MATERIAL RISK FACTORS & MEASURES TO MANAGE RISKS

LBP INSURANCE BROKERAGE INC. (LIBI) recognizes the importance of an effective financial risk management program and a Risk Management Manual was finalized and approved by the members of the Board in 2009.

The objective of the Manual is to serve as basis and reference of consistent risk management that is applicable to all employees of LBP Insurance Brokerage, Inc. (LIBI). It aims to create a culture of risk-awareness, not risk-aversion based on the prudential framework required by BSP circulars. It provides a general set or risk principles delegated to each business unit through its reporting and approval procedures.

A Risk Management Committee was created to be primarily responsible for the development and oversight of the risk management programs of LIBI which include oversight of management functions and approval of proposals regarding LIBI's policies, procedures and best practice relative to asset and liability management, credit, market and business operations risks ensuring that insurance requirements of its mother unit Land Bank of the Philippines and their lending units are passed on to LIBI; system of limits remain effective; and immediate corrective actions are taken whenever limits are breached or whenever necessary.

As part of identification risk, the following are classified as major risks that LIBI manages in the course of its business.

Market Risk

Market risk can be generally defined as risk of loss, immediate or over time, due to adverse, fluctuations in price or market value of instruments, products and transactions in LIBI's overall portfolio. Market risks are central focus of risk measurement methodologies and limits, as well as gauge by which LIBI can determine returns it will require for its activities.

LIBI as a subsidiary of Land Bank of the Philippines, has already a captured market for its products and services. Nonetheless, LIBI continues to intensify its campaign to solicit more direct business from private corporations and other government entities.

Foreign Exchange risk

LIBI-Forex's foreign currency held for trading has a minimal balance of P643,439 which is 0.65 per cent of the division's total assets of P98,201,416, thus, foreign exchange risk is low.

Liquidity Risk

It is the risk that LIBI will be unable to make a timely payment of any of its financial obligations to customers or counterparties in any currency. Trading Liquidity risk refers to inability to unwind positions created from markets, exchanges and counterparties due to temporary or permanent factors.

Prudent liquidity risk management implies sufficient cash and cash equivalents and marketable securities. Insurance and Forex Divisions' cash inflows from operations and readily marketable government securities investments provide the bulk of LIBI's liquidity buffer.

Interest Rate risk

This is the risk that future cash flows of a financial instrument will fluctuate because of changes in market interest rates. LIBI's fixed rate investments like short-term and held-to-maturity investments are exposed to such risk.

It is the policy of LIBI to invest excess funds in government securities (GS) of which the servicing and repayments are fully guaranteed by the government. The investment in GS may be placed with the Land Bank Treasury and Investment Banking Group or Land Bank Trust Banking Group.

LIBI's Investment Committee observes diversified GS portfolio, varied maturity spectrum and optimum yields in deciding the type and term of investment. When yields of GS are expected to go down, LIBI buys long-term GS in order to lock-in on high yielding GS. Conversely, when yields are expected to go up, it buys short-term GS to stay liquid and be able to switch to high yielding GS when rates start to pick up.

LIBI's principal financial instruments comprise of cash deposits; held-to-maturity investments consist primarily of investment in government securities like Retail Treasury Bonds, DBP Tier-II and Agrarian Reform Bonds. These are not subjected to mark-to-market valuation but impairment testing is being done on HTM in RTBs.

Credit Risk

a. **Direct Credit Risk** – is the risk that a customer or counterparty will be unable to pay obligations on time or in full as expected or previously contracted, subjecting LIBI to a financial loss. It lasts for the entire tenor and is set at full amount of a transaction. The possibility of non-collection of Accounts Receivable within one year is moderate due to intensified collection through faster sending of Statement of Accounts thru fax, email, mail and frequent follow-ups by phone. LIBI's collection rate of 90.47 per cent for the current year is 1 per cent lower than the 91.47 per cent collection rate last year. The management has negotiated with Land Bank of the Philippines for the advance payment of policies by the branches/lending units.

b. **Counterparty Risk** – is the risk that occurs from transactions where reciprocal obligations are made between LIBI and counterparties or customers.

   - **Pre-Settlement Risk** - risk that LIBI-Forex's counterparty or customer defaults prior to settlement date of transaction and will be unable to fulfill the transaction. LIBI would then be subjected to exposure equivalent to economic replacement cost for defaulted contract (a current market value) plus a potential increase in that cost due to future market fluctuation.

   - **Settlement Risk** – occurs from simultaneous exchange of value with a customer or counterparty, where verification of payment from counterparty is not received until after LIBI-Forex's is already delivered. Should a non-delivery on the part of the counterparty occur, LIBI-Forex is exposed to direct credit risk.

   - **Clearing Risk** – occurs from payments and transfer made on or behalf of customers, where transfers are made prior to verification of reimbursement. Similar to settlement risk, LIBI-Forex is exposed to direct credit risk if customer fails to make reimbursement

Settlement and clearing risks are noteworthy in that these may be controlled by using operational or transactional methods such delaying payment until receipt of funds is confirmed from the counterparties.

Compliance to Anti-Money Laundering Law and BSP regulations has to be conscientiously observed all throughout LIBI-Forex trading transactions. Trading personnel are encouraged to attend trainings / seminars for enhancement in trading skills and to keep abreast with new regulations (if any) from its regulatory body, the BSP.

Operational Risks

LBP Insurance Brokerage Inc. actively monitors its operational risks attributed to the company's operations thru:

- Continues revisit of both LIBI's Annual Risk and Control Self-Assessment (RCSA) for its business processes and Information Security Risk Assessment Register (RAR) to assess if controls set are adequate and properly managed and to identify any emerging risks or residual risks.
- Business Continuity Management
- Operational Risk Management Audit