Risk Management

- Key Highlights
- Executive Summary
- Risk Management Framework
- Credit Risk Management
- Market Risk Management
- Funding & Liquidity Risk Management
- Operational Risk Management
- Capital Management

Rodrigues

We value a **RIGOROUS** risk management as an integral part of our **GROWTH STRATEGY** across all lines of business.

The group aims at a **MODERATE RISK** profile to ensure a **BALANCED RISK** and **REWARD RELATIONSHIP** within set risk appetite.

Key Highlights

Despite the economic and financial challenges faced, the Group performed well within the set risk appetite whilst continuing to adapt to the ever-changing regulatory environment.

The main risk management objectives were as follows:

1. Structured risk management approach

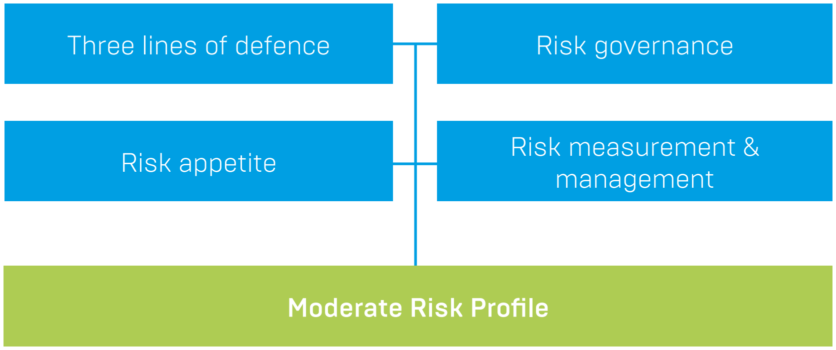
> Well defined risk management framework

> Risk function is adequately staffed and enabled with proper tools

> Strong risk governance and principles

> Business risk is continuously monitored to enable innovation and strategic expansion.

Main building blocks of our Risk Management Framework



2. STRONG BALANCE SHEET MANAGEMENT

- Loan to deposit ratio was consistently below 100%
- Adequate collateralised lending based on in-house risk rating model
- Defined Asset and Liability mismatch
- Proactive management of the liquidity coverage ratio with a pragmatic approach adopted for a net stable funding ratio.
- Strategic focus to limit LTD ratio
- Limited market risk and trading portfolios
- Limiting concentration risk

Loan to deposit ratio
69.31%
(Dec 15:69.19%)

Liquidity Coverage Ratio
115.59%
Mauritius Ops
(Dec 15:132.76%)

230.23%
India Ops
(Dec 15:1254%)

Net Stable funding ratio
125.34%
(Dec 15:107.04%)

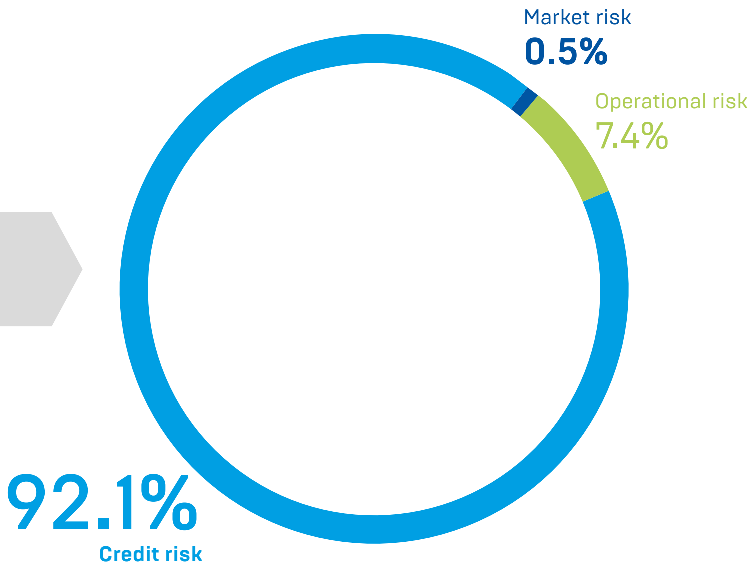
Trading book
Low risk

Key Highlights (cont'd)

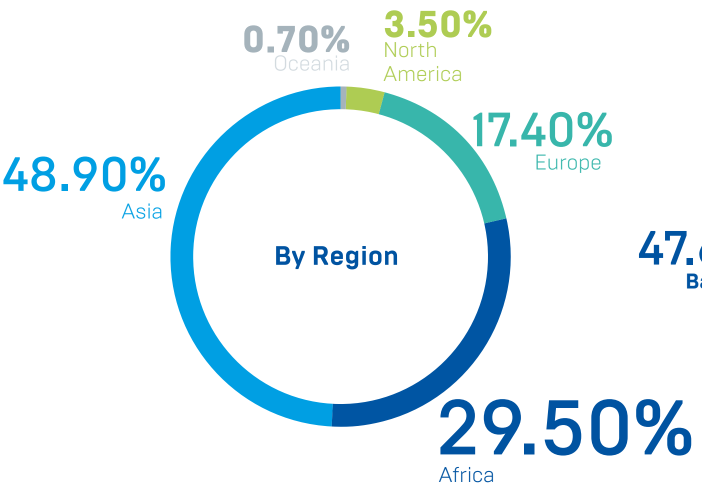
3. PORTFOLIO DIVERSIFICATION AND MANAGEMENT

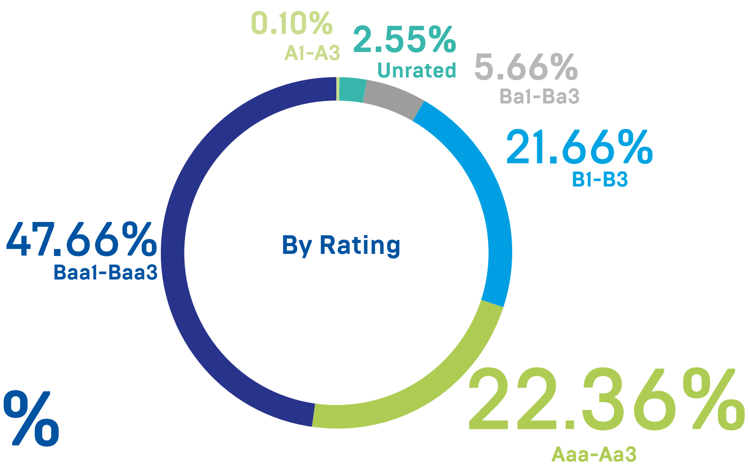
- Favorable advances growth in a deteriorating economic environment
- Our loan book is fully aligned with our strategic choices
- Concentration risk limits by industry, country, bank counterparty, single and group borrower are monitored and reported quaterly
- Main focus is to improve domestic market share and to grow cross-border exposures.

Risk Weighted Exposures



Distribution of Country Risk Exposures





4. SOUND CAPITAL AND LIQUIDITY MANAGEMENT

« The Group's balance sheet remained strong with adequate capital stress tested internally. CET1 above minimum regulatory requirement of 6.5%. CAR continues to be well above the Basel III minimum regulatory requirement of 11.125% by Jan 2017 to 13.5% by beginning of 2020. »

25.70%

TIER 1

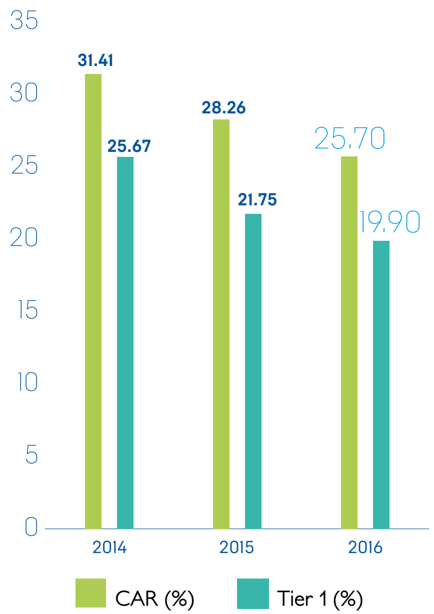
19.90 %

(Dec 15: 21.75%)
Within target range

COMMON-EQUITY TIER 1

19.90 %

(Dec 15: 21.75%)
Adequately capitalised



5. IMPROVED PROVISIONING COVERAGE

Net Impaired Advances as a % of Net Advances

2.60%

(Dec 15: 1.84%)

> Improved total provisioning with increasing coverage ratio

> A prudent approach is adopted in line with the credit risk policy and Bank of Mauritius Guideline on Credit Risk Management

1.38%

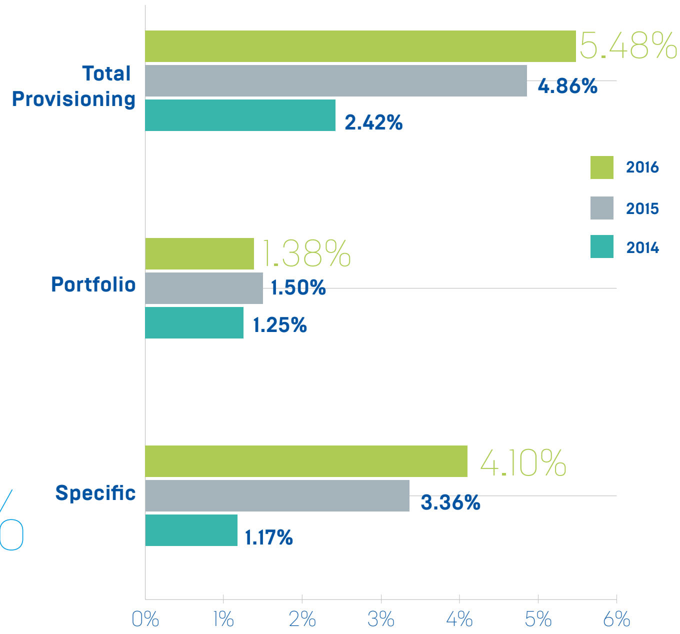
(Dec 15: 1.50%)

Portfolio Coverage

62.14%

(Dec 15: 65.37%)

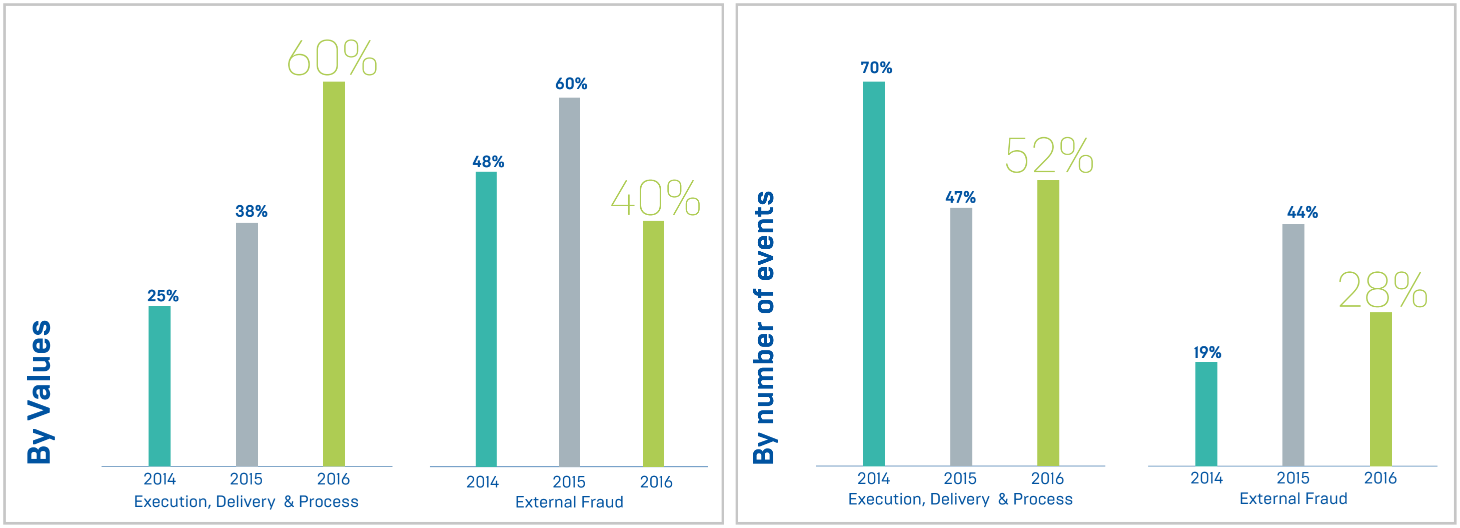
Specific Coverage



Key Highlights (cont'd)

6. STABLE OPERATIONAL RISK ENVIRONMENT WITH A CAUTIONARY OUTLOOK

Operational Losses – By Risk Categories



7. LONG-TERM VIEW

> Sustainable business over the long term

> Embedded risk culture

> Being a good corporate citizen

> Transparency

Executive Summary

The Group embraces risk management as a core competency of its strategy to support business in delivering sustainable growth and help to reinforce its resilience by adopting a holistic approach to risk management. This is achieved by embedding a strong risk culture throughout the organisation and optimising risk-taking through objectivity and transparency.

The financial performance was underpinned by a robust balance sheet, with a strong capital, liquidity and funding position, as well as sound credit quality, supported by the Group's diversified portfolios and prudent risk appetite framework.

Our RISK MANAGEMENT INITIATIVES

EMERGING RISKS

The Group has a portfolio of fixed rate FCY assets mainly funded via floating rate liabilities. Foreseeing the rise in US interest rates, the bank has embarked onto new products like interest rate and cross currency swaps through the **newly set up Derivatives Desk**. This engagement will enable the bank to participate in higher yields from longer dated assets while being hedged with respect to interest rate changes.
The Derivatives Desk will also trade in credit default swaps, whereby the bank will earn income by taking credit exposure in investment grade entities, without actually trading the actual assets. Risk inherent to those new areas will need proper monitoring and control.

IFRS 9 IMPLEMENTATION

SBM has already kicked off the **IFRS 9 implementation** to ensure compliance by January 2018. With the implementation of IFRS 9, the provisioning level is expected to be higher than the requirements under IAS 39. The bank is currently leveraging all the required systems and process changes to support the strategic outcomes of the new regulatory requirement and enhancing its governance framework across data, models and reporting to incorporate IFRS 9 impairment models.

END-TO-END PROCESSES

End-to end risk processes will be **optimised to improve our service delivery** in terms of customer on-boarding, loan disbursement, etc. In parallel we will increasingly leverage our new systems capabilities to come forward with innovative product offerings where risks need to be controlled.

Executive Summary (cont'd)

OUR RISK MANAGEMENT INITIATIVES (cont'd)

RISK CULTURE

In order to ensure that the **alignment between the organisational and employees values** leads to higher levels of commitment and engagement, a risk culture awareness exercise is being undertaken in 2017 to map the current risk culture to the desired future risk culture by identifying the gaps and areas for improvement and formulate a change strategy and specific initiatives on the best way forward.

TECHNOLOGY

On the technology front, the Group underwent a transformation in 2016 to refresh the technology platform and accommodate future business aspirations and geographical expansion in line with the strategies of the Group. 2017 will see continued focus on **stabilisation of our new systems.** Technology risk remains at the forefront of our focus.

CYBER SECURITY

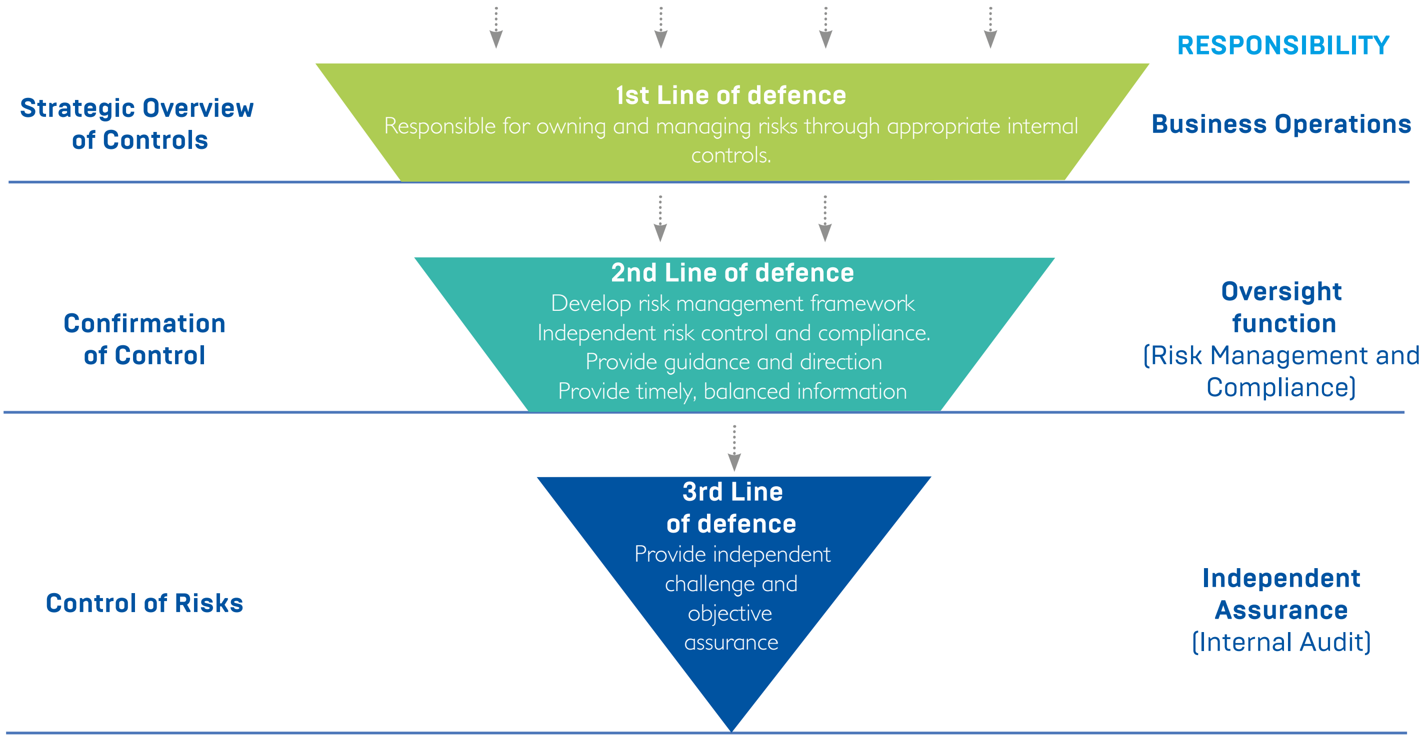
The Group is conscious of the **risk of cyber theft** which has long replaced the «traditional» concept of bank robberies in many parts of the world. In light of the growing concern, the information technology risk management framework has been further enhanced in order to manage technology risks and safeguard information system assets in place. Physical security also remains important. The **physical security policy has been enhanced** to cater for additional controls and for the increasing role of the anti-fraud department and a dedicated physical security department which will be set up in 2017 to review all the security aspects of the Group's premises. New measures are being put in place for cyber security to enhance resilience against cyber crime.

Risk Management Framework

The Group has an integrated and robust risk management framework which aligns strategy, policies, people, processes, technology and business intelligence to identify, assess, manage and report risks and risk-adjusted returns in a reliable and consistent manner.

1. Lines of defence

The Group's risk management framework is founded on the **three lines of defence principle** which ensures that risk is managed in line with the risk appetite as defined by the Board and the importance of its management is effectively cascaded throughout the Group.



The characteristics of an effective risk management framework are:

- Active board and senior management oversight;
- Adequate policies, procedures and limits;
- Adequate risk identification, measurement, monitoring and management information systems; and comprehensive internal controls.

« The framework is based on transparency, management accountability, independent oversight which is comprehensive enough to capture all risks that the Group is exposed to and has flexibility to accommodate any change in business activities in line with the Group's efforts to maximise sustainable shareholder value. The framework is subject to constant evaluation to ensure it meets the challenges and requirements of global markets in which the Group operates including regulatory standards and industry best pactices. »

Risk Management Framework (cont'd)

2. Risk Governance - Active Board and Senior Management Oversight

The Group has a well established risk governance structure which facilitates identification and escalation whilst providing assurance to the Board. The governance structure is supported with an active and engaged Board of Directors and a risk management function that is independent of the business units. The Head of Risk Management has direct access to the Board Chairman and the Risk Management Committee without impediment.

- The Group's risk management governance structure begins with oversight by the Board of Directors, either directly or through its committees to ensure that decision making is aligned with the Board's approved risk appetite.
- The executive management is responsible for **translating the high-level overall guidance** from the Board into operational aspects and then monitoring and reporting them back periodically to the Board/Board Committees.
- The aggregate enterprise-wide risk profile and portfolio appetite are discussed at the respective risk management forums and at the Board Risk Management Committee on a quarterly basis.

The chart below illustrates the inter-relationship between the Board, Board Committees and management committees that have the majority of risk oversight responsibilities for the Group and their corresponding roles.

RISK MANAGEMENT FRAMEWORK

			CONSTITUTION	RESPONSIBILITIES
STRATEGIC LAYER	L1	Board of Directors	Both executive and independent directors	The Board is responsible to authorise management to maintain an effective risk framework, and oversees compliance with safe, ethical and sound banking practices.
STRATEGIC LAYER	L2	Board Committees	A mixture of independent, experts and executive directors wherever allowed	The Board Committees which include primarily Audit, Risk Management, Strategy, Corporate Governance and Conduct Review, are responsible to advise Board on risk profile, risk culture, risk appetite, risk strategy and risk management framework
MANAGEMENT LAYER	L3	Management Forums	Key members of management including the Chief Executive	Some of the forums are Executive Forum, Investment Forum, Risk Management Forums (Asset and Liability Management Committee, Operational Risk Forum, Portfolio and Credit Risk Forum), Management Credit Forum. The aggregate enterprise-wide risk profile and portfolio appetite are discussed at the respective risk management forums
MANAGEMENT LAYER	L3	Risk Management Team	Portfolio and Credit Risk Team, Market Risk Team and Operational Risk Team.	The Team is responsible for identifying, measuring, monitoring and reporting significant risks across the organisation.

Note: The framework applies to each entity of the banking group and non-banking and ultimately reports to SBMH for risk reporting and aggregation.

3. Risk Appetite

The following chart provides an overview of the key components of the risk appetite framework which encompasses the risk universe.

RISK APPETITE							
Category	**Financial Risk**			**Non-Financial Risk**			
Primary Risk Drivers	Credit Risk	Market Risk	Liquidity Risk	Operational Risk	Reputational Risk	Business & Strategic Risk	Other Risks
Secondary Risk Drivers	• Borrower • Counterparty credit • Industry • Country • Group • NBFC • Sovereign	• Trading Book • Banking Book	• Currency • Legal Entity	• Process • People • IT • Compliance	• Macroeconomic environment • Competitive environment • Regulatory environment		• Legal • Model

Risk Universe

Risk Control Mechanism

(It encompasses frameworks, guidelines including best practices and guiding principles, policies including contingency plans and limits based on the following components.)

Credit Risk Management Framework	Market Risk Management Framework	Liquidity Risk Management Framework	Operational Risk Management Framework	Reputational Risk Management Framework	Other risk frameworks covering legal, model risks

Risk Capital Strategy components

Risk- bearing capacity	Risk bearing capacity represents the ability to bear risk in terms of available capital, and ability to raise additional capital. It also covers strength of operational processes and operating culture in the organisation
Risk Appetite Statement	Risk appetite is an articulation and allocation of the risk capacity or quantum of risk the Group is willing to accept in pursuit of its strategy, duly set and monitored by the Board, and integrated into the Group's strategy, business, risk and capital plans
Risk Tolerance	Risk tolerance refers to the limits in operational terms such as concentration limits, stop loss limits, etc. to ensure that the risk is within the defined risk appetite. Any breach thereof would lead to a control and/or mitigation action
Risk Target	Risk target is the optimal level of risk that the Group wants to take in pursuit of a specific goal. Setting the risk target should be based on the desired return, on the risks implicit in trying to achieve those returns and on SBM's capability of managing those risks.
Risk Limits	Risk limit determines thresholds to monitor that actual risk exposure does not deviate too much from the desired optimum. Breaching risk limits will typically act as a trigger for corrective action at the process level

Risk Management Framework (cont'd)

The Group maintains a comprehensive risk appetite framework, providing a robust foundation for risk appetite setting and management across the Group. The framework provides a structured approach to the identification, measurement, and control of risk. It encompasses a suite of policies, processes, controls and systems for assessing the appropriate level of risk appetite required to constrain its overall risk profile.

It is intended to ensure that the Group maintains an acceptable risk profile by providing a common framework and a comparable set of risk appetite measures, supported by management level limit structures and controls for senior management and the Board to clearly indicate the level of risk the Group is willing to accept.

The framework is guided by the following strategic risk objectives:

- Early identification and control of all types of possible risks.
- Maintaining adequate Group-side capital under stressed conditions to absorb losses, if any.
- Promoting stability of earnings to avoid unexpected losses.

Group-wide risk appetite is determined in conjunction with the overall strategy and capital planning process on an annual basis, based on bottom-up forecasts that reflect planned risk-usage by the businesses and top-down, Board-driven strategic risk objectives and risk appetite. Scenario stress testing of financial and capital plans is an essential element in the risk appetite calibration process.

A core aspect of the Group's risk appetite framework is a sound system of integrated risk controls to maintain its risk profile within its overall risk appetite.

« Management's dedicated attention to these risks creates a focus on forward-looking activities that keeps the Group within set risk appetite on an ongoing basis. »

The risk management framework is supported by a variety of risk management tools - like the ICAAP framework - which are regularly reviewed and updated to ensure consistency with risk-taking activities and relevance to the business strategies of the Group.

1. Policies and Limits

Policies related to specific types of risk or activities are used to manage risk exposure. Recommendations of risk management, internal audit, business units and senior executive management, industry best practices and regulatory requirements are factored into the policies.

Prudential limits and tolerances are set as a prudent approach to manage risks. Limit setting establish accountability for key activities within the risk-taking activities and establish the conditions under which transactions may be approved or executed.

The Board approves all the policies which have clear accountability and ownership and the management is responsible and accountable for the effective implementation and monitoring of risk appetite.

The policies are designed based on the following principles & objectives;

- Accountability and ownership
- Effective management
- Clarity on purpose
- Risk Appetite

2. Measurement, Monitoring and Reporting

The Group continuously monitors the risk exposures to ensure business activities are operating within approved limits or guidelines. Breaches, if any, are reported to senior management and/or to the Board.

3. Risk Bearing Capacity and Stress Testing

The risk-bearing capacity analysis is a key part of overall bank management and the group's Internal Capital Adequacy Assessment Process (ICAAP). The purpose is to ensure that sufficient capital is held for the risk profile of the Group at all times.

The Group conducts ICAAP to determine a forward looking assessment of its capital requirements given the Group's business strategy, risk profile, risk appetite and capital plan. This process incorporates the Group's risk management processes and governance framework. A range of stress tests are applied to the base capital plan.Together with risk management practices and contingency plans, including the recovery plans, these tests are used to assess the Group's internal capital adequacy requirements.

The Group complements its regular risk reporting process with stress tests to capture the effect of exceptional but realistic events on capital and liquidity positions. It also provides insights on the degree of vulnerability of various business lines and portfolios to given scenarios and acts as an early warning signal in itself.

As part of the ICAAP, contingency plans including recovery plans are maintained to restore the Group's financial strength and viability during an extreme stress situation. The main purpose of these receovery plans is to outline how to respond to a financial stress situation that would significantly impact the Group's capital or liquidity position.

Risk Management Framework (cont'd)

The chart below illustrates an overview of the stress testing process;

Scenario Generation

The first step is to develop key economic scenarios resulting in significant movements in **credit ratings, interest rates, foreign exchange rates**, as well as adverse changes in **counterparty default** and **recovery rates**. Several stress tests are applied both at group level and at cluster level in the form of sensitivity and scenario analysis and on different level of severity (Mild, Moderate, Severe).

Risk Profiling

The second step is to **translate these scenarios into loss levels** on various risk types such as credit risk, market risk, liquidity risk. For instance, for credit risk, the Group uses statistical methods(e.g **regression model**) to transform scenarios related to default risk , recovery risk , macroeconomic variables on its portfolios. Example of risk and capital analytics: PD, LGD, EAD, impairment, CAR

Impact Assessment

In the third step, the Group calculates its solvency **needs, combined with buffer requirement and the capital adequacy** under each scenario and assess their impact on net profit and the capital level.

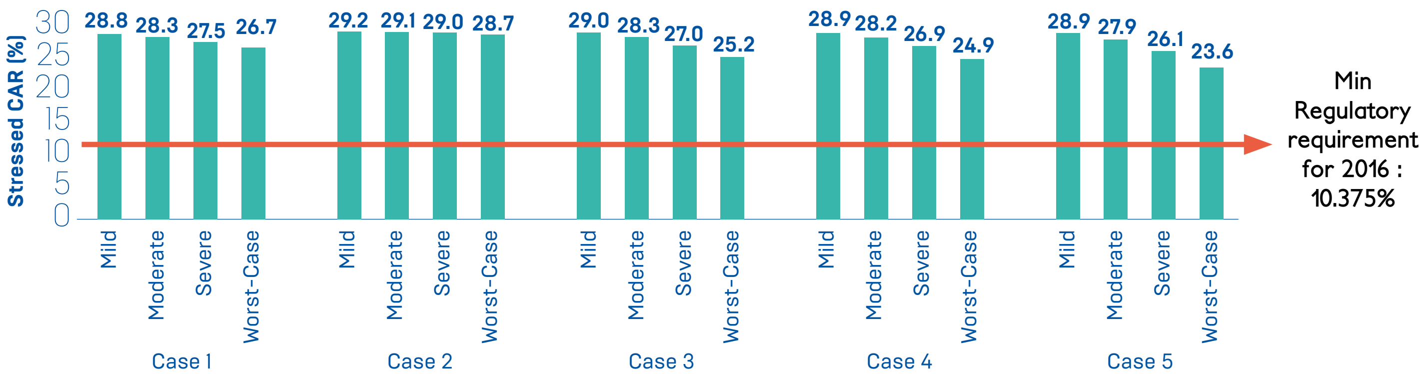
Results Assessment

Finally, all the results and methodology are evaluated and documented, including the contingency plans and relevant mitigating actions.

Reporting & Monitoring

Ultimately, the Board Risk Management Committee annually reviews the Group's risk appetite and then analyses the impacts of stress scenarios on the Group capital forecast in order to understand and manage the Group's projected capital adequacy.

List	Stress Testing scenarios	Mild	Moderate	Severe	Worst-Case Scenarios
		SENSITIVITIES			
		x% of the impacted portfolio becomes impaired			
Case 1	The global business sector has linkages with many other sectors of the economy. A general downturn in the economy will affect nearly all sectors. This could have serious consequences for the overall credit portfolio	2%	5%	10%	15%
Case 2	Slowdown of Chinese Economy impacting the Exports of textile products to the Eurozone	5%	20%	50%	100%
Case 3	Tourists' arrivals decrease and subsequently affect hotels' earnings.	5%	20%	50%	100%
Case 4	With the Impact of Brexit and Geopolitical situation in Europe worsens, the export-oriented sectors are affected namely; Agriculture, Manufacturing Textiles, Tourism, Commerce-Wholesale	5%	20%	50%	100%
Case 5	As global business firms move elsewhere, employees find themselves out of jobs. The labour market would be flooded with unemployed finance professionals and graduates who had been studying to get into the global business sector. The unemployment level rises with the following portfolios being affected ; Mortgage and Consumer Credit	5%	20%	50%	100%



Considering the above stress testing scenarios, the holding company will continue to have a strong capital position, ensuring that all its subsidiaries are adequately capitalised with a buffer over the regulatory minimum requirement and sufficient flexibility for future capital deployment is maintained.

Risk Management Framework (cont'd)

3.1 Measurement and Management of Principal Risks

In pursuing its goals and objectives the Group is confronted with various types of risks that cannot be addressed individually but require a holistic approach to risk management. These key risks can be categorised as follows:

Key risks	Arising from	Measurement, monitoring and management of risk
Credit Risk		
Credit risk is defined as the risk that the banking group will suffer economic loss due to a Group borrower or counterparty failing to fulfil its financial or other contractual obligations	Credit risk arises when funds are extended, committed, invested, or otherwise exposed through actual or implied contractual agreements, whether reflected on- or off-balance sheet. Amongst the risks faced by SBM, credit risk generates the largest regulatory capital requirement.	Credit risk is: • **measured** as risk weighted exposures for performing and non-performing exposures. • **monitored** within regulatory and prudential limits by borrowers, portfolios, country and bank, approved by the Board within a framework of delegated authorities. Regular review of portfolio to proactively manage any delinquency and minimising any undue credit concentrations. • **managed** through a robust risk control framework which outlines clear and consistent policies, principles and guidance.
Market Risk		
Market risk is the risk of loss that arises due to changes in market conditions that may adversely impact the value of assets or liabilities, or otherwise negatively impact earnings.	Market risk losses arise from variations in the market value of trading and non-trading positions resulting from changes in interest rate risk, foreign exchange risk and price risk, and in their implied volatilities.	Market risk is: • **measured** in terms of value at risk, which is used to estimate potential losses on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence, augmented with stress testing to evaluate the potential impact on portfolio values of more extreme, though plausible, events or movements in a set of financial variables; • **monitored** using measures including the sensitivity of net interest income and the sensitivity of structural foreign exchange which are applied to the market risk positions within each risk type; and • **managed** using risk limits approved by the Board.
Funding and Liquidity Risk		
The inability to meet contractual and contingent financial obligations, on- and off- balance sheet as they may come due. Our primary liquidity objective is to provide adequate funding for our business throughout market cycles, including periods of financial stress.	Liquidity risk arises from mismatches in the timing of cash flows. Funding risk arises when the liquidity needed to fund illiquid asset positions cannot be obtained at the expected terms and when required.	Liquidity and funding risk is: • **measured** using internal metrics including stressed cash flow projections, coverage ratios and advances to core funding ratios; • **monitored** against the Group's liquidity and funding risk framework and overseen by the Asset and Liability Management Committees (ALCO's) of different entities and the Board Risk Management Committee; and • **managed** on a stand-alone basis with no reliance on any other Group entity.

Key risks	Arising from	Measurement, monitoring and management of risk
Operational Risk		
Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events.	Operational risk arises from human error, inappropriate conduct, failures in systems, processes and controls or natural and man-made disasters. It is inherent in all products, activities, processes and systems and is generated in all business and support areas.	Operational risk is: • **measured** using the risk and control assessment process which allows identification and evaluation of risks and effectiveness of controls; • **monitored** through regular risk assessment procedures, key risk indicators and internal loss database; and • **managed** through a conducive control environment with robust operational risk policies, processes, systems as well as appropriate risk culture within the organisation which contribute in maintaining a low operational loss experience over the years.
Business and Strategic Risk		
Business and strategic risk is the risk of loss resulting from incorrect assumptions about external or internal factors, inappropriate business plans, ineffective business strategy execution, or failure to respond in a timely manner to changes in the regulatory, macroeconomic or competitive environments.	Strategic risks are risks that affect or are created by an organisation's business strategy and strategic objectives, which are critical to the growth and performance of the Group. Pursuing an unsuccessful business plan represents a possible source of loss to the Group.	Business and strategic risk is: • **measured** by using several key internal indicators and metrics as a yardstick which enable us to measure the progress against fulfilling the objective; and • **monitored** against our risk appetite set out by the board whilst taking into consideration our internal capabilities and growth prospects; and • **managed** by the board who sets the objectives for the Group in terms of growth orientation in consultation with our strategy team.
Reputational Risk		
Reputational risk is the risk that negative perceptions of the Group's conduct or business practices may adversely impact its profitability or operations through an inability to establish new or maintain existing customers/clients relationships.	Reputational risk arises from failure to meet stakeholder expectations as a result of any action, event or situation caused by the Group or its employees that can adversely impact the Group's reputation.	Reputational risk is: • **measured** by reference to our reputation as indicated by our dealings with all relevant stakeholders, including media, regulators, customers and employees; • **monitored** through analysis of root cause for justified complaints and reporting to appropriate forums/committees; and • **managed** through a framework where all employees are responsible for identifying and managing reputational risk that may occur within their respective areas of business. These responsibilities form part of SBM Code of Conduct.

Credit Risk Management

Credit risk remains one of our core risk areas and a significant part of our capital is allocated to this risk category. Credit risks vary with local and global macroeconomic environment together with concentration risks that may arise.

Effective credit risk management is a structured process to identify measure, control, monitor and manage credit risk on a consistent basis. This requires careful consideration of proposed selection of credit, the setting of specific limits, monitoring during the life of the exposure, active use of credit mitigation tools and a disciplined approach to recognising credit impairment.

The Group's **Credit Risk Management process** is as follows;

IDENTIFY

Identify and prioritise potential risk of losses from customers failing to repay their debts when they fall due

MEASURE

Make use of quantitative and qualitative tools to measure severity of risks, including credit risk mitigation instruments

CONTROL

Establish key control processes and best practices, including limit setting, early warning signals and classification of customers in watchlist

MONITOR

Independent monitoring of credit risk by the Risk Management Team

REPORT

Ensure that top risks and issues are being highlighted to the management and Board

The Group's credit processes are designed with the aim of combining an appropriate level of authority in its credit approval processes with timely and responsible decision making and customer services. Within the powers to act granted by Board of Directors, credits are approved by decision making authorities at different levels in the organisation depending on the risk categorisation and the credit exposure of the customer. An overview of credit approval process and procedures is depicted below:

Credit Origination

Sales Team :

> Initiate and manage sales of products
> Follow client-boading standards
> Receive and check applications
> Assist customers with information
> Execute account - monitoring tasks
> Input Risk Rating tools
> Analyse the risks and prepare the sales note for approval.

Credit Appraisal

Credit Risk Team:

> Screening of all applications forwarded by sales team
> Assessment of obligor
> Recommend to the appropriate authority for approval

Credit Approval

Credit Approval Authority:

> Board Credit Committee
> Management Credit Committee
> Credit RiskTeam
> Decision making tool for certain retail exposures

Documentation& Disbursement

Credit Service Unit:

Credit Administration
Credit Documentation
Credit Disbursement

Review & Monitoring

Risk Management :

> Monitoring of both prudential and regulatory limit for all credit exposures

Recovery & Workout

Recovery and Workout :

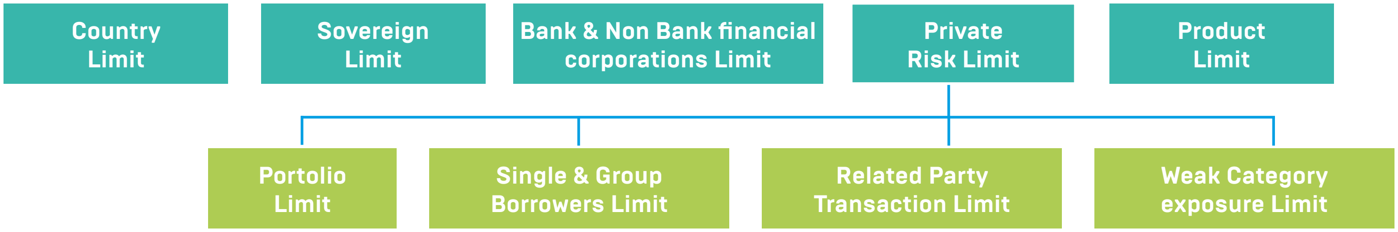
> Ongoing management of impaired loans
> Recovery of loans and advances due by impaired borrowers

Credit Risk Management (cont'd)

3.1 Credit Risk Limit Structure

Internal as well as regulatory credit limits are imposed to manage individual counterparty credit risk and to address concentration risk in the portfolio, including a comprehensive set of country limits and limits for certain products and industries and for counterparties.

The Risk management team monitors credit concentration risks against a set of internal prudential limits which are reviewed annually to align with industry norms while adhering to regulatory limits. Any deviation from the tolerance limits would be brought to the attention of Management and reported to the Risk Management Committee for appropriate actions including revision of internal limits and the allocated internal capital to credit risk. The structure of the internal prudential limits is as follows:



3.2 Credit Risk Mitigation

Besides establishing the Group's risk appetite and credit quality, we make use of an arsenal of credit risk mitigation techniques in order to ease the impact of potential credit losses and they are normally in the form of:

CREDIT RISK MITIGATION TECHNIQUES	
Eligible Collateral	The Group has an acceptable list of collaterals for each operation in line with their host regulatory guidelines. The list undergoes periodic valuation ensuring their continuous legal enforceability and realisation value. The policies and processes for collateral valuation and management are driven by legal documentation that is agreed with our counterparties and an internally independent collateral management function. Collateral/s received is/are segregated into the following two types: Financial and other collateral, which enables the Group to recover all or part of the outstanding exposure by liquidating the collateral asset provided, in cases where the borrower is unable or unwilling to fulfil its primary obligations. Guarantee collateral, which substitutes the borrower's ability to fulfil its obligation under the legal contract and as such is provided by third parties.
Credit Risk Limits	A set of prudential limits approved by the Board is used to address concentration of risk for each operation by counterparties. For example, limits on country, sovereign, bank and institutional customers, single and group borrower, products and line of business including services, are reported quarterly to the Board.
Risk Transfers	The Group in some cases holds guarantees, letters of credit and similar instruments from third parties which enable it to claim settlement from them in the event of default on the part of the counterparty. Guarantor counterparties include banks, parent companies, shareholders and associated counterparties.
Netting Agreement	Netting agreements are utilised in accordance with relevant regulatory and internal policies and require a formal agreement with the customer to net the balances.

3.3 Credit Risk Profile as at 31 December 2016

The following sections details the sub-category of credit risk;

1. COUNTRY RISK

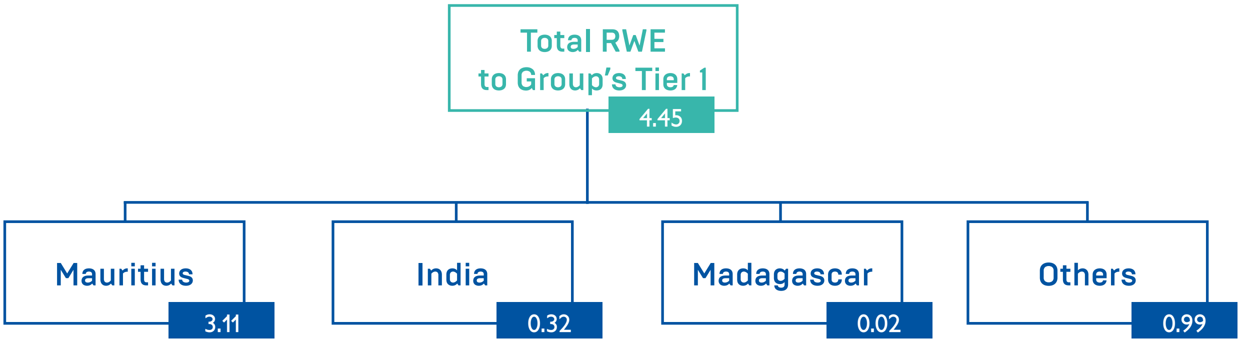
Country risk is the probability that changes in the economic and/or political environment in a particular country affects the ability of the counterparties including the relevant sovereign in that country to fulfil their obligations, resulting in a financial loss for the Group.

RWE as a % Group Tier 1

99.12%

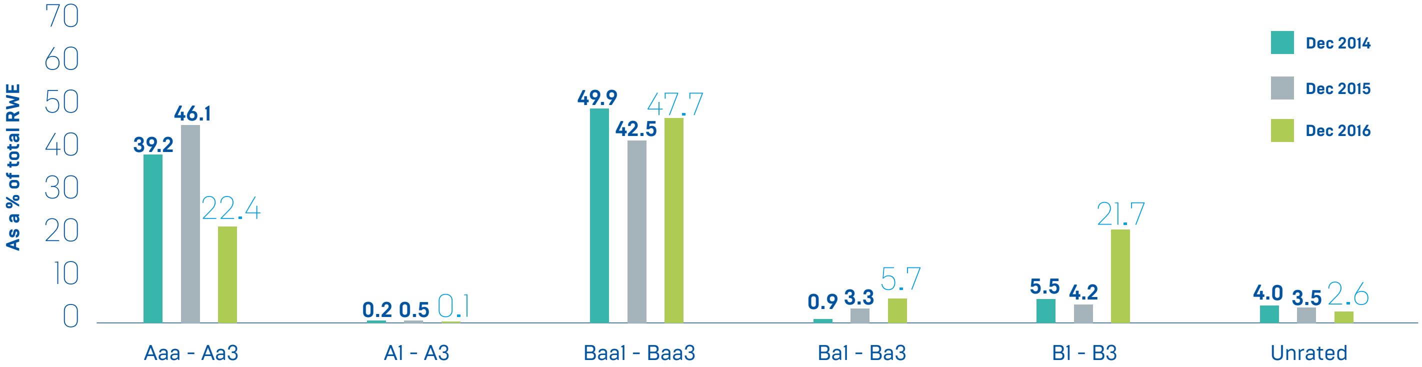
(Dec 15: 96.69%)

1. Breakdown of Risk-Weighted Exposures on Countries (no. of times to Group's Tier 1)

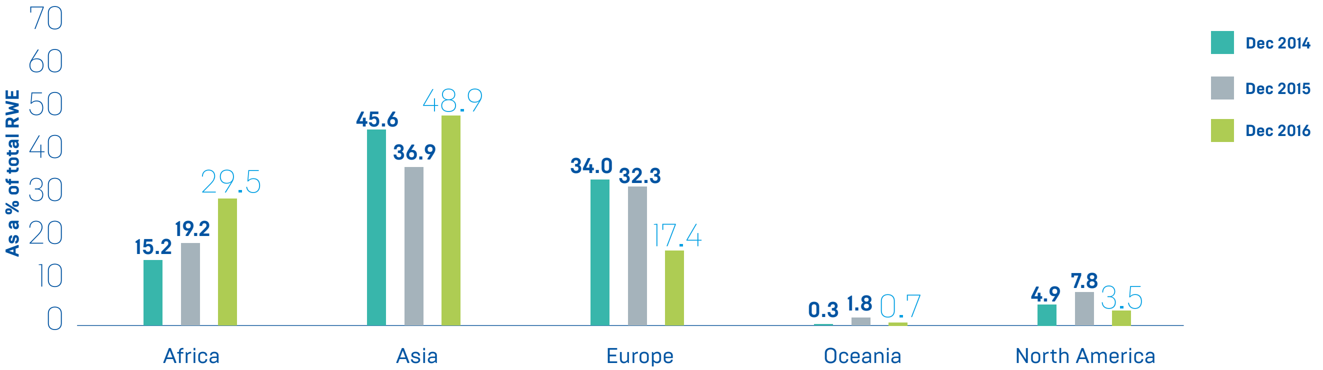


Credit Risk Management (cont'd)

2. Distribution by Rating



3. Distribution by Region



« Whilst domestic banking remains the mainstay of the Group, it has started tapping business opportunities in identified target markets, mainly in East Africa which thus explains the increasing exposures to non A-rated countries. The growth in cross-border is within the risk appetite set by the Group and is supported by adequate and enhanced due diligence on these African countries, keeping in mind their economic outlook and regulatory environment. The Group has been lending mostly to banks and Financial Institutions in this region and also to corporates against Stand by Letter of Credit. Bank risk is generally considered to be lower risk. »

2. SOVEREIGN RISK

Sovereign risk is the risk that a government could default on its debt (sovereign debt) or other obligations.

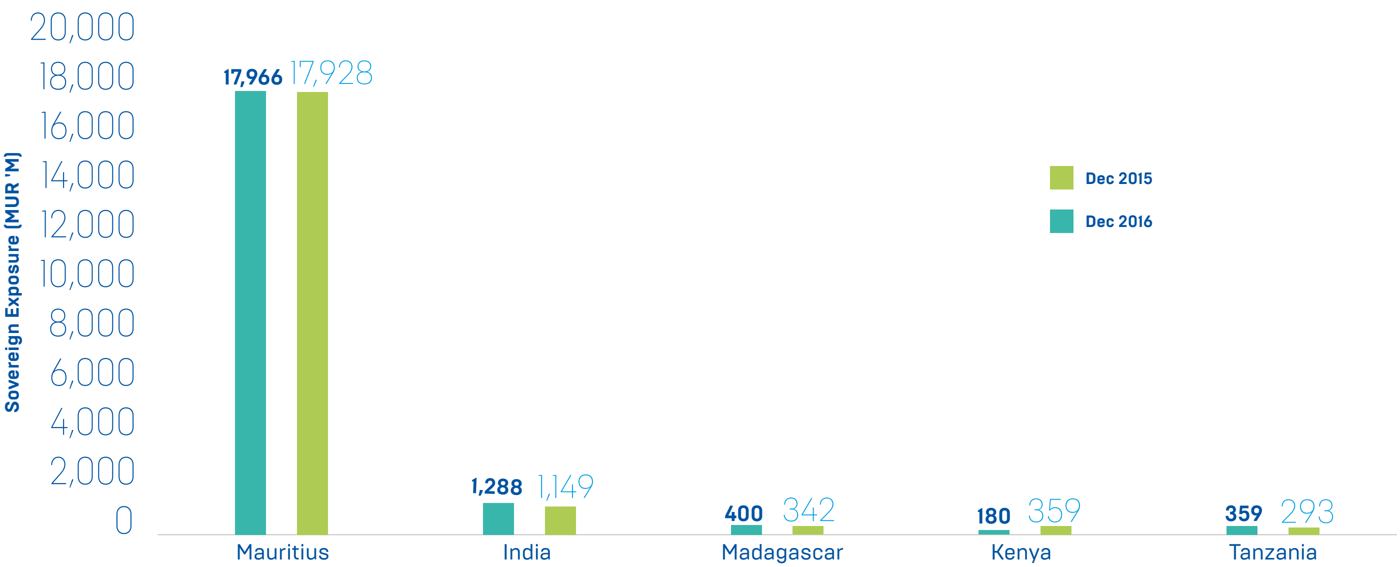
RWE as a % Group Tier 1

8.43%

(Dec 15: 8.67%)

The following chart depicts the distribution of sovereign risk exposures to the Group.

Breakdown of Sovereign Exposures as at 31 December 2016



As at 31 December 2016, total sovereign exposures stood at MUR 20.01 billion, representing 108% of the Group Tier 1 capital (Dec 15: MUR 20.19 billion, 111%), with the highest exposure pertaining to the Government of Mauritius amounting to MUR 17.93 billion, out of which Government Bonds accounted to 78% of total exposure with a maturity greater than 1 year.

However, the exposures to the Government of Mauritius carry a zero risk weight under the Bank of Mauritius guidelines.

On a risk-weighted basis, the sovereign risk-weighted exposures were MUR 1.57 billion, representing 8.43% of the Group's Tier 1 capital (Dec 15: MUR 1.58 billion, 8.67%)

Credit Risk Management (cont'd)

3. BANK RISK

Bank risk is the risk that a counterparty bank could default on its debt or other obligations.

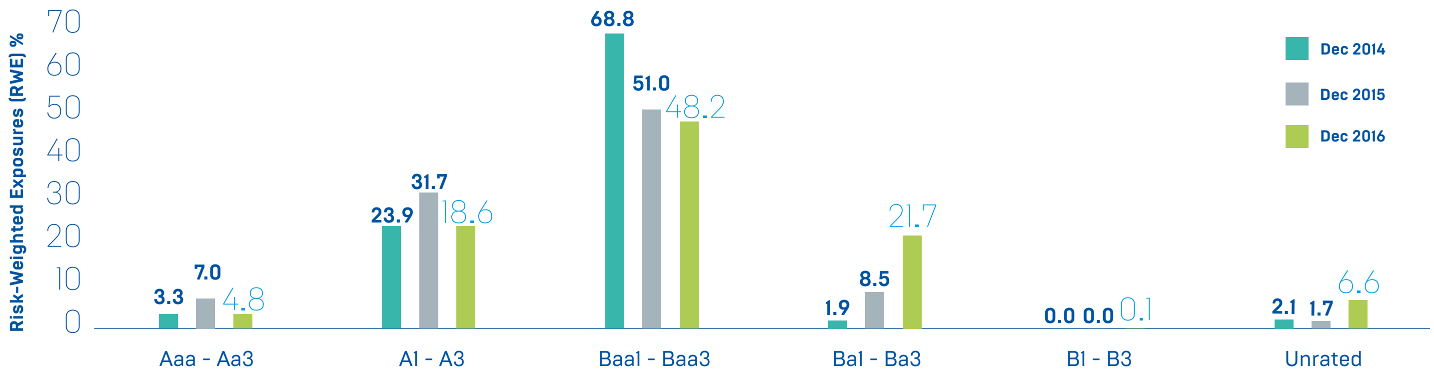
RWE as a % Group Tier 1

68.99%

(Dec 15: 95.76%)

The following chart depicts the distribution of bank risk-weighted exposures to the Group.

Bank Risk-Weighted Exposures by Rating as at 31 December 2016



As at 31 December 2016, total bank risk-weighted exposures stood at USD 357.41 million, representing 0.69 times of the Group's Tier 1 capital (December 2015: USD 486.76 million, 0.96 times).

Note: The Group has highest concentration to banks with rating range Baa1-Baa3.

4. PRIVATE RISK

1. Portfolio Concentration

The Group maintains a well-diversified portfolio through internal portfolio limits set to ensure that the Group is not impacted drastically due to significant concentration in a particular portfolio.

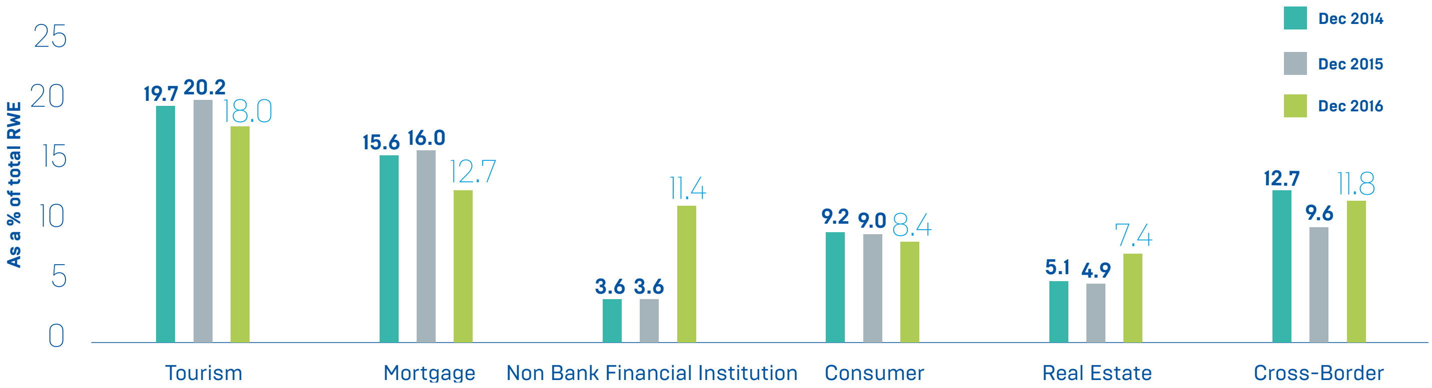
RWE of top 5 portfolios as a % Group Tier 1

168.30%

(Dec 15: 164.17%)

The charts below show risk-weighted exposures of top 5 portfolios as a percentage of total risk-weighted exposure by country of operations.

Mauritius Operations – Top 5 portfolios by Risk-Weighted Exposure (%) + cross-border exposures



Credit Risk Management (cont'd)

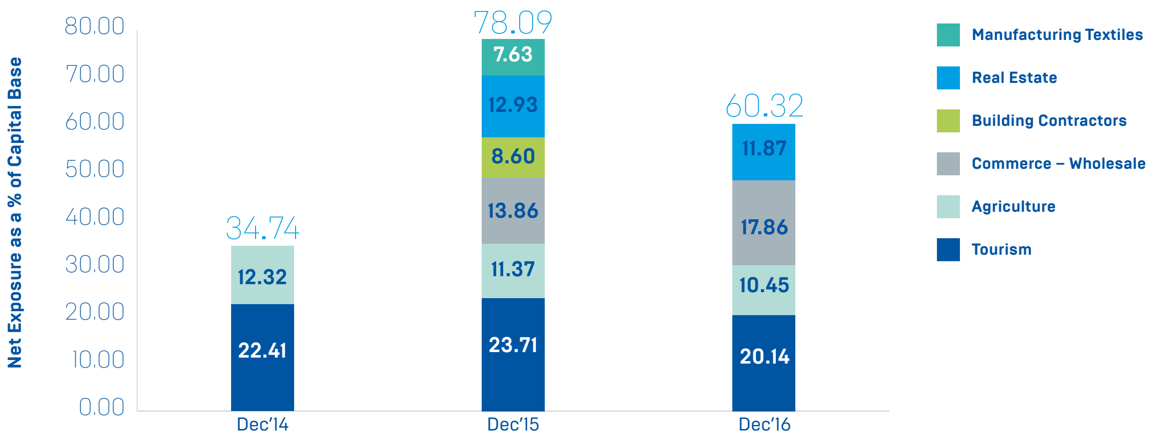
2. Customer Concentration

The Group monitors single large exposures, groups of closely related exposures and aggregate of large exposures above 15% of capital base against regulatory limits as per the guidelines issued by the regulator. The Group is even more conservative in this aspect and sets much stricter internal prudential limits than those set by the Bank of Mauritius while using allocated capital to credit risk instead of the Group's capital base.

Regulatory credit concentration limit for Mauritius Operations

Regulatory Credit Concentration Limit – Mauritius Operations	As at 31 Dec 2016
Credit exposure to any single customer shall **not exceed 25%** of the Group's capital base	Highest single customer: **9.6%**
Credit exposure to any group of closely-related customers shall **not exceed 40%** of the Group's capital base.	Highest Group of closely-related customer: **17.9%**
Aggregate large credit exposures to all customers and groups of closely related customers above 15% of the Group's capital base shall **not exceed 800%** of the Group's capital base	**60.3%**

Aggregate large credit exposures to all customers and groups of closely related customers above 15% of the Group's capital base



3. Related Party Transactions

All exposures to related parties are reported to the Corporate Governance and Conduct Review Committee as per the Bank of Mauritius Guideline on Related Party Transactions. A "related party" means:

a. a person who has significant interest, that is owning directly or indirectly 10% or more of the capital or voting rights of the financial institution or the financial institution has significant interest in the person;
b. a director or senior officer of the financial institution;
c. close family members of (a) and (b) above;
d. an entity that is controlled by a person described above;
a person or class of persons who has been designated by the Bank of Mauritius as a related party.

Category 1

This includes exposures to

(a) a person including a body corporate that has significant interest in the financial institution;

(b) a director of the financial institution;

(c) a director of a body corporate that controls the financial institution;

(d) the spouse, child and parent of a natural person covered in (a) or (b) or (c);

(e) any entity which is controlled by a person described in (a) or (b) or (c) or (d); and

(f) any entity in which the financial institution has a significant interest, excluding a subsidiary of the financial institution.

Category 2

This includes exposures to

(a) senior officers, which are outside the terms and conditions of employment contracts;

(b) the spouse, child and parent of senior officers;

(c) senior officers of a body corporate that controls the financial institution;

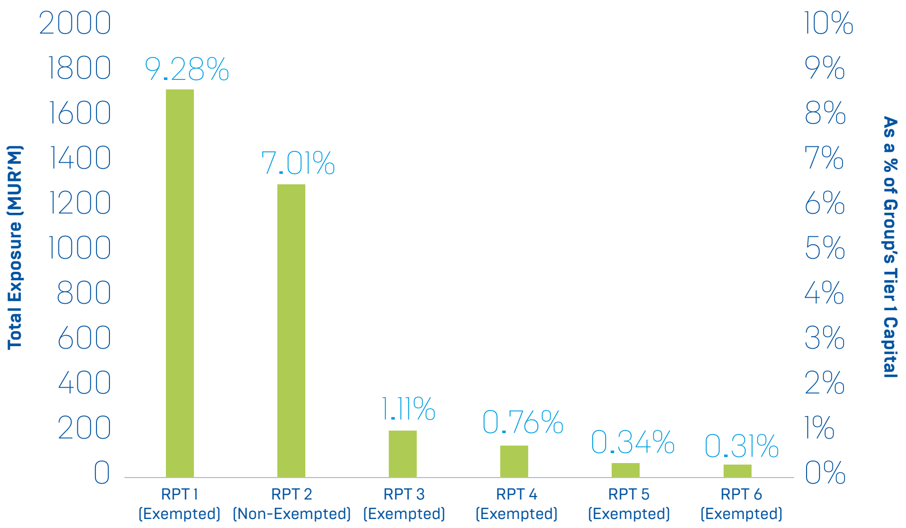
(d) any entity that is controlled by a person described in (a) or (b) or (c) above; and

(e) a subsidiary of the financial institution with no shareholder (natural person) holding directly or indirectly more than a significant shareholding in the parent financial institution.

As at 31 December 2016, the aggregate of non-exempted exposures to related parties represented 7.01% of the Group's Tier 1 capital, which is within the regulatory limit of 60% for category 1 and within the regulatory limit of 150% for category 1 & 2 (Dec 15: 9.35%).

Credit Risk Management (cont'd)

Top 6 related party exposures were as follows;

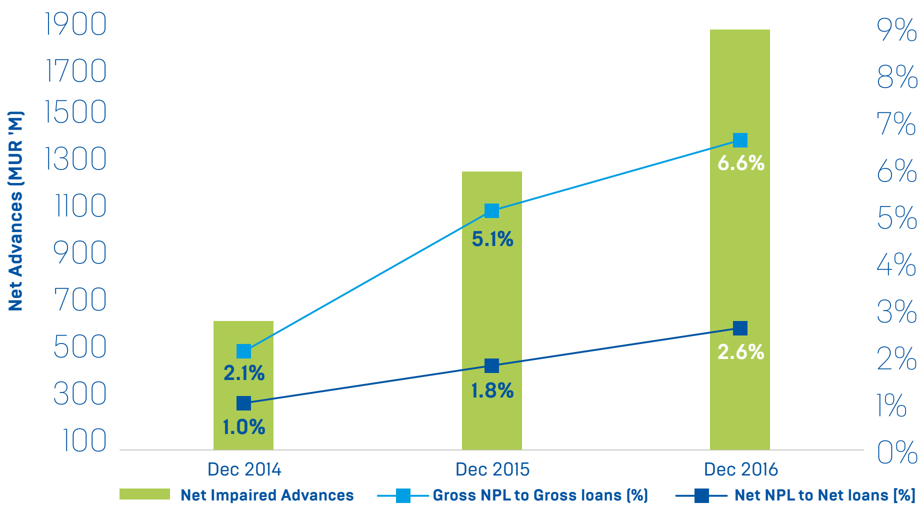


Note: (*) Exempted from Regulatory Limits

4. Credit Quality – Impairment

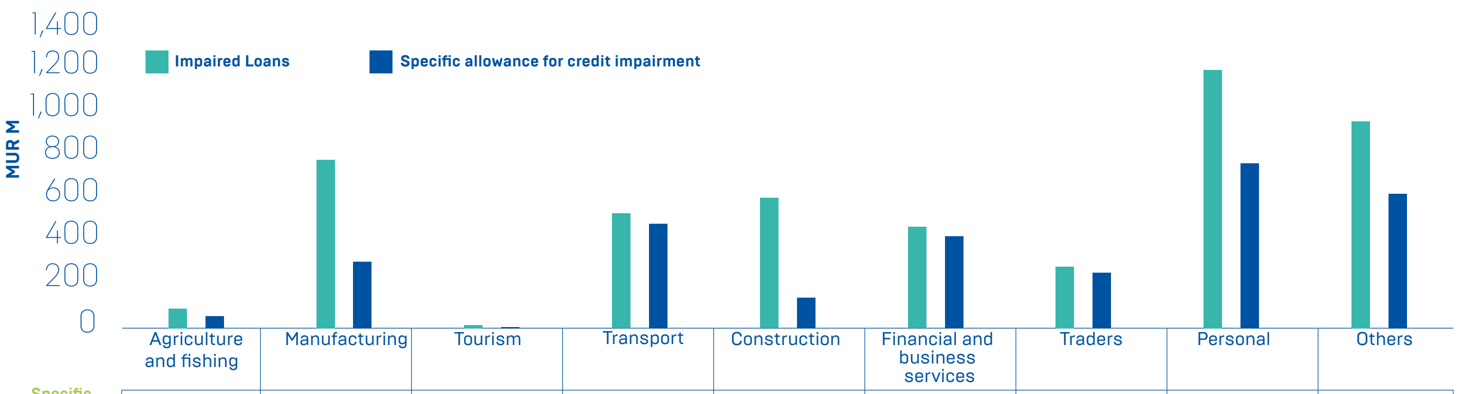
The net impairment of **2.6%** of net advances was after adequate provisioning of **62.1%**.

The net impairment to net advances ratio stood at 2.6% as at 31 December 2016, representing an increase of 80 basis points compared to 1.8% in December 2015, mainly on account of a couple of corporate customers classified as impaired. The Group shall continue with recovery actions to realise collaterals and maximise recovery.



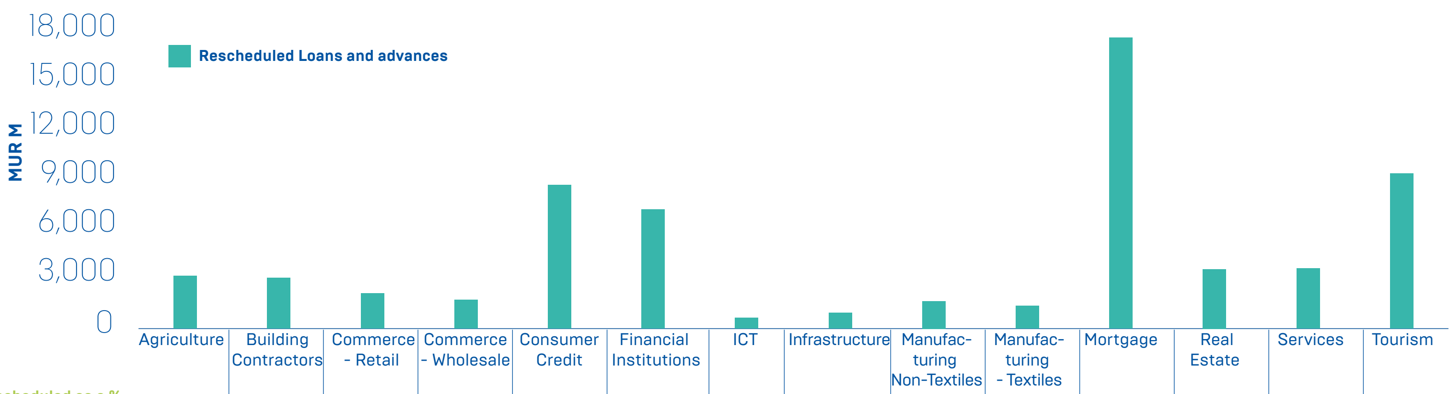
Gross impaired advances increased from MUR 3,713 million at December 2015 to MUR 4,998 million at December 2016. The Group ensured adequate provisions were maintained as per the guidelines of the respective central banks and International Financial Reporting Standards. Specific allowance for credit impairment stood at MUR 3,106 million, representing a provision coverage ratio of 62.1% (December 2015: 65.37%).

A breakdown of the credit portfolio by economic sectors and level of provisions are as follows;



	Agriculture and fishing	Manufacturing	Tourism	Transport	Construction	Financial and business services	Traders	Personal	Others
Specific coverage (%)	62.2%	39.5%	34.1%	91.1%	23.4%	90.7%	89.9%	63.8%	65.0%

Moreover, the total rescheduled loans stood at 59.7% of total credit portfolio as at 31 December 2016, compared to 79.8% in December 2015. A breakdown of the rescheduled loan by portfolio as at 31 December 2016 was as follows;



	Agriculture	Building Contractors	Commerce - Retail	Commerce - Wholesale	Consumer Credit	Financial Institutions	ICT	Infrastructure	Manufac-turing Non-Textiles	Manufac-turing - Textiles	Mortgage	Real Estate	Services	Tourism
Rescheduled as a % of total outstanding per portfolio	11.4%	2.2%	2.8%	9.9%	1.4%	1.7%	0.0%	0.1%	4.6%	0.0%	1.0%	2.9%	8.6%	13.3%

« These exposures are closely monitored and early warning signals are in place to trigger the management in case of any deterioration in their ability to pay and by tagging these customers under watchlist. »

Market Risk Management

The Group has a sound and well-informed strategy to manage market risk. The objective of market risk management is to control market risk exposures to optimise return while maintaining risk at acceptable levels.

Market risk arises from both banking and trading books. The classification of assets into trading book and banking book portfolios determines the approach for analysing the market risk exposure.

1. Market Risk Governance and Oversight

The Board approves the market risk appetite which is defined in terms of the splits between domestic and international markets, foreign currency and interest rate exposures, percentage exposure allocation for position-taking and percentage target splits in terms of maturities of exposure. It also approves new products after having gone through an independent assessment by the Risk Management team ensuring the products are within the policy and risk appetite as well as ensuring the processes defined, system readiness and the resources are adequately trained.

The Group has an independent market risk team to identify, control and monitor the market risk exposures against a set of prudential limits approved by the Board. The limits are sufficiently granular to conduct an effective control of various market risk factors on which an exposure is maintained. Product control procedures and analysis are made of changes in portfolios, in order to detect possible incidents for their immediate correction.

Business units must at all times comply with the Board approved limits and the risks on derivatives are continually reviewed to ensure that complexities of the products are adequately monitored and controlled. In the event of a limit being exceeded, the business units have to explain the reasons for the excess and provide the action plan to correct the situation, which in general can consist of reducing the position until it reaches the prevailing limits or set out the strategy that justifies an increase in limits.

2. Market Risk Profile as at 31-Dec-2016

1. INTEREST RATE RISK

Interest rate risk is the exposure of the Group's financial condition to the variability of interest rates due to re-pricing and/or agreed maturity mismatches, changes in underlying rates and other characteristics of assets and liabilities in the normal course of business. Interest rate risks mainly include repricing risk, yield curve risk, benchmark rate risk and option risk.

The Group interest rate risk management is aimed at maximising the risk-adjusted net interest income within the tolerable level of interest rate risk and risk appetite.

Impact of 200 bps parallel rate change	
Rise in rate	Decline in rate
0.08% decrease in Net Interest Income (Loss of MUR 29Mn)	0.08% increase in Net Interest Income (Gain of MUR 29Mn)
0.16% EaR as a % of Tier 1 Capital	0.16% EaR as a % of Tier 1 Capital

The interest rate risk in the banking book is managed by controlling interest rate sensitivities, which measure the immediate effects of interest rate changes on the assets, liabilities and off-balance sheet items.

With the composition of the Balance Sheet as at 31 December 2016, the Group expected the Net Interest Income (NII) to rise in a decreasing rate scenario and fall in a rising rate scenario. An increase of 200 bps in interest rate would result in a decline of 0.08% in NII (0.16% of Tier 1 capital) whereas a decrease of 200 bps in rate would result in an increase of 0.08% in NII (0.16% of Tier 1 capital). The Group is largely deposit funded with 94% of its total deposits being interest sensitive and out of which 43% are non-interest bearing. On the assets side, 52% of the total assets are floating rate and 24% of total assets are fixed income securities.

(Repricing Gap figures are provided in Note 40 (d) to the Financial Statements at pages 265 to 270)

2. FOREIGN EXCHANGE RISK

Foreign exchange risk is the likelihood that movements in exchange rates might adversely affect the foreign currency holdings in Mauritian Rupee terms thus impinging on the Group financial condition.

FX Value at Risk

MUR **0.75** Mn

Insignificant relative to the Group's Tier 1 capital

In order to manage transactional foreign currency exposures, the Group operates within regulatory parameters and also within more conservative prudential limits approved by the Board including the intraday/overnight open position limits (both aggregate and currency-wise), deal size limit, and stop losses limits. Moreover, we manage the counterparty exposure arising from market risk on our OTC derivative contracts by using collateral agreements with the more risky counterparties.

For the financial year under review, Mauritius Operations maintain an average Aggregate FX Open Position of USD 5.7 million and operated within the regulatory limit of 15% of Tier 1.

For India Operations, the Aggregate FX Open Position stood at INR 8 million well under the Reserve Bank of India's limit of INR 300 million.

(Exposures in foreign currency are given in Note 40 (d) to the Financial Statements at pages 265 to 270.)

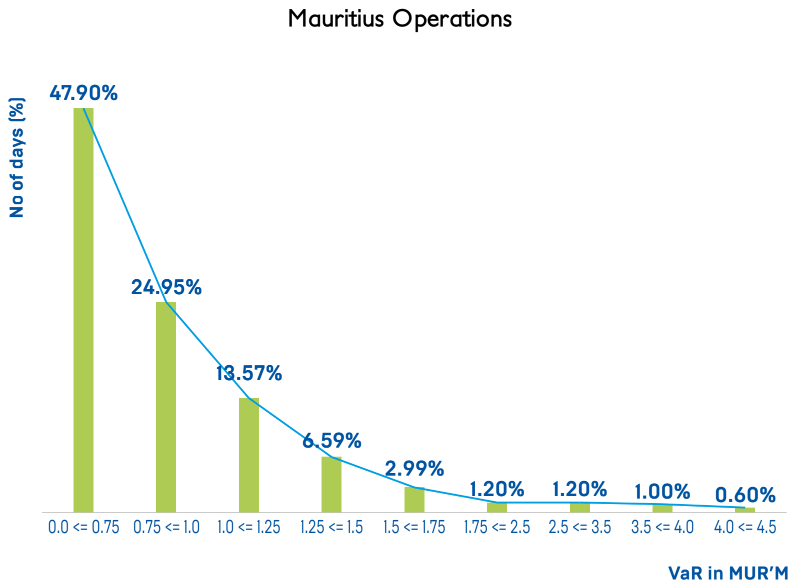
Market Risk Management (cont'd)

Value at Risk (VaR)

Value at Risk measures the market risk based upon a common confidence interval and time horizon. The methodology used to calculate VaR is based on historical data and assumes that historical changes in market values are representative of future movements. VaR is computed by using a ten-day holding period and based on a 99 percent one-tailed confidence interval. This implies that only once in every 100 days, one would expect to incur losses greater than the VaR estimates, or about two to three times a year.

The VaR values was insignificant relative to the Group's Tier 1 capital, MUR 0.75 million as at 31 December 2016 (31 December 2015: MUR 0.75 million, 31 December 2014: MUR 1.27 million).

The chart depicts the distribution of average Foreign Exchange risk in terms of VaR from 2015 to 2016. The positively skewed distribution is characterized by many small losses and a few extreme losses.



To ensure the continued integrity of the VaR model, back-testing is conducted to confirm the consistency of actual daily trading revenue against the model's statistical assumptions. The Group also simulates for a one-day time horizon at 99 percent confidence level that would best reflect the market environment. The rationale behind this principle is that it is assumed open foreign currency positions can be liquidated in the market over one single day.

3. PRICE RISK

Price risk is the risk that arises from fluctuations in the market value of trading and non-trading positions resulting in adverse movements on the value of relevant portfolios.

As at 31 December 2016, the change in the value of the Group's portfolio was within the prudential limits and stop loss limits set by the Board.

The Group is exposed to risk through equity and to both locally and foreign quoted securities, and which are controlled by Board-approved portfolio and limits. The portfolio is managed by the Financial Markets Division under the strategic direction of ALCO and Investment Committee. Besides the Mauritius Gilt-edged securities, the Group maintains a well-diversified portfolio comprising primarily of investment grade or better foreign banks' bonds and which are highly liquid. With US Dollar interest rate likely to rise, the portfolio has not much been impeded as the rise had already been forecasted and the Group disinvested in bonds with long-term maturity.

Funding and Liquidity Risk Management

Liquidity Management is a basic element in the Group's business strategy and a fundamental pillar, together with Capital, in supporting its balance sheet strength.

Liquidity has gained importance in the last few years because of the tensions in financial markets against the backdrop of the global financial crisis. The liquidity risk framework remains robust and no material changes were brought to policies and practices for the management of liquidity and funding risks in 2016.

1. Liquidity Risk Framework

RISK IDENTIFICATION

- Funding Liquidity Risk - Ability to settle obligations immediately when due.
- Market Liquidity Risk - Inability to offset or eliminate a position at the prevailing market price because of inadequate market depth or market disruption.

RISK MEASUREMENT

- The Group conducts currency-wise gap analysis. Evaluation of the disparity between assets and liabilities (both on- and off-balance sheet) that mature within a specific interlude.
- Scenario Analysis and Stress testing. An array of liquidity scenarios, covering a series of explicit events, are analysed to better quantify and assess potential losses arising from low-probability but plausible extreme market conditions
- Short /Long Term Liquidity Risk Ratios

RISK MANAGEMENT & CONTROL

- Ensures maintenance of sufficient liquidity currency-wise, including a cushion of unencumbered, high quality liquid assets, to withstand stress events, including those involving the loss or impairment of both unsecured and secured funding sources.
- The Group has a clearly articulated liquidity risk tolerance that is appropriate for its business strategy.
- In order to avoid excess reliance on a particular source of funding, the Group has adopted a strategy which ensures diversification and undue concentration on few specific customers or product types or currencies.

MONITORING & REPORT

- A wide set of funding and depositors' concentration ratios are regularly monitored and reported to Senior Management on a regular basis and to the Board on a quarterly basis.

Funding and Liquidity Risk Management (cont'd)

Liquidity Profile

The liquid asset ratio provides an assessment of the extent to which assets can be readily converted into cash or cash substitutes to meet financial commitments. The Group liquid assets echo a sound liquidity standing, adequate to counterbalance the impact of a stressed funding environment. It is capable of utilising its own resources extensively and to invest in higher yielding assets. It also strives to attain the right trade-off between liquidity and profitability.

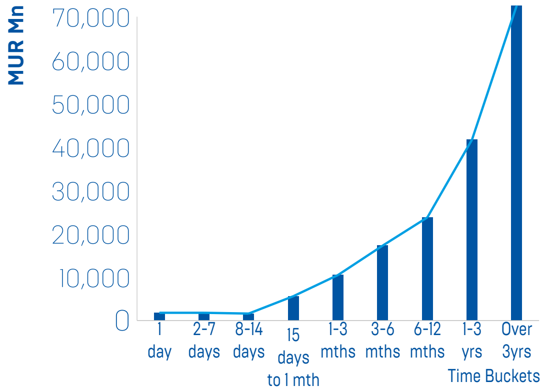
The Mauritius and India Operations were in compliance with Basel III LCR and the NSFR well ahead of schedule. Both the ratios were well above the Basel III requirement of 100 percent for Mauritius and India Operations.

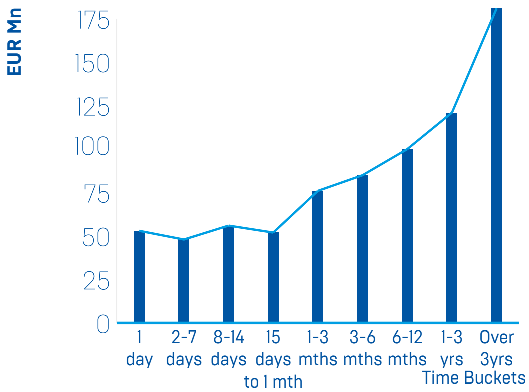
Liquidity Metrics

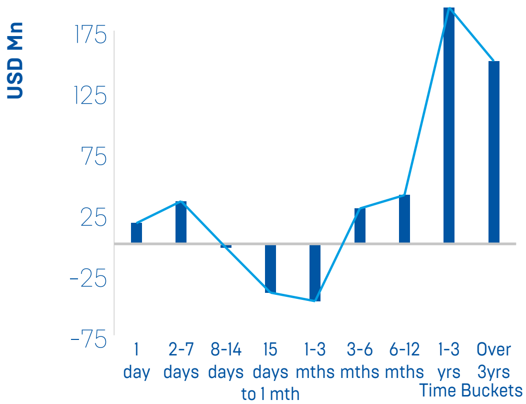
	Dec-16	Dec-15	Dec-14
Liquid Asset to Deposits Ratio	43%	44%	42%
Loans to Total Deposits	69%	69%	75%
Loans to Total Funding	63%	65%	68%
Liquidity Coverage Ratio (LCR)*	116%	133%	118%
Net Stable Funding Ratio (NSFR)*	125%	107%	101%

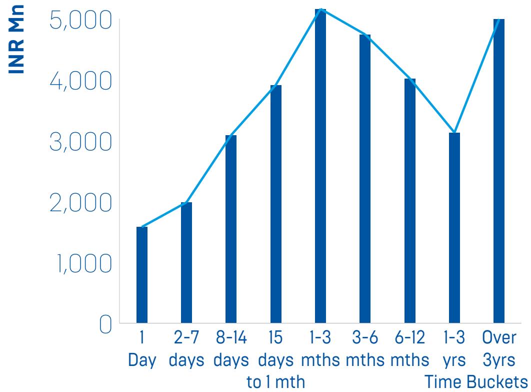
* For Mauritius Operations only

As at 31 December 2016, the Group had a sound, positive liquidity gap and was amply capable of meeting future expected cash flows both in local currency and major foreign currencies as depicted by the charts below:





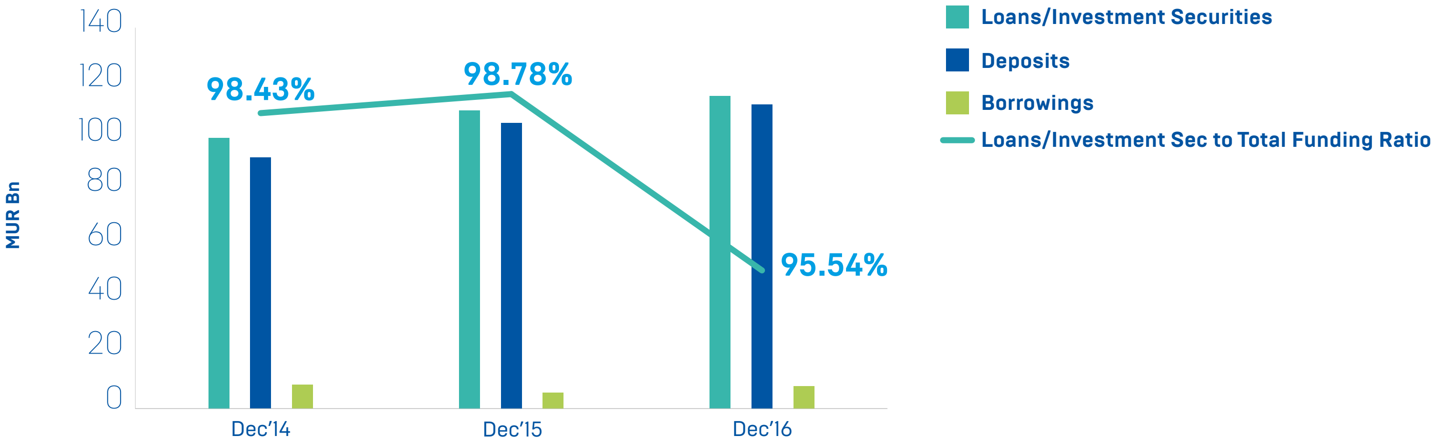




2. Funding

The Group ensures that its funding sources are well diversified and that the funding source concentrations are regularly monitored and analysed. It has its principal sources of funding from capital, core deposits from retail, local and international clients. The Group maintains deposit concentration limits to ensure that it does not place undue reliance on a single entity as a funding source.

In 2016, the Group's core deposits represented over 90% of the total funding, unchanged from the previous year, which is adequate to counterbalance the impact of a stressed funding environment.



Scenario Analysis and Stress Testing

An array of liquidity scenarios, covering a series of explicit events, are developed, analysed, and reported to the ALCO and to the Board Risk Management Committee. Examples of stress scenarios include but are not limited to the following:

	Deposits- % Withdrawal	Advances - % Impairment	Maximum Negative Liquidity Gap (MUR Bn)	Maximum Negative Liquidity Gap as a % of available funding
In the event of reputational or operational issues, a certain percentage of deposit-base is unexpectedly withdrawn within the first 2 weeks.	10% 30%	0% 0%	(6.49) (26.84)	18% 73%
In the event of some credit risk factors, a certain percentage of loans go impaired across all time buckets.	0% 0%	10% 40%	(3.84) (24.20)	10% 66%
Combination of various scenarios, stress conditions are applied to both sides of the balance sheet.	10% 30%	10% 40%	(6.52) (26.99)	18% 73%

The stress testing results shows that the Group has adequate funding to support any shortfall.

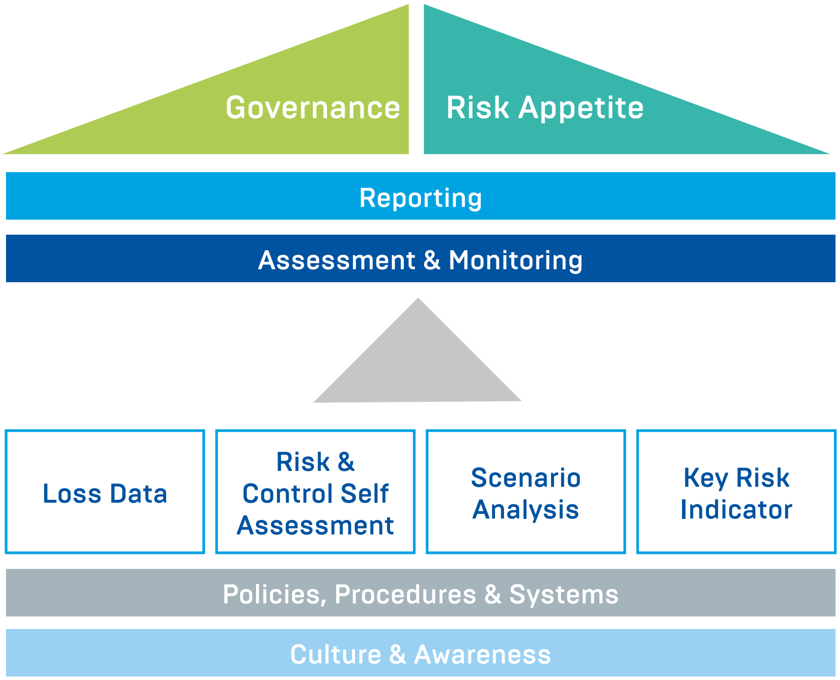
Operational Risk Management

Operational risk is inherent in all business activities and is the risk of loss resulting from inadequate or failed processes or systems, human factors or due to external events, including legal risk, that are neither market nor credit related. These events would result in financial losses and other damage to the organisation, including reputational harm.

Operational Risk Management (ORM) Framework

The various risks that the Group is exposed to are actively and effectively managed in accordance with regulations, guidelines and internal policies. The Group has a robust operational risk management framework with the objective to ensure that risks are identified, assessed, monitored and reported in a structured and systematic manner.

More so, the Group has risk mitigation tools that include a multitude or organisational safeguards and control measures within the framework including but not limited to internal policies and procedures, segregation of duties and 'four eyes principles', access control, compliance checks, limit management, disaster recovery and business continuity planning, risk transfer and sharing, risk awareness and active monitoring.



Governance holds the whole operational risk framework together and formalises the operational risk appetite & threshold for inherent and residual risks. It is also responsible for establishing a management culture which is the foundation for operational risk management.

The Group has well defined and documented policies and procedures coherent with defined risk appetites and compliant with regulations. Policies are reviewed annually to cater for emerging risks.

The four pillars of the risk identification mechanism in the framework are:

- Loss data
- Risk and Control Self-Assessment (RCSA)
- Scenario Analysis
- Key Risk Indicators (KRI)

Risks identified are assessed, monitored and reported in a structured and consistent manner to the Operational Risk Forum and the Risk Management Committee ensuring transparency through all the layers.

Information Technology (IT) Risk

IT is a key enabler for achieving our business objectives and strategies including reaching out to customers and meeting their needs. The year 2016 witnessed a major business-aligned technology transformation to refresh the Group's technology platform and accommodate future business aspirations and geographical expansion. Post system implementation issues adversely impacted customer experience and service delivery. Customer satisfaction improved as issues got resolved and employees became acquainted with the new IT platform.

Teething and system stabilisation issues following the major transformation in 2016 impacted the Group's reputation. Transparent communication and a crisis management team were in place to minimise the impact on stakeholders and ensure smooth service delivery. A post crisis analysis of events conducted allowed weaknesses to be identified and remedial actions taken.

An information technology risk management framework, which promotes information risk management policies and practices across the group in order to manage technology risks and safeguard information system assets, is in place. The framework is supported by a set of IT policies and standards, control processes and risk mitigation programmes including:

- Security awareness training
- Security solution within the eco-system and perimeter to prevent cyber-attacks.
- Strong access control & authentication.
- Redundant systems and business contingency measures.
- Regular vulnerability assessment.
- Monitoring of risk and performance metrics (KRI).
- Regular risk reporting to senior management and Board committees.

The Group's technology platforms are hosted and managed by our IT strategic partner. The Group is conscious of the risks associated with outsourcing arrangements and has taken the appropriate measures to curb same by having service level agreements and well established outsourcing vendor management framework in place.

Business Continuity

Business Continuity Management (BCM) is an integral part of the Group's strategy and is concerned with the development of proactive arrangements and procedures that ensure the resiliency of the Group.

It is an on-going process where threats /weaknesses are proactively identified and appropriate strategies and tactics are implemented to manage the risks which may threaten to disrupt the activities of the Group.

The Business Continuity framework is regularly tested and corrective actions are taken to ensure that fundamental strategies and tactics remain effective. It should be noted that the Group has reached the advanced stage in terms of Business Continuity for technology where the Group conducted its entire Cards & Payments operations for two full days from its Disaster Recovery Site in March 2016. The next exercise is planned around the same period in 2017. The Group understands that a crisis situation is unpredictable and that each situation requires a dynamic response.

> « A Crisis Management Team, under the leadership of the Chief Executive (CE), takes prompt action to minimise impact on service delivery and to build a communication channel with key stakeholders. »

Regulatory Compliance Risk

The Group continuously monitors and accommodates regulatory changes. Failure to comply with applicable laws and regulations could result in regulatory sanctions, financial loss or damage to the reputation of the Group.

The Group has an independent Regulatory Compliance team for each country of operations which assesses compliance risk and, also, manages the risk of breaches and sanctions relating to Anti-Money Laundering and Combatting the Financing of Terrorism. The Regulatory Compliance team in Mauritius acts as a contact point within the Group and delivers timely advice in relation to compliance queries.

Operational Risk Management (cont'd)

With the technology transformation programme that went live in 2016, the Compliance function is now equipped with a specialised software which allows enhanced monitoring of transactions to combat money laundering and terrorist financing.

Fraud Risk

All employees and directors within the Group are expected to act with integrity at all times to safeguard the Group's reputation, protect customers and company resources.

The Group follows the following key guiding principles:

- A zero tolerance policy towards staff fraud
- Stringent control procedures
- Timely disclosure of fraudulent activities
- Training and awareness programme
- Whistleblowing
- Human resource policy including code of ethics and business conduct and conflict of interest

The Group Fraud Management Policy consists of four major pillars – Deterrence, Detection, Mitigation and Response to fraud.

In this context, the Group set up an Anti-Fraud Department ("AFD") in November 2015 to cater for the four pillars. The AFD is totally independent and reports directly to the Audit Committee. It carries investigations on fraud to determine root causes and make recommendations for remedial actions.

The Board approved the implementation of the Group's Fraud Prevention and Investigation Framework which sets the parameters within which the AFD functions, in line with international best practice.

Since the inception of the AFD, the main focus has been on "prevention" through fraud awareness campaigns to various departments within the Group. Parallel to the preventive approach, the AFD has also conducted investigations into potential fraud, malpractices and irregularities cases within the Group.

The Group has also an effective Whistleblowing Policy and all staff are encouraged during fraud awareness campaigns to report potential cases of fraud, malpractices and irregularities without fear of reprisal. All cases reported to the AFD are treated with utmost confidentiality.

Cyber Security

Cybercrime is ranked among the top security threat worldwide as the frequency and intensity of attacks are increasing. SBM has taken measures on top of existing IT security measures to strengthen its resilience against e-Grouping fraud, while recognising that internet and digital technologies can transform customer experience and enable major business opportunities.

In addition to the deployment of resources and a 24/7 monitoring system, SBM believes that customers' awareness about cyber security is an imperative line of defence. Regular security vulnerability assessments and penetration testing are also conducted on our systems and network in compliance with regulatory requirements to proactively identify and remediate security vulnerabilities.

The evolution of losses by category shows a decrease in external fraud both in number and value over the years (refer to figures on page 134) on account of measures implemented.

Reputational Risk

Reputational risk is the risk that the Group's reputation is damaged by one or more reputation events, as reflected in negative publicity about its business practices, conduct or financial condition. Such negative publicity, whether true or not, may impair public confidence in the Group, resulting in costly litigation, or lead to a decline in its customer base, business or revenue. The Group closely and continuously assesses and monitors reputational risk and reports to the Risk Management Committee on a quarterly basis.

> **A dedicated complaints handling team remains alert and sensitive to customer complaints and ensures all complaints are treated with the utmost sincerity, confidentiality and fairness. SBM Group has an approved Reputational Risk Policy in place. Reputational risk is monitored and reported on a quarterly basis to Risk Committee and to the Board.**

Operational Risk Profile as at 31 December 2016

For the year 2016, there has been an increase in processing errors, system issues and complaints from stakeholders. This is mainly due to the post implementation impact of the major system transformation programme. Users experienced higher than usual system downtime and major system related incidents. These resulted in an increase in customer complaints. However, customer satisfaction improved as issues got resolved and employees became acquainted with the new platform.

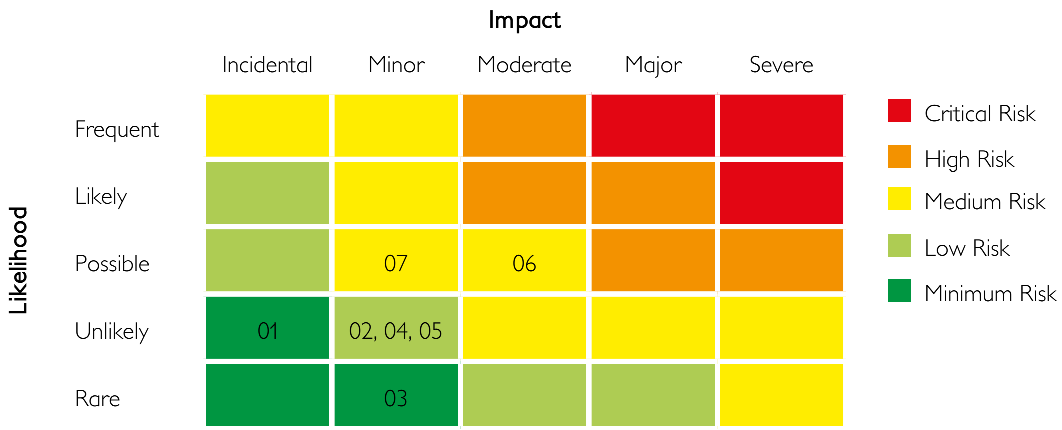


FIGURE 2: HEAT MAP – OPERATIONAL RISKS PROFILE

The heat map below indicates the residual risk level of the seven operational risks categories as per the Basel framework for the year 2016 on a 5x5 likelihood and impact matrix.

Operational Risks	Risk Rating – Year 2015	Risk Rating – Year 2016	Risk Direction
O1 Internal Fraud			↔
O2 External Fraud			↔
O3 Employment Practices and Workplace Safety			↔
O4 Clients, Products, and Business Practices			↔
O5 Damage to Physical Assets			↔
O6 Business Disruption and System Failures			↑
O7 Execution, Delivery and Process Management			↑

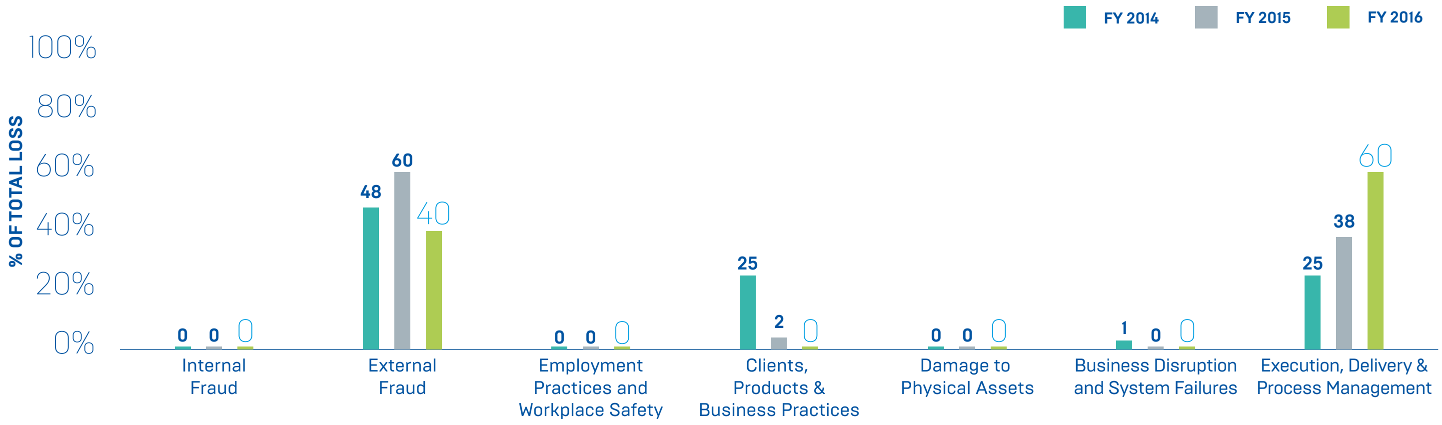
Table 1: Shows the evolution of the seven operational risk categories for the year 2015 and 2016

Operational Risk Management (cont'd)

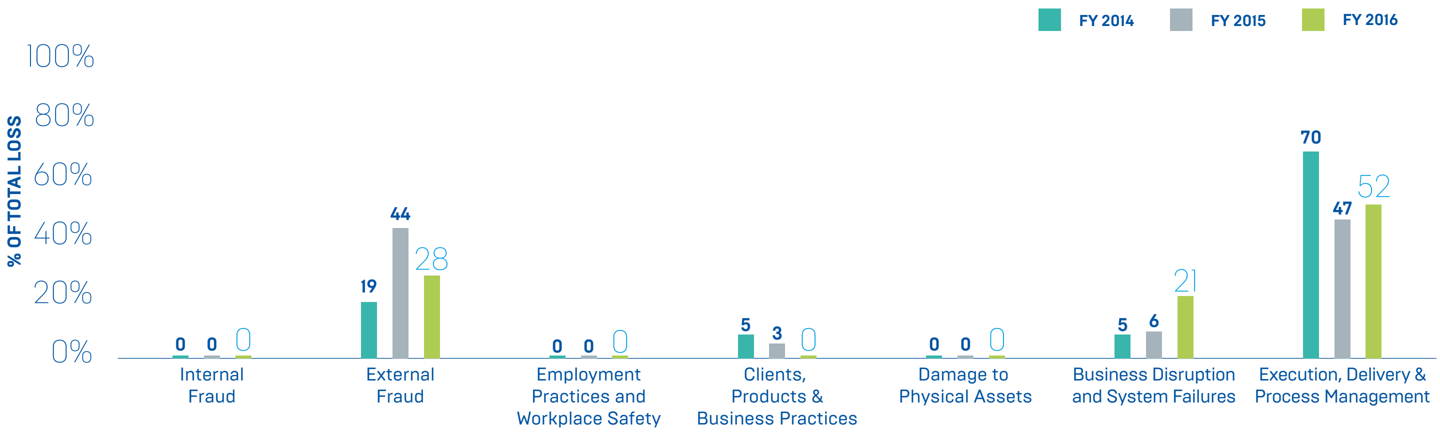
In 2016, we witnessed a decrease in the absolute loss amount for all operational risk categories. Though the absolute loss amount has decreased, there is a perceived increase in the loss associated to Execution, Delivery & Process Management. This is due to the overall decrease in operational loss during the year compared to the previous year.

Financial loss associated with Business Disruption and System Failures has been minimal during the year. However, due to the major system transformation programme in 2016, users experienced a higher than usual system downtime which has since been resolved following the normal phase of system adaptation.

1. Loss by operational risk category



2. Number of events by operational risk category



Capital Management

The Group's capital management strategy aims to achieve a balance between providing competitive returns to our shareholders and maintaining adequate capital to support business growth and foster depositor and creditor confidence. .

The capital management process aims to ensure that sufficient capital is held by each entity within the Group to meet legal and regulatory requirements whilst being in tune with the Group's risk appetite and investor expectations.

The Group is committed to maintaining a strong capital base to support the risks associated with its diversified businesses.

> **A healthy Capital Adequacy Ratio (CAR) protects the Group against excessive leverage and insolvency risks. CAR is defined as the ratio of the Group's capital/subordinated debts in relation to its risk weighted assets. Capital is categorised by applicable regulation under two tiers (Tier 1 and Tier 2) according to the ability to absorb losses and degree of permanency.**

TIER 1 CAPITAL

Tier 1 capital absorbs losses before other types of capital and any loss absorbing instruments. It includes ordinary shares issued and retained earnings and is capable of immediate use to cover risks or losses as soon as these occur.

CET 1 Ratio

19.90%

(Dec 15: 21.75%)

Tier 1 Ratio

19.90%

(Dec 15: 21.75%)

TIER 2 CAPITAL

Tier 2 capital is the supplementary capital and provides loss absorption capacity after Tier 1 capital. It typically consists of subordinated debt securities with a minimum maturity of five years

Tier 2 Ratio

5.81%

(Dec 15: 6.51%)

Capital Management (cont'd)

Risk weighted assets is a measure of the amount of the Group's assets, adjusted for risks. The risk-weighted assets by risk type are as follow

RISK WEIGHTED ASSETS

Credit Risk

MUR **86.1** Bn

(Dec 15: MUR 77.1 bn)

Market Risk

MUR **439** Mn

(Dec 15: 439 M)

Operational Risk

MUR **6.9** Bn

(Dec 15: 6.4 bn)

Despite the challenges faced during the year under review, the Group has remained well capitalised with a capital adequacy ratio of 25.70% as at 31 December 2016. The Group has adequate capital for future expansions or projects. The increase in capital base was primarily due to increased profits while the increase of 11.4% in risk weighted assets arose mainly from the growth in advances.

At all times throughout the year, the banking entities maintained their respective capital adequacy ratios comfortably above the applicable regulatory requirements.

Total CAR for the Group : 25.70%

	SBM Mauritius Ops	SBM Indian Ops	Banque SBM Madagascar
Minimum Regulatory Requirement	**10.375%**	**9.625%**	**8.0%**
CAR as at 31 Dec 16	**12.83%**	**42.59%**	**21.95%**

Note: The Bank of Mauritius prescribes a CAR of 10% excluding buffers against 8% as stipulated by Basel Committee on Banking Supervision and the Group was well within the minimum capital requirement with a CAR of 25.70%.

In general, a higher capital adequacy ratio is seen as good for the financial system as lenders have more capital to cover the cost of unforeseen risks thereby benefiting depositors.

Financial crises and uncertainties in the world have increased the importance of capital adequacy requirements. In Mauritius, the impact of recent financial crises was low due to strong capitalisation of banks and a robust regulatory environment.

1. Regulatory Capital

The Group is subject to the capital adequacy guidelines issued by the Bank of Mauritius, which are based on the framework of the Basel Committee on Banking Supervision.

As at 31 December 2016, the minimum total capital adequacy ratio required by the Bank of Mauritius for banks operating in Mauritius stood at 10% of risk-weighted assets.

In addition, those that qualify as Domestic Systemically Important Bank (D-SIB) are keeping an additional capital ranging from 0 to 2.5% as from 1 January 2016, in a phased manner till 1 January 2019.

As from 1 January 2017, banks will be further required to constitute a capital conservation buffer starting with 0.625% and increasing by 0.625% annually to reach 2.5% on 1 January 2020.

Capital Buffers	Description
Capital Conservation Buffer	This Pillar 1 buffer is intended to promote the conservation of capital and the build-up of adequate buffers above the minimum that can be drawn down in periods of stress.
Domestic Systemically Important Bank (D-SIB)	This capital surcharge is intended to address externalities caused by banks that are not significant from an international perspective, but which nevertheless could have an important impact on their domestic financial system and economy compared to non-systemic institutions. The Bank of Mauritius identified five banks in Mauritius as D-SIBs based on the assessment of five factors namely : size, exposure to large groups, interconnectedness, complexity and substitutability.

There are several categories of rules related to capital under Basel III. Taken together, these rules require banks to hold enough capital to equal at least 13.5% of their total risk-weighted assets by the beginning of 2020 in Mauritius.

Capital Management (cont'd)

The Group has applied the Basel framework which is made up of three pillars:

PILLAR 1

Minimum capital requirements

- Credit Risk
- Market Risk
- Operational Risk
- Equity Risk

Establish minimum standards for management of capital on a more risk sensitive basis

PILLAR 2

Supervisory Review Process

Assessment of other risks by considering stress tests results;

- IRRBB
- Concentration Risk
- Reputational Risk

Increase the responsibilities and levels of discretion for supervisory review and control

PILLAR 3

Market Discipline

- Additional Reporting

Expand the content and improve transparency of financial disclosures to the market

2. Capital Structure

As per the Bank of Mauritius Guideline on Scope of Application of Basel III and Eligible Capital, the Group has adopted the Standardised approach for credit risk, Standardised Measurement approach for market risk and Alternative Standardised approach for operational risk.

Mauritius Operations and India Operations adhere to Basel III as contained in the Bank of Mauritius Guideline on Scope of Application of Basel III and Eligible Capital and RBI circular on Basel III Capital Regulations respectively while Banque SBM Madagascar, our foreign subsidiary, is compliant with Basel I requirement currently in force in Madagascar. At Group level, consolidation is based on Guidelines issued by the Bank of Mauritius.

The risk-weighted assets are worked out by applying risk weights from prescribed risk parameters, classified according to its nature and reflecting an estimate of credit, market and other risks associated with each asset and counterparty. To determine the relevant risk weights applicable to its claims on banks and sovereigns, ratings assigned by Standard & Poor's, Moody's Investors Service and Fitch are used and these external rating companies have been approved by the Bank of Mauritius.

The following tables provide figures for the RWAs after credit risk mitigation (CRM) for both **on-balance sheet and off-balance sheet assets :**

On-balance sheet assets - MUR Million	31 Dec 2016 Amount	31 Dec 2016 Weight %	31 Dec 2016 Weighted Assets	31 Dec 2015 Weighted Assets	31 Dec 2014 Weighted Assets
Cash Items	2,031	0-20	1	30	42
Claims on Sovereigns	28,127	0-100	1,030	535	491
Claims on Central Banks and International Institutions	7,886	0-100	365	447	344
Claims on Banks	22,999	20-150	10,242	7,953	6,341
Claims on Non-Central Government Public Sector Entities	463	0-100	408	524	788
Claims on Corporates	36,998	100	36,998	33,312	28,467
Claims included in the Regulatory Retail Portfolio	8,510	75	6,382	6,869	6,977
Claims secured by residential property	15,142	35-125	5,925	6,277	6,123
Claims secured by Commercial Real Estate	3,456	100	3,456	4,461	7,770
Past due claims	1,828	50-150	2,091	1,344	665
Other assets	13,882	100-250	15,933	12,427	11,673
Total On Balance Sheet	141,321		82,830	74,178	69,681

In terms of risk profile, on-balance sheet assets increased by 11.66% as a result of increases in:

- **Claims on corporates** from MUR 33.3 billion, accounting for 44.9% of total on-balance sheet assets, to MUR 37.0 billion, accounting for 44.7% of total on-balance sheet assets.

- **Claims on banks** from MUR 8.0 billion, accounting for 10.7% of total on-balance sheet assets to MUR 10.2 billion, accounting for 12.4% of total on-balance sheet assets.

Off-balance sheet assets	Credit Conversion Factor (%)	31 Dec 2016 Nominal Amt (Rs m)	31 Dec 2016 Credit Equivalent Amt (Rs m)	31 Dec 2016 Weight %	31 Dec 2016 Risk Weighted Assets (Rs m)	31 Dec 2015 Risk Weighted Assets (Rs m)	31 Dec 2014 Risk Weighted Assets (Rs m)
Direct Credit Substitutes	100	1,291	1,291	0 - 100	1,108	277	527
Transaction-Related Contingent items	50	3,281	1,641	0 - 100	1,524	2,003	2,261
Trade-Related Contingencies	20	1,392	278	0 - 100	230	175	205
Other Commitments	0 - 20	6,787	439	0 - 100	411	492	324
Total non-market-related risk-weighted assets		12,751	3,649		3,273	2,947	3,317
Interest Rate contracts	1 to 4	2,361	94	50	47	52	49
Foreign Exchange contracts	2 to 5	6,393	183	20 - 100	170	194	261
Total market-related risk-weighted assets		8,754	277		217	246	310
Total		21,505	3,926		3,490	3,193	3,627

Capital Management (cont'd)

A summary of the Group's capital requirements for credit, market and operational risk and the capital base and the capital adequacy ratio as on 31 December, 2014, 2015 and 2016 is presented below.

Regulatory Capital

MUR Million	31 Dec 2016	31 Dec 2015	31 Dec 2014
Common Equity Tier 1 Capital (CET 1)			
Share Capital	32,500	32,500	32,500
Statutory Reserves	592	592	583
Retained Earnings	(196)	(430)	(1,109)
Accumulated other comprehensive income and other disclosed reserves	(22)	(1,471)	116
Restructure Reserve	(5,415)	(5,415)	(5,415)
Treasury (own) shares	(4,875)	(4,875)	(4,875)
Other Intangible Assets	(3,770)	(2,371)	(1,252)
Deferred Tax	(215)	(277)	(171)
Common Equity Tier 1 Capital	18,598	18,254	20,376
Additional Tier 1	-	-	
Tier 1 capital (T1 = CET1 + AT1)	18,598	18,254	20,376
Tier 2 Capital			
Subordinated SR Bonds	3,835	3,835	3,567
Other Reserves	549	579	123
Portfolio Provision	1,045	1,049	861
Tier 2 Capital	5,429	5,464	4,551
Total Regulatory capital	24,027	23,718	24,927
Risk Weighted Assets			
Credit risk	86,103	77,126	72,998
Market risk	439	439	487
Operational risk	6,938	6,370	5,881
Total Risk Weighted Assets	93,480	83,935	79,366
Common Equity Tier 1 capital ratio (%)	19.90	21.75	25.67
Tier 1 capital ratio (%)	19.90	21.75	25.67
Total capital ratio (%)	25.70	28.26	31.41

The capital adequacy ratio stood at 25.70%, well above the regulatory limit of 10.375% (including capital charge for D-SIB).

Market Risk Capital

The Group follows the Standardised methodology outlined in the Bank of Mauritius Guideline on Measurement and Management of Market Risk.

The following table provides the comparative figures for the aggregate net open foreign exchange position for the Group :

MUR million	Dec 2016	Dec 2015	Dec 2014
Aggregate net open foreign exchange position	222.1	193.5	176.9

Operational Risk Capital

The Group has adopted the Alternative Standardised Approach for the computation of capital for operational risk.

The operational risk capital charge is arrived at by:

	Average of past 3 years for each line of business		Line of Business		Beta		Fixed Factor
1			Trading and Sales		18%		
2	Positive annual gross revenue	Multiply by	Payment and Settlement	Multiply by	18%		-
3			Agency Services		15%		
4			Asset Management		12%		
5	Outstanding balance of loans and advances	Multiply by	Retail Banking	Multiply by	12%	Multiply by	0.035
6			Commercial Banking		15%		

The capital charge is revised on an annual basis at 31 December.

The table below sets out, at the dates indicated, the operational risk capital charge for the Group :

MUR million	Dec 2016	Dec 2015	Dec 2014
Capital charge for Operational Risk	693.8	637.1	588.1

An assessment of the capital requirement of the Group is carried out through a comprehensive projection of future businesses that takes cognisance of the strategic intent of the Group, profitability of particular businesses and opportunities for growth. The proper mapping of credit, operational and market risks to this projected business growth enables assignment of capital that not only adequately covers the minimum regulatory capital requirement but also provides room for growth. The calibration of risk to business is enabled by a strong risk culture in the Group aided by appropriate technology-based risk management systems.

> **A key focus for the year ahead will be to ensure that the Group remains adequately capitalised and positioned to respond to higher capital requirements for the regional expansions.**