credit risk at all relevant levels of the organization. The Corporation defines credit risk as the risk that the loans granted to borrowers and/or other financial institutions will not be paid when due, thereby causing the Corporation to incur financial losses.

SB Corporation therefore exercises prudence in the grant of loans over its exposures to creditrisk, taking into consideration the developmental objectives of the Corporation as mandated by the Magna Carta for MSMEs. This is managed through the implementation of theborrower risk rating and monitoring of loan covenants in the loan agreements. The borrower risk rating is being used, among others, as basis for determining credit worthiness of loan applicants. Further, the Corporation mitigates such credit risks through the acceptance of eligible collaterals as secondary form of payment.

Operational Risk

Cognizant that operational risk is inherent in all activities, products and services, and is closely tied in with other types of risks, SB Corporation monitors risks arising from inadequate or failed internal processes, people, and systems or from external events suchas natural and man-made disasters. Towards this end, the Corporation conducts a Risk Control Self-Assessment (RCSA) to assess inherent operational risks and the design and effectiveness of mitigating controls, and residual risk.

ERMG validates the RCSA exercise to determine, among others, the completeness and appropriateness of the identified risk events and its potential impact to operations as wellas to identify and understand risk triggers.

An Internal loss database which can be fed back into the operational risk management process to accumulate history of operational risk losses is also being operationalized. This allows a quantified view of incurred risks turning them into valuable source of information for assessing exposure to operational risk and the effectiveness of internal controls. Requirements for risk event reporting are also being operationalized.

Business Continuity Risk

Given SB Corporation's developmental mandate and crucial role in the Philippine financial system particularly during a crisis, it is important to ensure that its operations can withstand the effects of major disruptions. The Corporation therefore delivers its messageof commitment, service and integrity towards its mandate as defined under the Magna Carta for MSME.

Guided by its vision, mission, service philosophy and core values, SB Corporation acknowledges the need to establish, implement and maintain appropriate procedures for managing the immediate consequences of disruptive incidents with due regard to the welfare of employees, clients, and guests, operational options for responding to incidents, prevention of further loss or unavailability of prioritized activities, and recovery and resumption of business critical and mission essential functions.

At the onset of the COVID-19 pandemic, SB Corporation immediately puts in motion its business continuity plans which revolve around its countercyclical role during a crisis, when private financial institutions become risk-averse and private financing contracts. Nevertheless, the Corporation commits to the attainment of the following business continuity objectives as it delivers its mandate:

a. To safeguard human life;
b. To enable effective decision-making and communication during incidents;
c. To implement a plan to adjust and adapt even if resources are constrained;
d. To ensure that workplace policies are responsive, equitable, compliant, and adaptable;
e. To reduce dependency on a specific business critical or mission essential function-holder;
f. To develop a clear, measurable, fair, and practicable Performance Management System specifically designed for remote work to align with the crisis or pandemic situations and ensure that individual and team performance dovetails into organizational goals; and,
g. To ensure continuous improvement of the organization through public service continuity management.

SB Corporation's business continuity plan now evolves into Public Service Continuity Plan (PSCP). The PSCP is an all-hazard plan that aims to ensure continuous delivery of services to micro, small and medium enterprises amidst any disruption. The PSCP highlights the internal capacities, recovery requirements strategies to minimize damage and loss to essential processes, ensure succession of leadership and improve continuity capabilities of SB Corporation (Board Resolution No. 2021-11-3186).

Market Risk – Interest Rate Risk

SB Corporation anticipates, measures, and manages its interest rate sensitivity position to ensure its long-run earning power, build-up of its investment portfolio and avoid economic losses. Special emphasis is placed on the change in net interest income/expense that will result from possible fluctuations in interest rates, changes in portfolio mix and tenor.

Liquidity Risk

SB Corporation seeks to manage its liquidity profile to be able to finance operating and capital expenditures and service maturing debts. To cover its financing requirements, corporate and P3 funds shall be intended to utilize.

As part of its liquidity risk management, the Corporation regularly evaluates its projected and actual cash flows and institutes liquidity risk controls. It also continuously assesses conditions in the financial markets for opportunities to pursue fund raising activities, in case any requirements may arise. Fundraising activities may include stand-by credit lines from government banks.