Risk and capital management report

Introduction

Our philosophy

Our general approach

The conduct of our businesses and activities inherently exposes our organisation to risks. Managing risks effectively is fundamental to the successful execution of our strategy an d delivery of sustainable value to our multiple stakeholders

Our key objectives

Alongside complying with industry best practices, good corporate governance standards and applicable statutory and regulatory requirements, the Group places prudent and informed risk-taking at the centre of each decision. It ensures that the risks faced are effectively identified, assessed, monitored and managed within acceptable levels. It sets out to continuously improve the risk-return profile of its activities, while creating conducive conditions for tapping into market development opportunities

Our integrated risk management set-up

- While entities are accountable to manage the risks faced at their respective levels, the risk management framework of MCB Group Ltd provides guidance for achieving sustainable business growth within the precinct of the Group-wide risk appetite
- The framework – which sets requirements in terms of responsibility, accountability, independence and transparency – ensures that a holistic, coordinated and systematic approach to risk management is adopted across the organisation

Key directions formulated by the Group's risk management framework for its entities

Articulating an overall framework that calibrates risk management policies and processes to be adopted by the organisation

Providing guidance on the adoption of a dependable and coherent approach to identify, mitigate and manage risk

Promoting the general alignment of methodologies used to manage risks faced

Ensuring alignment in terms of the attitudes and behaviours of employees towards assuming and managing risk

Foundations and focus areas

General orientations

- Ensuring that our risk management principles are anchored on advocated norms and principles
- Adherence by entities to sound capitalisation, asset quality and funding/liquidity management principles
- Establishment of strong governance frameworks, with clearly-defined and segregated authorities, accountabilities and responsibilities for taking on and managing risk
- Establishment of clear risk appetite which sets out the types and levels of risk that the Group is willing to take
- Availing strong, coherent and harmonised risk management processes, policies, limits and targets
- Catering for an adequate balance between risk and reward considerations

Governance framework

- Ultimate responsibility of the Board of MCB Group Ltd for risk management, with responsibilities delegated to its sub-committees
- Direct oversight exercised by the Boards of entities and their relevant committees
- Effective delegation of authority from the Board of each entity to its management and risk functions, with the scoping of the latter depending on the nature and depth of relevant operations and activities
- Well-defined intra-Group service delivery and collaboration in support of effective risk management, as gauged by MCB Ltd providing *inter alia* internal audit, risk management and compliance services to other entities where appropriate

Other key foundations

- Regular review and update of risk management practices to ensure consistency with business activities and relevance to financial strategies, while catering for changes in the economic and market landscapes
- Adoption of policies and processes that are clear and simple to be understood and executed, alongside ensuring that they are well-documented and disseminated across all layers of the Group
- Adherence to a common set of behaviours, attitudes, skills and guiding courses of action that are integrated throughout the Group in support of coherent decision-taking at all levels of the organisation
- Ensuring that the price charged for solutions is reasonable in relation to the relative riskiness of the exposure

Risk and capital management report

Positioning and performance of the Group during the period under review

Facing up to and coping with the exceptional circumstances engendered by the COVID-19 pandemic

Significance and ramifications of the pandemic

- The COVID-19 pandemic led to the predominance of an unprecedented and highly challenging operating environment for the Group. Indeed, after provoking major and persisting economic and social disturbances across markets and geographies, the pandemic has – to varying scales and depth – influenced the Group's banking and non-banking entities, with ramifications on their customer base being shaped up by the types of markets being attended to, the diversification and inherent vulnerability/resilience of portfolios and the risk mitigants in place. Whilst the context remains highly dynamic, developments triggered by the pandemic have exerted pressures on the operational, credit as well as liquidity and funding risks faced by the Group, while leading to a relative deceleration of our business growth momentum. The repercussions of the pandemic on our organisation have been engendered by the following: (i) prevalence of lockdown periods and sanitary concerns across presence countries; (ii) dampened revenue generation capabilities of individuals and businesses amidst the deteriorating performances of specific economic sectors (mainly tourism and hospitality, transport, export oriented industries, with SMEs particularly impacted), closing of borders, supply chain disruptions and rising unemployment; (iii) increased volatilities across markets and subdued investor sentiment; and (iv) curtailed inflows of foreign currency within economic systems.

Maintaining the resilience and stability of the Group's operations and business activities

- In spite of the challenges faced, it is encouraging to note that the entities of the Group have upheld their healthy business development across market segments and preserved their general financial soundness. Towards this end, Group entities have capitalised on their robust risk management and internal control frameworks, which enabled them to identify, monitor and mitigate risk exposures in a consistent manner. More contextually, the quality of their portfolios have been generally upheld on the back of specific relief measures implemented to help clients withstand the economic downturn, notably in terms of loan moratoria. Entities also benefitted from support initiatives that are being executed by Central Banks and Governments with a view to sustaining supply of credit to the real economy and bolstering the capacity of commercial banks to help clients in distress.

- Whilst this situation testifies to the soundness of the Group's business model and our proactive stance amidst testing conditions, we are aware that the economic environment prevailing across presence countries and internationally remains difficult. There is very little visibility as to when conditions will normalise and an upturn in activities will gain momentum during the course of the coming quarters and years. This situation, therefore, continues to warrant our close strategic focus and the systematic monitoring of our portfolios and operations, while we stand ready to take adapted measures in view of the evolving operating landscape.

Our financial soundness

- Notwithstanding the difficult context, MCB Group has maintained comfortable capital levels that exceed minimum regulatory levels and support its growth endeavours. It has also managed to preserve generally stable non-performing loan ratios.

- Furthermore, the Group took active and prompt measures that enabled it to post strong liquidity and funding ratios, thus helping the organisation to meet its obligations in a timely manner. Worth noting, MCB ensured that it has adequate FCY resources to fund its regional diversification endeavours, while our foreign banking subsidiaries have maintained long foreign currency positions that offer cushion from a potential structural depreciation of their local currencies.

- Encouragingly, in spite of challenging conditions faced, MCB Ltd preserved its investment-grade credit ratings. However, as it is being the case for an extensive range of banks globally, Moody's Investors Service and Fitch Ratings have assigned a negative outlook to MCB Ltd, after factoring in the impact of the COVID-19 pandemic on the Bank's operating context and downside risks to its financial profile. That said, these agencies have underscored the Bank's healthy fundamentals, solid franchise, business model and management quality, adequate risk management and resilient financial metrics heading into the crisis.

Dedicated moves to tackle the impact of the COVID-19 pandemic

- Given the unprecedented context, MCB Group moved quickly and in an orderly way to preserve its status as a strong and resilient organisation. To cope with the crisis situation, the Group endorsed key operational and strategic moves in a pragmatic manner.

- We fostered the continuity of our operations amidst safe working conditions. We attended to key organisational imperatives, especially relating to governance, resource allocation, deployment of sanitary measures in our premises as well as the regular internal and external communication of initiatives taken during and after the lockdown phase. In parallel, after reviewing our inherent capabilities and preparedness levels, we further strengthened our risk management set-up and internal control processes, alongside gearing up our oversight of market developments. We undertook a systematic monitoring and assessment of the ramifications of the pandemic on economic and market conditions across our presence countries. This assisted us in carrying out a thorough and informed evaluation of the impact of pandemic-related developments on our internal operations and risk profiles.

- In light of the impact of the pandemic on our business activities and commensurate with the uncertain and unpredictable economic environment, MCB Group has materially increased its Expected Credit Losses during the second half of FY 2019/20. This reflects the proactive and prudent approach endorsed in order to assess adequate provisioning levels to be kept in the wake of unfolding operating conditions, underpinned by informed analyses, careful assumptions and thoughtful modelling exercises.

Banking cluster: Impact assessment of the COVID-19 pandemic

MCB Ltd

Portfolio review

- The Bank ran impact analyses on its portfolios, particularly, but not limited to, domestic corporates, SMEs, international structured finance, and Energy and Commodities. This was achieved by undertaking an appraisal of crisis transmission mechanisms and relevant sectorial assessments. Client-specific circumstances prevailing prior to the pandemic as well as the adequacy and impact of support measures adopted by the authorities were assessed. The Bank reviewed its risk appetite for its international business and country risk appetite in order to cater for the evolving economic environment, current business conditions and its strategic endeavours.

- Overall, while the Bank has continued to address underlying vulnerabilities inherent across key local market segments in the wake of turbulences confronting specific economic sectors, it has been, in particular, been comforted by the overall resilience of its Energy and Commodities and international structured finance portfolios amidst the testing operating environment.

Evaluating the soundness of its local portfolios towards delivering tailored support

- MCB Ltd established a Portfolio Assessment Team to undertake an in-depth vulnerability assessment of its exposures in the most affected local sectors and clients. The assignment involved a macroeconomic assessment of the following sectors: (i) Tourism and Hospitality; (ii) Export Oriented Manufacturing and Textile; (iii) Construction and Property Development; and (iv) Small and Medium Enterprises (SMEs). The findings fed the second phase of the exercise, which consisted of a micro-financial assessment of systemic corporate Groups (conglomerates) in Mauritius to appraise difficulties being encountered amidst the crisis.

- This exercise was conducted by cross-functional working groups from various areas of the Bank, namely Strategy, Research and Development, Risk, Corporate and Institutional Banking and Business Banking SBUs. This multidisciplinary approach underpinned an informed assessment of clients' needs, while gauging its capacity to provide long-term support.

- Along with providing a framework for devising longer-term and more definitive restructuring measures and solutions to support its clients, findings gathered from the assignment have so far helped the Bank to plot an initial way forward with respect to its engagement with large customer groups and bring them due relief, especially in respect of capital repayment holidays (and also interest in some cases) for ongoing credit facilities and the delivery of working capital facilities to meet cash flow needs.

Determination of ECL

Quarter ended 31 March 2020

- In line with IFRS 9 requirements, the Bank's ECL incorporated an increase of Rs 1,488 million over the second quarter of FY 2019/20, based on an inherent increase in credit risks and its forward-looking view of the repercussions of the pandemic on its operations.

- While complying with international practices advocating post-model overlays/adjustments in instances where effects of COVID-19 cannot be accurately reflected in models and given relative lack of data, MCB Ltd opted not to alter its models, but, instead, to align one of its most important risk parameters, namely the Probability of Default (PD), to factor in potential ramifications of the pandemic.

- Wholesale portfolio: On the back of the analysis performed and the availability of reasonable information at the onset of the crisis, the Bank has identified two sectors, namely 'Accommodation and Food Service Activities' and 'Textile', as High Risk and effected a 'de-notching' exercise, which consisted of attributing a higher 12-month PD.

- Retail portfolio: MCB Ltd adjusted its forward-looking factor, leading to a major rise in ECL, as compared to 31 December 2019.

- The Bank applied a management overlay, amounting to 30% of the ECL reported for 31 December 2019, to cater for uncertainties, bearing in mind that the ECL adjustment exercise was performed at a very early stage of the crisis.

Quarter ended 30 June 2020

- As the impact of COVID-19 continued to unfold, the Bank reported total ECL of Rs 3,290 million for FY 2019/20 following an increase of Rs 1,735 million as compared to the third quarter of the year. During the quarter, it also performed the annual recalibration of its models, which consisted of incorporating an additional year of historical data, independently of COVID-19 induced outcomes.

- Forward-looking indicators: It updated the forward-looking indicators (consisting of macroeconomic variables such as GDP and unemployment rate forecasts as well as financial variables such as lending rate and credit index) used to determine the Probability of Default as part of the sensitivity analysis. Three types of economic scenarios have been incorporated into the range of reasonably possible outcomes as regard the evolution of macroeconomic indicators over the coming 36 months (bull, bear and baseline scenarios), with probabilities assigned to each, based on judgments regarding economic and market developments and outlooks.

- Wholesale portfolio: Insights from the Portfolio Assessment Team and financial forecasts from key clients, including those under stress, were leveraged in order to conduct creditworthiness assessments. The outcomes were reflected, where deemed necessary and appropriate, in the clients' internal ratings (and, thus, in their 12-month Probability of Default) by means of rating overlays. In a small number of cases, the Bank judged that there were significant increases in credit risk and proceeded with staging overlays (i.e. moving some clients from Stage 1 to Stage 2).

- Retail portfolio: Outcomes of various simulations undertaken to reflect potential surges in the risk profiles of its retail clients triggered an additional general overlay, representing 10% of the overall retail portfolio ECL reported as at 30 June 2020.

- The Bank applied a management overlay, amounting to 10% in respect of total exposures as at 30 June 2020, as an additional buffer for further risk mitigation.

Read more in the 'Credit risk' section of the Risk and Capital Management Report on pages 175 to 180

Foreign banking entities

Portfolio review

- The entities, in their own respects, undertook a review exercise to ascertain the impact of COVID-19 on key sectors, with three risk categories, namely High, Medium and Low Risk, established for classification. They performed an in-depth analysis of three sectors, namely Tourism, Transport and Logistics, and SMEs, since these were classified as High or Medium Risk.

- They assigned a vulnerability rating to each of these three sectors, after taking into consideration the outcome of the afore-mentioned analysis and the appraisal of the impact of dedicated support measures being implemented by the authorities. They reviewed their respective Top 50 credit exposures, after paying particular attention to (i) the nature and extent of banking facilities granted; (ii) the staging classification of such exposures under IFRS 9; (iii) collaterals used to secure such facilities; (iv) clients financial fundamentals; (v) assistance received from Governments in the form of wage assistance or loans guarantees; and (vi) further assistance required from our foreign banking entities in the form of moratoriums or working capital loans.

- In the process, the entities maintained regular interactions with their customers to understand and identify their needs and provide tailor-made solutions to address liquidity issues faced by them. The entities have devised a questionnaire to be filled in by customers requesting such accompanying measures, with the following information being, amongst others, asked for in order to underpin proper assessment of client conditions and requirements: (i) best estimates of their cash-flow forecasts; (ii) efforts made by management in terms of cost cutting, salary reviews or other restructuring measures being implemented by them; (iii) strategies in place to face up to the grim consequences of the pandemic on their operations; (iv) capital injections by the shareholders; and (v) support emanating from the Government.

- Notwithstanding vulnerabilities witnessed in some areas, the entities were comforted by the overall resilience and soundness of their loan portfolios, as gauged by sustained credit quality and the achievement of conservative cost of risk and coverage ratios.

Determination of ECL

- On the basis of the afore-mentioned initiatives, the entities updated their credit modelling tool for the purpose of determining the Expected Credit Losses to reflect heightened credit risks and their forward looking stance. They reassessed their macroeconomic outlooks, with forward-looking indicators (relating to economic and financial variables) being updated and inputted in their credit model to determine the updated lifetime and 12-month Probability of Default for different segments, namely Large Corporates, SMEs and Retail. This enabled the entities to compute their Expected Credit Losses.

- During the exercise, management overlays for specific sectors considered inherently more vulnerable were duly considered. The Expected Credit Losses of the performing portfolio as a percentage of the total loan portfolio of the foreign banking entities were then benchmarked against each other as well as with that of MCB Ltd to ensure coherence and consistency across the Group.

Adopting further moves and initiatives to reinforce overall risk management

Banking cluster

- To enable the Board undertake an informed identification and assessment of the universe of risks that the entities are being exposed to, notably in terms of their pertinence and significance, the Group has, as a key move during the period under review, implemented an Enterprise Risk Management framework and methodology for its foreign banking subsidiaries to allow for a prioritisation of actions and controls in relation to challenges faced. Supported by investment in a digital platform, key objectives of the framework are as follows: (i) formalising the documentation of the Group's Risk Register comprising a description of each risk together with the measurement and recording of the inherent and residual risk exposures around key themes, namely Strategic, Financial, Operational and Compliance; and (ii) monitoring residual risk exposures and mitigating controls to bring such exposures below tolerable levels. As for MCB Ltd, in order to underpin the successful achievement of its business strategies by means of enhanced risk identification, assessment and management, it has initiated the preparation of an overall Risk Heat Map (catering for inherent and residual risks) around the afore-mentioned risks. The project has involved workshops that helped to raise awareness of and prioritise key risks deemed to be relevant to the Bank, while assessing their likelihood of occurrence and potential impacts on its activities as well as ascertaining and reviewing specific controls that need to be endorsed accordingly.

MCB Ltd

- To ensure that it could continue to deliver on its strategic objectives, while abiding by advocated rules and standards, the Bank strengthened its overall risk management set-up, while reinforcing relevant policies and processes. During the period under review, key focus was laid on boosting the Bank's Compliance framework and processes after making allowance for evolving local and international stipulations, codes and norms, alongside bolstering applicable tools and instruments in order to tackle risks linked to Anti-Money Laundering/Fraud Prevention and Combating the Financing of Terrorism. In the same vein, given its growing importance and complexity, the Compliance function – which formerly sat within the Permanent Control function – has been reorganised as a stand-alone SBU. In fact, to foster alignment with its strategic orientations and advocated practices, the Bank conducted operational realignment initiatives to bolster its risk oversight. The Permanent Control function has been integrated within the Risk SBU. This is in line with the requirement from the Bank of Mauritius that the Risk SBU should have oversight on all risk areas across the Bank. Consequently, while it continues to build up capabilities to put in place its new operating model, the Risk SBU is being reorganised under four clusters: (i) Risk Management (comprising Credit Risk, Country Risk, Credit Modelling and Market Risk); (ii) Credit Management; (iii) Permanent Supervision, Operational and Information Risk; and (iv) Special Assets and Recovery.

- While maintaining its market vigilance and adapting its relevant risk management mechanisms to the changing operating environment, the Bank continued to ensure that business deals remain properly selected, structured, ring-fenced and reviewed. As an increasingly prominent focus area in view of the digitalisation of its processes, the Bank has geared up its capabilities and frameworks so as to enhance its information security and increase its resilience in case of potential cybersecurity breach. In the same vein, a review of applicable processes was undertaken to cater for the secure and smooth execution of Work From Home practices amongst employees making use of online devices and platforms for undertaking their activities.

- Reflecting its commitment to pursue its regional expansion strategy amidst reinforced risk oversight, the Bank is in the process of setting up of a dedicated Country Risk function within the Risk SBU. As its core mandate, the function will provide an appropriate and consistent set-up for the identification, assessment, monitoring, management and reporting of country risk faced by the Bank across its activities. It will oversee the governance for the Bank's Country Risk Management Framework, including the setting and monitoring of Country Risk Appetite and Country Limits, and provide advice to the Chief Risk Officer and the Country Risk Committee. Alongside closely collaborating with internal stakeholders and the Bank's Representative Offices, it will capitalise on a network of correspondents in the countries under review to obtain regular updates on risk evolutions within each country.

- To underpin the afore-mentioned initiatives, the Bank pursued ongoing moves to bolster its inherent capabilities to further improve its risk management and compliance set-up. It strengthened its staff expertise and tapped into enhanced synergies amongst relevant functions of the Bank, with the Risk SBU assisting business units to reinforce their respective risk oversight. It upgraded its information systems, notably towards facilitating the online recording, reporting and monitoring of its business activities.

Risk and capital management report

Foreign banking entities

- In light of the changing operating context and regulatory scrutiny, our foreign banking subsidiaries have further strengthened their ability to identify, mitigate and manage risks faced. While endeavours to strengthen the management of credit risks across portfolios have been sustained, KYC remediation efforts have progressed satisfactorily across entities, with a risk-based approach adopted to ensure that records of active customers are regularly updated. The cyber security environment was bolstered through the implementation of new infrastructure, tools and processes, complemented with comprehensive penetration and vulnerability testing carried out by external consultants. Entities pursued the testing of their business continuity management, disaster recovery and relocation processes, to ensure that policies, procedures and processes are effective. As a key ongoing initiative, an Overseas Subsidiary Information Risk Management, Operational Risk and Compliance Committee (IORCC) is being put into place to shore up the reporting, evaluation, oversight and monitoring of risk matters across foreign entities. In this respect, whereas the spread of the COVID-19 pandemic and the lockdown of countries hampered the conduct of earmarked proceedings so far, MCB Seychelles managed to hold a first meeting of its own IORCC in February last, which was attended by its representatives as well as those of MCB Investment Holding and dedicated functions of MCB Ltd, notably at the level of Risk and Compliance SBUs.

- MCB Seychelles further improved its underlying risk monitoring framework and control processes. Efforts have been made to optimise the capacity and utilisation of its Risk-Based Due Diligence tool. The latter, which has become fully functional, allows for the automation of customer risk ratings and the update thereof in view of any changes in periodic scores assigned as per parameters set by the tool. In addition to fostering the adoption of compliance certificates by business units to further embed the permanent control framework, the entity undertook specific policy and procedure reviews with respect to information security, compliance and human resource, in tune with obligations triggered by the evolving regulatory landscape and so as to ensure consistency with Group standards. On the compliance side, in line with endeavours to adopt a risk-based approach to customer and transaction monitoring, due focus has, also, been laid on promoting the adoption of relevant standards and mechanisms, notably relating to risk appetite setting and sanctioning policies. In addition, the entity has made headway in upgrading and documenting its Internal Capital Adequacy Assessment Process (ICAAP) in order to underpin informed assessments of relevant performance metrics and provide comfort to the Central Bank with regard to the appropriateness of capital resources being mobilised, in alignment with Basel standards, regulatory stipulations and the external operating landscape.

- MCB Maldives implemented a Risk-Based Due Diligence module in its Financial Crime Risk Management system, thus leading to a refined evaluation and an increased automation of the customer risk rating process for both the retail and corporate segments as well as a more accurate risk assessment of customer transactions. The ratings, which are available for viewing on the Core Banking System, are dynamically reviewed. Moreover, the entity established an improved credit rating methodology for loan portfolio screening. Also, an onsite audit of its Compliance function was conducted by the Compliance SBU of MCB Ltd in line with the concept of Group Shared Services. Moreover, the entity continued to upgrade and formulate new policies in respect of information security and compliance (notably relating to rules and processes to prevent fraud, bribery and corruption and foster business continuity) towards nurturing alignment with MCB Group standards, industry best practice and local regulations.

- MCB Madagascar has shored up its Compliance and AML/CFT frameworks, supported by dedicated training programmes for staff and the reinforcement of relevant policies, essentially relating to customer on-boarding, anti-bribery and corruption. In addition to strengthening its credit risk team with additional recruitments and bolstering the monitoring of loan portfolios, the entity undertook an overall review exercise for all user access rights on applications in use to optimise and reinforce the security and confidentiality of customers' information. Of note also, the entity has reviewed and upgraded specific policies and procedures in place – notably in relation to information security and compliance – so as to make allowance for the changing operating environment and its growth ambitions, alongside comprehensively implementing its Business Continuity Management framework.

Other entities

- Following the publication of the Anti-Money Laundering and Countering the Financing of Terrorism Handbook 2020 issued by the Financial Services Commission, MCBCM has strengthened its risk management and compliance framework by appointing a Compliance Officer to all licensed entities within MCBCM. The Compliance Officer has a significant role to play, being responsible for the implementation and ongoing compliance of MCBCM with internal controls and procedures in accordance with applicable anti-money laundering laws and regulations, and for reporting to both senior management and the Board of MCBCM. During the course of the financial year, MCBCM appointed Ernst & Young Ltd (EY) to facilitate a risk identification and assessment exercise. EY submitted their report in June 2020 and their findings are being applied to further strengthen, where applicable, the risk management framework of MCBCM.

- International Card Processing Services Ltd (ICPS) continued to reinforce its risk management framework, under the guidance of its Audit and Risk Committee. During the past three years, ICPS adopted an Enterprise Risk Management approach. In this context, business risks workshops have been regularly carried out to enable the organisation manage the potential impact of risks permeating across all processes, activities, stakeholders as well as products and services. Anchored on an appropriate culture, Enterprise Risk Management is a critical component of the entity's plan-based strategy that aims to identify, assess and prepare for any risk that may interfere with its business development goals and objectives, in line with the changing business environment.

See more in the forthcoming sections of the Risk and Capital Management Report

Risk and capital management report

Looking ahead: Endeavours to anchor sound and stable operations and business growth

General targets and intents

- Uphold the soundness of our key financial metrics amidst a challenging operating context, backed by (i) the strengthening of our risk management and compliance framework, aided by continuous upgrades to relevant policies, practices and processes; and (ii) further entrenchment of an adequate risk culture across the organisation to embrace proper attitudes and behaviours

- Ensure that our business development endeavours across segments and geographies materialise in a disciplined manner on the back of effective risk oversight; judiciously and speedily identify, appraise and manage emerging risks to which Group entities are exposed, notably those linked to adoption of technological and digital devices as well as environmental degradation

- Further reinforce the inherent capabilities and operating models of Group entities, notably through the (i) continued upskilling of staff across risk functions and increased automation of processes; (ii) increased synergies amongst risk functions and business lines; and (iii) establishment of dedicated structures and platforms to diligently accompany growth endeavours

- Increase collaboration between Group entities, notably for information sharing purposes and fostering the smooth replication of risk management practices wherever required, alongside ensuring the organisation-wide alignment of policies and processes

Key moves to deal with the ramifications of COVID-19

- Exercise a close scrutiny of the duration and depth of the economic crisis impacting our clients across markets and entities, the more so given that it remains difficult to predict when turbulences linked to the operating context will stabilise and a ‘new normal’ will emerge

- Foster the sustained engagement of dedicated risk functions with front-line teams to (i) undertake a close and systematic monitoring and management of risks faced by clients; (ii) nurture an in-depth understanding of client needs; and (iii) assess their level of comfort with respect to solutions being proposed to help clients cope with the crisis

- Take further measures to preserve the Group’s credit quality by (i) exercising a tight monitoring of our portfolios, particularly with respect to clients to whom we have not granted repayment holidays; and (ii) updating our stress testing capabilities, alongside deriving new stress scenarios to take into consideration the high volatility and severity of the current economic crisis

- Maintain close discussions and interactions with the authorities as well as the Mauritius Investment Corporation and the banking sector generally to find the best possible ways to confront the economic downturn

- Maintain a prudential approach in determining our Expected Credit Losses across entities and the Group so as to keep building a ‘buffer’ over the coming quarters of FY 2020/21 if deemed necessary, so that we can stay in a strong position to absorb the impact of potential shocks

Financial soundness

Capitalisation

Philosophy

While ensuring that applicable regulatory requirements are met at all times, the capital management approach of the Group is to ensure that its subsidiaries are adequately capitalised to help achieve sound and sustained business growth and uphold adequate buffers to confront any untoward circumstances, alongside protecting and maintaining the trust of shareholders and fund providers.

Towards this end, the Group favours internal capital generation through retained earnings while being well positioned to tap into capital markets as and when required, on the basis of its status as the most liquid stock on the local stock exchange. Moreover, it seeks to maintain appropriate discipline over the nature and extent of its market development initiatives and lays due emphasis on optimising the allocation of capital across businesses.

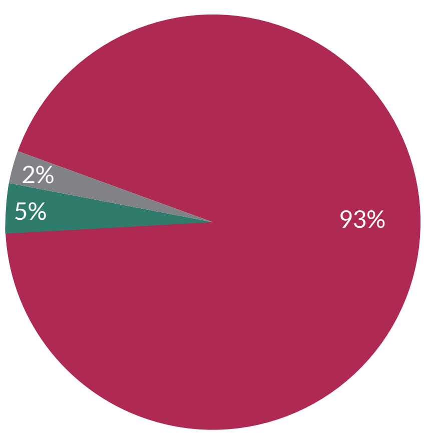
Performance

Over the period under review, the Group has, on a consolidated basis, maintained comfortable capitalisation levels as gauged by the BIS and Tier 1 ratios rising to 18.6% and 17.2% respectively as at 30 June 2020. The increase in the ratios was driven by a notable widening of our capital base on the back of higher retained earnings and the successful conversion of more than 75% of our Subordinated Debt into Convertible Preference Shares amounting to Rs 3.4 billion, which qualify as Additional Tier 1 capital.

The predominant contribution to our capitalisation performance emanated from our banking entities, for which the maintenance of adequate capital levels is a key priority by virtue of their business operations and regulatory responsibilities. Risk-weighted assets of the Group stood at Rs 369 billion as at 30 June 2020, out of which 83% was accounted for by MCB Ltd and some 7% by the foreign banking subsidiaries. The Group's overseas associates, namely Société Générale Moçambique and Réunion-based BFCOI – whose investments have been risk-weighted at 250% in line with applicable Basel III rules – represented 3% of overall risk-weighted assets.

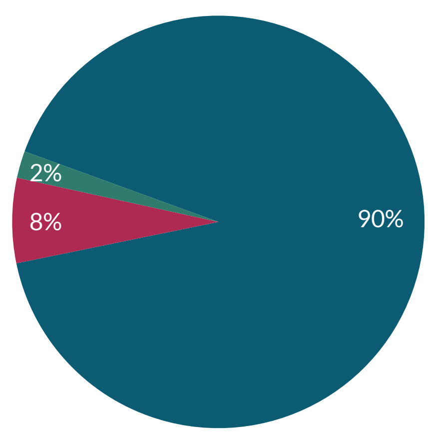
Distribution of risk-weighted assets as at 30 June 2020

By cluster



Banking · Non-banking financial · Other investments

By type of risk



Credit risk · Operational risk · Market risk

Risk and capital management report

MCB Group	Jun 19	Jun 20
Capital base	**Rs m**	**Rs m**
Ordinary shares (paid-up) capital	2,608	2,719
Retained earnings	47,972	52,502
Accumulated other comprehensive income and other disclosed reserves	6,076	7,495
Common Equity Tier 1 capital before regulatory adjustments	**56,656**	**62,716**
Regulatory adjustments		
Goodwill and intangible asstes	(1,520)	(1,735)
Deferred tax assets	(261)	(924)
Common Equity Tier 1 capital (CET1)	**54,876**	**60,057**
Additional Tier 1 capital (AT1)	-	3,396
Tier 1 capital (T1 = CET1 + AT1)	**54,876**	**63,453**
Capital instruments	2,229	637
Provisions or loan-loss reserves	3,144	4,169
45% of surplus arising from revaluation of land and buildings	953	1,060
Tier 2 capital before regulatory adjustments	**6,326**	**5,866**
Regulatory adjustments	**(722)**	**(802)**
Tier 2 capital (T2)	**5,604**	**5,064**
Total capital (T1 + T2)	**60,480**	**68,517**

Risk-weighted assets	Rs m	Rs m
Weighted amount of on-balance sheet assets	283,925	303,086
Weighted amount of off-balance sheet exposures	31,439	30,397
Weighted risk assets for operational risk	26,072	29,337
Aggregate net open foreign exchange position	3,012	5,954
Capital charge for trading book position exceeding 5% or more of its total assets	4,259	-
Total risk-weighted assets	**348,707**	**368,775**

Capital adequacy ratios (%)	Jun 19	Jun 20
BIS risk adjusted ratio	17.3	18.6
of which Tier 1	*15.7*	*17.2*

Note: Figures may not add up to totals due to rounding

Asset quality

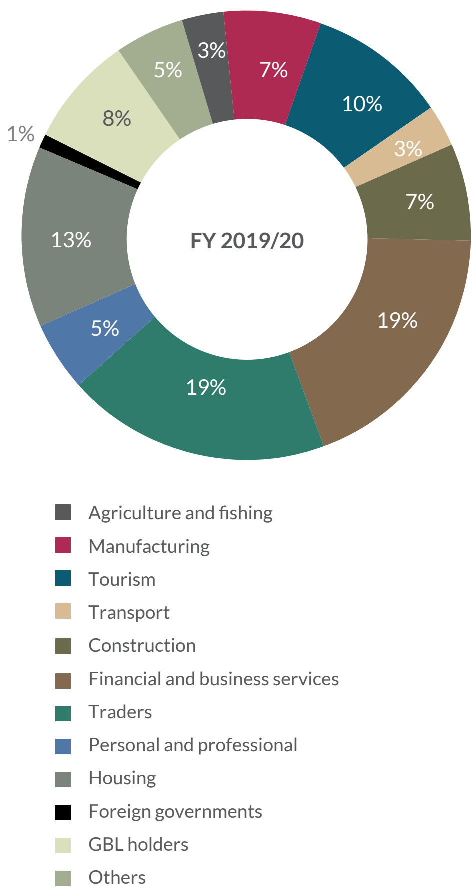
Philosophy

Backed by continued market vigilance as well as the careful formulation and diversification of its strategic orientations, the Group is committed to preserving the soundness of its exposures. Emphasis is laid on healthy loan portfolio through strong credit discipline, prudent market development approach and sensible strategy execution, cautious loan origination and disbursements, and active efforts for debt collection and recovery.

Performance

In light of the repercussions of the pandemic on economic and market environments across its presence countries, the Group managed to uphold the general quality of its portfolio on the back of its disciplined market endeavours and dedicated measures taken to face up to the tough conditions witnessed across economic sectors. In fact, the gross NPL ratio of the Group increased slightly by some 10 basis points to attain 4.2% whereas, in net terms, the ratio remained at 2.9% as at 30 June 2020. While the metrics marginally deteriorated at the level of MCB Seychelles and MCB Madagascar, the gross NPL ratio of MCB Ltd remained stable at 3.8%, with the corresponding ratio in net terms declining to 2.6%. The Group's specific coverage ratio increased from 30.3% to 32.9%, with the remaining portion being adequately covered by collateral, suitably discounted to reflect current market conditions and expected recovery time.

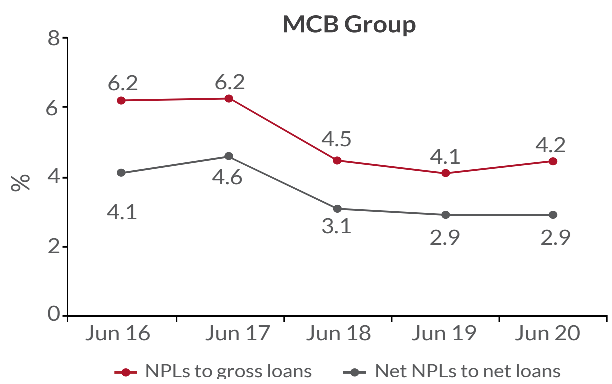
Sectorwise distribution and quality of exposures

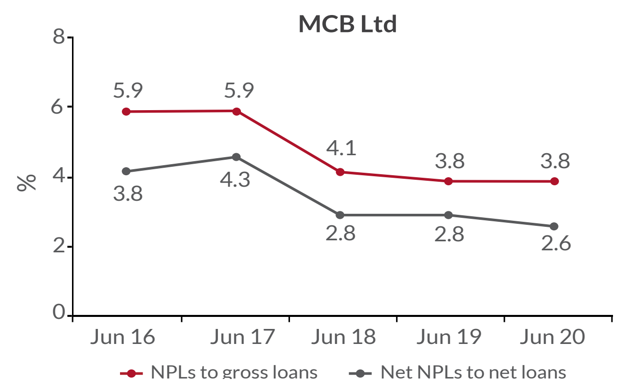


June 2020	Non-performing loans (NPLs)		Allowances for credit impairment	
MCB Group	**Rs m**	***% of loans***	**Expected Credit Loss**	**Incurred Loss**
Loans to customers	**11,632**	**4.6**	**5,401**	**5,780**
Agriculture and fishing	1,228	*18.6*	281	925
Manufacturing	647	*3.8*	349	334
of which EPZ	*179*	*6.0*	*142*	*121*
Tourism	608	*2.4*	1,846	213
Transport	1,497	*18.2*	173	1,635
Construction *(including property development)*	1,466	*7.9*	267	550
Financial and business services	1,279	*2.6*	423	219
Traders	2,678	*5.7*	526	1,024
Personal and professional	1,883	*4.2*	497	706
of which credit cards	*29*	*3.6*	*24*	*20*
of which housing	*1,059*	*3.3*	*100*	*298*
Global Business Licence holders	114	*0.6*	740	63
Others	234	*1.6*	299	109
Corporate notes	**-**	**-**	**366**	**-**
Investments fair valued through other comprehensive income	**90**	***100.0***	**-**	**10**
Loans to banks	**-**	**-**	**10**	**12**
Total	**11,722**	***4.2***	**5,777**	**5,801**

Notes:
(i) For the computation of asset quality ratios, total exposure include corporate notes and exclude interest in suspense on loans
(ii) Figures may not add up to totals due to rounding

Credit quality





Funding and liquidity

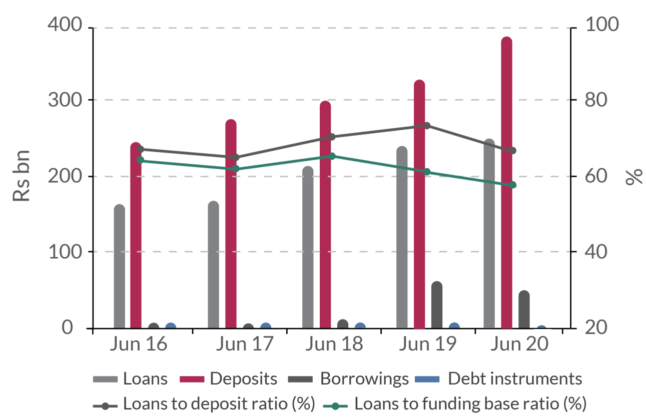
Philosophy

The Group seeks to keep sound funding and liquidity positions in support of its business development ambitions. While accessing wholesale markets as and when required, the banking entities of the Group maintain cost-efficient, diversified and stable sources of funding which predominantly comprise customer deposits. Furthermore, an appropriate level of liquid assets is kept to ensure that obligations can be met within a reasonable time-frame.

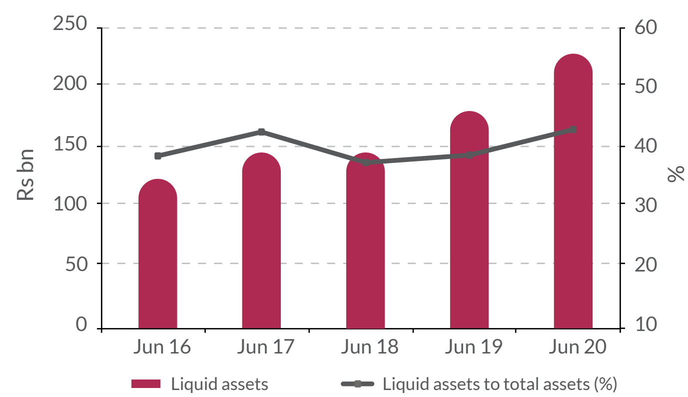
Performance

During the year under review, the Group continued to be exposed to relatively high local-currency liquidity conditions across its presence countries. Against this backdrop and after making allowance for proactive steps taken to maintain comfortable buffers in the wake of the difficult economic environment, the Group posted strong funding and liquidity positions in FY 2019/20, as demonstrated below. We have been active across markets to uphold sufficient funding resources to help our customers ride through the downturn and support our growth ambitions. Notably, reflecting endeavours to hold adequate FCY resources in support of its regional diversification initiatives, MCB Ltd has, during and after the local lockdown period, built up and maintained a good funding buffer in excess of USD 1 billion in the form of placements from banks, trade loans, repos and credit and swap lines with the Bank of Mauritius.

Loan and funding base



Liquid assets



Note: Liquid assets comprise cash, balances with BoM, placements, T-Bills, Government securities and bonds

MCB Ltd: Key liquidity ratios

In spite of pressures emanating from the challenging landscape, MCB Ltd maintained strong liquidity ratios in both MUR and FCY during FY 2019/20, thanks to its solid deposit base and its foreign lines of credit, which enabled the Bank to duly accompany its customers.

Liquidity Coverage Ratio (LCR)

As at 30 June 2020, the Bank operated comfortably above the stipulated LCR requirements. It reported a consolidated LCR of 503%, which is equivalent to a surplus of around Rs 110 billion over stressed total net cash outflows. At a currency level, the Bank also exceeded the mandatory LCR limits relating to rupee and significant foreign currencies. It posted a comfortable liquidity position in US dollar terms with the US dollar LCR standing at 190% as at 30 June 2020. It can be noted that HQLA eligible for the purpose of calculating the LCR as per set rules consists of cash or assets that can be converted into cash at little or no loss of value in markets. In this light, MCB Ltd maintained suitable levels of investment in sovereign, high-quality corporate and cash liquid assets.

Net Stable Funding Ratio (NSFR)

Though not yet a regulatory standard in Mauritius, MCB Ltd regularly monitors its performance in terms of NSFR, which requires an amount of available stable funding to be maintained in relation to required stable funding. As at 30 June 2020, MCB Ltd reported an NSFR of 124%, which exceeds the minimum level recommended by Basel III, itself set to at least 100% on an ongoing basis.

Risk and capital management report

Our risk management strategy and framework

Main risks faced

To achieve its strategic objectives, the Group adopts a consistent and integrated approach to risk identification, mitigation and management. Material risks that could impact our business model, performance, solvency and liquidity are continuously monitored.

Financial principal risks	General definitions	Key objectives
	Credit risk	
	The risk of financial loss should borrowers or counterparties fail to fulfill their financial or contractual obligations as and when they fall due; Credit risk includes counterparty risk, settlement risk and concentration risk, with the latter referring to the risk arising from an excessive build-up of exposures to a counterparty, industry, market or product, amongst others	(i) To foster sound credit risk management principles; (ii) To uphold a well-diversified credit portfolio consistent with the risk profiles defined in the risk appetite as well as the broad characteristics set out in target market criteria; (iii) To achieve the targeted risk-return profile of the portfolio; (iv) To promote, monitor and manage the quality of the credit portfolio
	Country risk	
	The risk of loss arising when political or economic conditions or events in a particular country inhibit the ability of counterparties in that country to meet their financial obligations	To provide for a comprehensive framework and adequate control processes for assessing country risk, determining risk tolerance and allocating exposures across geographies
	Market risk	
	The risk of loss caused by movements in market price parameters (including interest rates, exchange rates as well as stock and commodity prices among others)	To monitor, report and control the overall market risk exposures, including market-contingent risks such as counterparty credit risk as well as profit and loss risks arising from market risk activities
	Interest rate risk	
	The risk arising from changes in interest rates or in the prices of interest rate related securities and derivatives, insofar as they tend to impact the Group's earnings or economic value of equity	To manage the impact of interest rate changes on the overall risk profile both from an earnings and economic value perspective
	Foreign exchange risk	
	The risk of losses on account of adverse foreign currency movements	To detect and manage impact of currency fluctuations, alongside properly managing the Group's net open position
	Funding and liquidity risk	
	Funding risk: The risk linked to a relative lack of availability of funds or the risk that a maturing liability or class of liabilities may not be able to be refinanced (without additional relative cost) over any given period of time *Liquidity risk:* The risk arising from insufficient realisable financial assets to meet the financial commitment as and when they fall due	To maintain adequate liquidity levels and have access to diversified and stable funding sources to rapidly and effectively respond to the demands of our clients and foster our business development
	Equity investment risk	
	The risk of gain or loss arising from adverse changes in the fair value of an investment in a company, fund or any financial instrument, whether listed or unlisted	To protect the Group's value by aligning timing and size of investment to applicable risk appetite

Non-financial principal risks

General definitions	Key objectives
Operational risk	
The risk of loss resulting from human factors, inadequate or failed internal processes and systems or external events. It includes fraud and criminal activity, project risk, business continuity, information and IT risk, etc	To identify, mitigate and manage the Group's operational risks in line with acceptable tolerance limits and with a strategic intent to provide our customers with seamless services and foster an adequate risk culture within the organisation
Information risk	
The risk of accidental or intentional unauthorised use, modification, disclosure or destruction of information resources which would compromise the confidentiality, integrity or availability of information	To maintain the confidentiality, integrity, security and availability of information assets stored, processed and transmitted throughout the organisation
Cyber risk	
The risk of breach of information technology security arising from the malicious or unauthorised use of information systems that may have an adverse effect on the confidentiality, availability, or integrity of information or information systems	To handle and mitigate cyber risks and establish a strong IT platform to aid the delivery of the organisation's strategic objectives, while protecting confidentiality and preventing misuse of systems and business disruptions as well as strenghtening the effectiveness and adequacy of human firewalls
Regulatory and compliance risk	
The risk arising from changes in legislation, regulations and advocated norms on the operation and functioning of the Group. It is the risk of sanction and material financial loss or reputational damage	To comply with all relevant stipulations in force and advocated norms to safeguard the assets of the organisation and shield it from legal and regulatory sanctions and financial / reputation losses
Reputation risk	
The risk arising from the damage to the Group's image caused by negative media coverage, compliance failures, pending litigations or underperformance. Such damage may result in a breakdown of trust, confidence and business relationships, which may impair the Group's ability to retain and generate business	To bolster our brand image and values and ensure that our actions and behaviours are in line with best practice standards
Strategic and business risk	
The risk arising from inappropriate business decisions or strategies in relation to the operating environment. The risk is linked to changes in the business environment, regulatory decisions, client behaviours and technological progress, as well as Group-specific factors such as poor choice of strategy and inflexible cost structures	To set out and deploy our strategic orientations in a judicious and well-thought manner, remain attentive to changes in the operating environment and pay close attention to the current/future exigencies of our customers
Environmental and social risk	
The risk that unforeseen events stemming from changes in our environment and society will result in disruptions in business activities as well as impact our customers and counterparties, while influencing our internal operations	To support decision-making to mitigate and manage environmental and societal impact on our operations so as to evaluate and deploy an effective approach and strategy to deal with such risks, while, in parallel, managing our footprint through environment-friendly and sustainable practices and products

Risk and capital management report

Our business model

Key principles

We consider that, in addition to being a threat, risk can turn out to be a real competitive differentiator if it is managed in a thoughtful way. In line with our business aspirations, we manage risk in an open, transparent and disciplined way, after making due allowance for the exigencies of our stakeholders. Our risk management approach and policies are regularly reviewed and updated to account for changes in the Group's business strategies and the external landscape, notably with regard to legal and regulatory stipulations as well as developments taking place within the economic environment.

Stakeholder engagement

- Our risk policies make allowance for the long-term interests of our customers, regulators and other stakeholders
- While achieving sustained business growth, we help our stakeholders realise their ambitions and prosper

Key elements of our risk management set-up

Operating within the directions set by the Board of the Group, individual entities have their own arrangements to manage risks faced. The following illustration provides an overview of the underlying set-up being generally adopted by entities of the Group, with the scale of structures in place differing as per the nature of each entity's activities.

The Board has the ultimate responsibility to ensure that risks are properly identified, measured, monitored, mitigated and managed	**Board**	As a major objective, the Board sets the organisation's risk appetite that eventually underpins the formulation of strategic business decisions which are cascaded to business lines
The Board has the authority and mandate to delegate duties for risk identification, monitoring and management	**Board committees**	The committees act upon the specific responsibilities and accountabilities delegated to them by the Board
The Bank ensures that risks are managed in line with the set risk appetite, supported by the risk management framework	**Risk appetite**	The agreed risk appetite is considered in key decision-taking processes to foster the soundness of activities
Risk management is underpinned by dedicated teams and resources with clear mandates	**Governance set-up**	Responsibilities are clearly defined for identifying, assessing, measuring, mitigating, monitoring and managing risks faced at different levels
Responsibilities for risk oversight and assurance are effectively segregated	**Three lines of defence**	Dedicated functions cater for risk control and management, alongside overseeing recovery operations
Policies and standards are clearly defined to measure and monitor risks faced	**Risk measurement and monitoring** | **Risk mitigation and management**	Defined processes exist to mitigate observed risks, with actions undertaken based on informed and robust grounds
We aim to embed risk identification and management in our thinking, attitudes and behaviours	**Risk philosophy** | **Risk resources and capabilities**	Our human capital, processes and systems are continuously upgraded for judicious risk management
	Identification of risks	

Risk and capital management report

Governance and oversight

To ensure that key risks faced by its entities are properly identified, measured and monitored, the Group adopts a robust governance framework, backed by the articulation of coherent responsibilities, reporting lines and oversight across the organisation. The risk management framework of the Group provides high-level direction for each entity on how to manage risk in a consistent and interactive manner, underpinned by broad synchronisation in respect of the approach and methodology used. The allocation of responsibilities across the Group is structured to ensure that decisions are taken at the most appropriate levels, in alignment with the mandates of internal stakeholders and the strategic orientations pursued by the organisation. Overall, the governance set-up of the Group seeks to provide the organisation with optimal resources to foster a sound financial performance and stakeholder value creation. At individual entity level, each subsidiary of the Group is endowed with the autonomy and flexibility to determine and apply its own governance frameworks, in alignment with Group-level orientations, its inherent specificities and prevalent market realities.

Board

- In alignment with its business development orientations, the Board of MCB Group Ltd determines the principal strategies in respect of the risk management of the Company and its subsidiaries, while ensuring that all laws, regulations and codes of business practice are adhered to.
- Underpinned by the establishment and enforcement of clear lines of responsibility and accountability throughout the organisation, it ensures that relevant procedures and practices are in place in order to protect the Company's assets and reputation. For the discharge of its duties, the Board is assisted by committees which enable it to properly formulate, review and approve policies on monitoring and managing risk exposures.

Risk Monitoring Committee

- The Risk Monitoring Committee (RMC) advises the Board on risk issues and the monitoring of portfolios against the formulated risk appetite, in particular for the banking subsidiaries. While assigning relevant responsibilities and accountability lines, it ensures that rigorous internal processes and controls are implemented to identify, monitor, measure and report different types of risks.
- The RMC monitors risk portfolios against set limits with respect to, *inter alia*, risk concentration, asset quality, large and foreign country exposures, in compliance with regulations and internal policies.

Other committees

- The Audit Committee caters for the monitoring of internal control processes, while ensuring the preparation of accurate financial reporting and statements in compliance with applicable legal requirements and accounting standards. It also reviews operational and compliance risks and the actions taken to mitigate them.
- The Supervisory and Monitoring Committee continuously oversees the overall management of the Group and is also responsible for the ongoing monitoring of the Group's performance against set objectives.

Read more on the key mandates and focus areas of the Board sub-committees of MCB Group Ltd in the 'Corporate Governance Report' on pages 117 to 122

Our risk appetite framework

A key objective of the Group's risk management strategy is to determine the level and type of risk that the organisation is able and willing to take when executing its business strategies. The risk appetite is established by means of a complementary set of statements that are determined at Group level and cascaded throughout the entities and their business segments. Qualitative statements seek to make sure that the desired risk culture is adhered to across entities. Quantitative statements seek to shield the organisation from potential adverse events in the operating environment. While ensuring congruence with directions established at Group level as well as relevant mandatory requirements, Group entities set their own risk appetite, control and tolerance levels and mechanisms, which they continuously monitor and, if necessary, update to shape up the optimal level of risk that they are willing to take for the sound execution of their short and medium term business strategies.

As an example, key considerations that guide the Group's main subsidiary, i.e. MCB Ltd, for the identification and quantification of risks are as follows:

Framework	• The Bank articulates and monitors its risk appetite on the back of its solid framework and processes. They provide an informed guidance for the management and monitoring of its risk profile in relation to the defined risk appetite, alongside promoting the sound execution of our growth agenda. • The purpose of setting risk appetite is not necessarily to limit risk-taking, but to align the Bank's risk profile and strategic orientations. Its risk appetite is regularly updated to reflect stakeholder aspirations and the context.
Key underpinnings	• MCB *inter alia* defines its risk appetite for (i) credit risk in terms of allocation of range targets for domestic and international credit exposures, exposures by sectors as well as risk profiles and asset quality of portfolios; and (ii) market risk in terms of the splits between domestic and international markets, foreign currency and interest rate exposures, exposure allocation for position-taking and target splits in terms of exposure maturities. • For proper risk identification and quantification, the Bank caters for: (i) continuous monitoring of risk targets; (ii) quarterly risk reporting to RMC; (iii) preparation of risk reports for capital management; and (iv) the application of a stress-testing framework. The size of the internal risk limits is a function of regulatory requirements and the risk appetite set by the Bank, after making allowance for the relevant economic and market environments. In its day-to-day business, the Bank makes use of internally-generated and externally-sourced rating tools for the purpose of risk identification, quantification and monitoring.

Key tenets of MCB Ltd's risk management strategy

Risk capacity

MCB determines the maximum level of risk that it can assume given its current level of resources, relevant regulatory dispositions and stakeholder requirements, to the extent that these dynamics tend to influence its ability to take risk.

Risk appetite

The Bank ensures that its activities are undertaken within the precinct of its risk appetite. The latter is subject to constraints, such as the need to *inter alia* uphold the Bank's financial soundness, foster sound and sustainable revenue growth and preserve its investment-grade credit rating.

Risk tolerance

The Bank establishes the maximum level of risk that it is willing to tolerate for a particular risk category or specific initiative, while ensuring that it achieves its business strategies and operates within its broader-level risk appetite.

Risk profile

Expressed in terms of quantitative indicators and qualitative interpretations, its risk profile refers to its current net risk exposures for risk categories across customer segments and geographies. Amidst an evolving operating environment, the Bank regularly monitors its risk profile, thereby helping to prevent the level of risk from going beyond the set risk appetite.

Risk control

To maintain the size of its risk profile within its risk appetite, risk control tools and mechanisms are leveraged. Its control activities are notably underpinned by target market criteria and risk limits which place practical constraints on its activities.

Limit structure of MCB Ltd

Regulatory

- Capital adequacy
- Credit concentration
- Macroprudential limits
- Related party lending
- Cash reserve ratio
- Liquidity Coverage Ratio
- Open FX position

Internal limits and desired risk profile

- Country limit
- Bank limit
- Sectorial concentration
- Portfolio risk profile
- Product limits
- Counterparty credit risk limit
Valuation limit
Daily settlement limit

Rating tools used by MCB Ltd

Internally-developed model	Country	**Country rating model** The rating monitors macroeconomic developments, social unrest, nationalisation and expropriation of assets, Government repudiation of external indebtedness, foreign exchange controls and currency movements amongst others
	Banks	**Bank scoring model** The credit worthiness is assessed by assigning a score based on the bank's financial strength, the probability of receiving affiliate and/or Government support in case of financial stress as well as the sovereign risk of the country in which the institution operates
	Retail clients	**Credit scoring model** The rating assesses the credit standing, source of repayment and debt service ability of the borrower
	Corporate clients	**Customer Rating software** It evaluates the counterparty's financial position and uses MCB's historical default experience to generate ratings and Probability of Defaults
External rating agencies	Country and banks	**International ratings** Moody's Investors Service, Fitch Ratings, Standard & Poor's and others as deemed appropriate
	Corporate clients	**CARE Ratings** Financial obligations subscribed by the Bank in favour of domestic corporate customers can be rated by CARE Ratings, with capital relief being applicable on investment-grade ratings

Risk and capital management report

Overview of risk management by cluster

General approach

MCB Group Ltd

- The entities of the Group adhere to the overall risk management principles and frameworks validated by the Board of MCB Group Ltd. These entities are monitored in this respect by the Risk Monitoring Committee of the latter.

At entity level

The Board

- Functioning in alignment with the Group's objectives and targets, the Board of each entity supervises its overall risk management, alongside overseeing the establishment of relevant policies, controls, standards, practices and processes, in alignment with the inherent realities of the business. It also acts as the focal point of contact for shaping the relationship with MCB Group Ltd.
- The Board is responsible for strategy formulation in respect of risk-taking, risk appetite and policy setting. It ensures that its business strategies are clearly linked to its risk appetite and tolerance level. The aim is to ensure that the organisation manages its capital resources at an optimal level in support of growth-related objectives.
- In discharging its duties, the Board demonstrates, to the satisfaction of regulatory authorities and other stakeholders, that clear structure of policy and control systems emanating directly from it is adopted to identify and manage the risk inherent in activities.

Delegation of duties

- For each entity, risk governance is executed through the delegation of authority and responsibilities from its Board to dedicated committees and/or the Management. Control processes and reporting lines have been put into place to foster the coherent and sound segregation of duties with regard to risk-taking, processing and control.

Control processes

- The types of risk infrastructure and control processes that are adopted by each entity is a function of the nature, size and complexity of the risk involved.
- The approach and practices embraced by entities to fulfill their risk management obligations are shaped up by the following factors: (i) advocated corporate governance and risk management principles; (ii) the risk-return profiles of markets in which they are involved; (iii) the opportunities and challenges characterising the economic environment; and (iv) relevant legal and regulatory requirements as well as local and international codes and standards impacting the industries and countries in which businesses are carried out.

Intra-Group initiatives

- Entities of the Group leverage the core competences and synergies available throughout the organisation in line with the concept of Group Shared Services. Specific business units of MCB Ltd are engaged in the provision of intra-Group services to the foreign banking subsidiaries as well as the non-banking entities of the Group, backed by the elaboration of clear guidelines and mandates. As per the modalities set out in Service Level Agreements, the business units operating under the aegis of the Internal Audit SBU of the Bank – namely Internal Audit and Anti-Money Laundering and Fraud Prevention – provide technical and advisory assistance in support of the operation and functioning of the Group's local and foreign subsidiaries as per their respective areas of competence. Dedicated support also emanates from the Bank's Risk and Compliance SBUs (notably with regard to Business Continuity Management, cyber-security, information risk management and Permanent Control), in line with activities falling under their purview.
- MCB Investment Holding Ltd seeks to foster more focused and integrated stewardship with regard to the operations and performance of the Group's foreign banking subsidiaries. Its Finance & Risk team supports the conduct of risk management activities, with the Risk SBU of MCB Ltd being involved wherever appropriate. The team engages in risk reporting to the Risk Monitoring Committee of the respective foreign banking subsidiaries as well as that of MCB Group Ltd. It also leads or assists foreign subsidiaries in the development and implementation of risk policies and other risk-related matters. It assists overseas banking subsidiaries as regards credit risk management, notably by reviewing credit files with exposure amounts exceeding a specific threshold, helping to structure or restructure complex credit files and monitoring out-of-order customer files. Moreover, the Operations team provides assistance in terms of project management, alongside offering guidance in respect of the execution and monitoring of risk- and compliance-related initiatives. It also contributes to and monitors the implementation of internal and external audit recommendations.

Risk and capital management report

Banking cluster

Governance

MCB Ltd

Board of MCB Ltd

- The Board of MCB Ltd has the ultimate responsibility for ensuring adequate risk management across the Bank, in line with good corporate governance principles. It provides clear guidance for the setting out and regular review of applicable strategic thrusts, processes and policies for risk management.

- As a key focus area, the Board is responsible to validate the Bank's risk appetite towards achieving its objectives. It delegates authority to Board committees, which formulate the specific responsibilities and required policies for effective risk management.

Board committees

Risk Monitoring Committee (RMC)

- It is the primary board committee overseeing risk matters. It assists the Board in setting up risk strategies as well as assessing and monitoring MCB's risk management process. It recommends to the Board, for approval, of the risk appetite in terms of credit risk and market risk, Asset Liability Management risk as well as for review of risk appetites and tolerances as appropriate. It analyses risk portfolios against the risk appetite, while reviewing and exercising oversight over capital management.

- The RMC is entrusted with the authority of determining the Bank's overall international capital allocation and exposure limits while monitoring country exposures against set limits at least quarterly and on an ad hoc basis when required. It approves country risk policies and proposed amendments and reviews the country risk framework and risk appetite parameters. Five out of the six members of the RMC are non-executive directors, thus strengthening the Bank's independent oversight and control functions.

Other committees

- The Supervisory and Monitoring Committee sets the overall direction for the strategic development of the Bank. It monitors the Bank's performance against such strategy.

- The Audit Committee monitors internal control processes and ensures compliance with relevant laws and regulations. It sets operational risk tolerance levels and ensures the regular review of business continuity plans.

Adherence to the three lines of defence approach

1st line of defence	Risk ownership

- The first line owns risks emanating from deployed strategic activities. It is called upon to adopt adequate processes and mechanisms to suitably manage risks faced and escalate knowledge of risks identified in the course of activities for appropriate mitigating actions.
- Employees engaged in client-facing divisions and support functions as well as business line managers have the first-level responsibility for day-to-day risk management in the interest of the Bank.

2nd line of defence	Risk control and compliance

- The second line is mandated to establish the limits, rules and constraints under which the first line activities shall be performed.
- The Risk SBU is responsible to provide independent risk control. The Chief Risk Officer (CRO) has direct oversight on all risk areas across the Bank, while relevant Managers of the SBU establish methodologies and activities for risk measurement and regularly monitor and report risk exposures and profiles. Alongside having an administrative reporting line to the Chief Executive Officer (CEO), the CRO reports to the Audit Committee on risk matters relating to Permanent Supervision, Operational and Information Risk and reports to the Risk Monitoring Committee on matters relating to monitoring and management of other risk areas.
- The Compliance SBU, which is henceforth reorganised as a standalone Strategic Business Unit has a direct reporting line to the Audit Committee and administratively reports to the CEO. This reporting structure confers the required independence to the Head of Compliance to discharge responsibilities to ensure compliance with applicable laws, regulations, codes of conduct and standards of good practice.
- Independent teams oversee the legal and physical security functions. The Head of the Legal SBU acts as the Money Laundering Reporting Officer (MLRO) to ensure strict independence. The Physical Security BU reports to the Chief Operating Officer's office.

3rd line of defence	Risk assurance

- The Internal Audit SBU evaluates and provides independent assurance on the effectiveness of the risk governance, the control environment and risk management processes and mechanisms, in tune with business strategies and the evolving external environment.
- The function provides independent assurance that the control objectives are achieved by the first and second lines of defence in line with the set risk appetite. It has an administrative reporting line to the Chief Executive Officer and is accountable to the Audit Committee.
- While reporting to the Head of Internal Audit, the Anti-Money Laundering/Fraud Prevention (AML/FP) BU promotes staff awareness on fraud and money laundering risks. It conducts enquiries with respect to suspected fraud cases perpetrated internally or by outsiders.

Risk and capital management report

In addition to the Board committees and the adoption of the three lines of defence approach, the risk management framework also allows for dedicated executive committees of the Bank to assist in the oversight and monitoring of risk areas within the business.

Executive committees

Financial principal risks	
Credit risk	
Executive Credit Committees (ECC)	• The ECC (A), which comprises, amongst others, the Chief Executive and Deputy Chief Executive, sanctions/declines credit applications where customer group total commitment exceeds Rs 150 million • The ECC (B) sanctions/declines credit applications with total client commitment of up to Rs 150 million
Credit Committee (CC)	• The CC sanctions/declines credit applications where customer group total commitment is up to Rs 50 million for retail clients and Rs 60 million for corporate clients
Country Risk Committee (CoRC)	• The CoRC, which is chaired by the Chief Executive and comprises the Deputy Chief Executive and Chief Risk Officer as members, is responsible for setting individual country limits within the validated risk parameters as well as reporting any excesses observed to the RMC

Market risk	
Asset and Liability Committee (ALCO)	• The purpose of the ALCO is to oversee the asset/liability position, market risks and overall balance sheet management of the Bank. The ALCO ensures that the overall asset/liability position as well as the resulting market, liquidity and funding risks that the Bank is exposed to are managed within the relevant limits and targets set by its Market Risk Policy, alongside being aligned with guidelines laid down by the Bank of Mauritius, notably stipulations relating to capital adequacy, liquidity coverage and funding stability • The ALCO sets and reviews all trading book limits and banking book targets, in alignment with the diversification and growth of the Bank's balance sheet, whether it is from a domestic, foreign currency or consolidated perspective • The committee, which comprises members of the Bank's Leadership Team, is chaired by the Deputy Chief Executive, with targeted monthly meetings or, as deemed necessary, ad-hoc and special meetings held

Non-financial principal risks	
Information and Operational Risk Committee (IORC)	• The monitoring of the entire operational cycle is entrusted to the IORC, chaired by the Chief Executive. The IORC acts as the focal point and coordinating committee to ensure that management of information and operational risks is in line with the relevant policies, guidelines and procedures of the Bank. Significant risks observed are escalated to the IORC and then, if warranted, to the Audit Committee
Compliance, Anti-Money Laundering and Legal Committee (CALC)	• The CALC is mandated to review and monitor the compliance, anti-money laundering and legal framework of the Bank. The CALC assists Management and the Board through the Audit Committee in fulfilling their oversight responsibilities by reviewing adherence to applicable standards as well as policies/controls to be adopted, based on the identification and assessment of compliance, anti-money laundering and legal risks

Foreign banking subsidiaries

Board and its committees

- The respective Boards exercise their responsibilities in respect of risk management through: (i) the oversight of the risk governance process, including setting risk appetite in line with Group-level orientations; (ii) regular and comprehensive assessment of risks; (iii) the maintenance of sufficient capital adequacy levels in alignment with the Group's framework, the internally-set risk appetite and regulatory requirements; and (iv) clear delegation of authority to relevant committees and management.

- Risk management matters are reported to the Board of each foreign entity through their respective committees, namely the Audit Committee and the Risk Monitoring Committee, while major issues identified are also escalated to the corresponding Board committees of MCB Group Ltd. The management teams of the entities are responsible for conducting business within the strategic framework and risk appetite set by their Board, while monitoring risk portfolios through dedicated committees.

Executive committees

Key responsibilities	
Subsidiary Credit Committee	• It is responsible for the planning, sanctioning, controlling and monitoring of credit risk • It sanctions/declines credit applications for customers with exposures of up to USD 150,000. Exposures from USD 150,000 to USD 1.5 million are approved by a joint MCB Ltd and subsidiary committee. Facilities above this level are channeled to the Executive Credit Committee of MCB Ltd before a final decision is reached
Asset and Liability Committee	• The Asset and Liability Committee of each foreign banking subsidiary is responsible to ensure that overall asset and liability allocation decisions are adequately managed within limits/targets set by the Board and in accordance with local regulations
Overseas Subsidiary Information Risk Management, Operational Risk and Compliance Committee (IORCC)	• The IORCC of each subsidiary reviews and monitors the management and reporting of information, operational and compliance risks, while assisting the entity's Board and Management team to fulfill their responsibilities in respect of such areas. In the process, the IORCC aims to (i) ensure alignment among the entity's underlying risk management framework, risk appetite and tolerance as well as related policies and procedures; and (ii) help ascertain the necessary corrective actions/controls to be adopted to mitigate identified risks. The committee seeks to ensure that the dedicated functions in charge of Information Risk Management, Operational Risk and Compliance within the entity are endowed with adequate resources to achieve their objectives

Risk and capital management report

Key risk areas: Overview and management

Our risk management process

The risk management process is of strategic importance to the Group, notably due to the broadening palette of its offerings and its expanding market footprint. The overall risk management process in place at the Group, which cuts across the entire cycle, allows for the proactive and disciplined identification, measurement, monitoring, mitigation, management and reporting of risks.

Identification

Identification of internal and external risks related to the Group, which may directly or indirectly influence our business performance, our ability to achieve set targets as well as our overall viability over time

Measurement

Assessment, by means of proven methodologies, of the likelihood of identified risks to materialise (under existing or stressed conditions) as well as their likely impact and materiality under different scenarios; review of the default rates of specific products; determination of capital requirements across risk types

Monitoring

Analysis of the sources and specificities of risks faced; appraisal of outcomes posted following the management of risks faced, while factoring in the risk appetite and set KPIs; verifying whether risk controls are efficient in both their design and operation; finding ways and means to further enhance the efficiency of risk assessment and mitigation

Mitigation

Adoption of measures to reduce the level of risks faced, while deploying actions that minimise the impact should there be contrary events; establishment of an appropriate internal control framework to deal with specific risk situations

Management and reporting

Stress testing the resilience of selected portfolios and ensuring that sufficient capital is available to withstand potential losses; regular elaboration of accurate and relevant information on pertinent risk characteristics and trends; ensuring urgent escalation of observed events and outcomes to internal parties and the authorities, wherever applicable

Our approach, processes and methodologies

Credit risk

General approach and objectives

- Credit risk represents the main type to which the Group's banking subsidiaries are exposed in view of the nature of their operations and activities.

- The banking entities ensure that sound credit risk management principles are adopted to uphold quality and well-diversified portfolios that are aligned with the set risk appetite and help to meet targeted risk-return considerations. Both counterparty and concentration risks are duly managed, backed by market vigilance, the adoption of effective control mechanisms and the judicious diversification of portfolios across customer and industry groups, product types, maturity levels and geographies. The banking entities strive to adopt a strong culture of responsible lending and debt recovery, while leveraging a robust risk management and control framework. They continuously reassess their risk profiles in the face of the changing operating context and monitor the exposures against regulatory as well as internal limits and targets.

- The Credit Risk Policy of the banking entities, which is approved and reviewed by their respective Boards and relevant sub-committees, sets forth the principles by which they conduct their credit risk management activities. The policy formulates the roles and responsibilities whereby credit risk is to be managed across business segments. It provides guidance in the formulation of the appropriate structures and architectures that work towards ensuring that business generation is harmonised with the established target market criteria. The modus operandi shaping up the credit risk management set-up is governed by rules set out in Central Bank Guidelines. At the level of MCB Ltd, these include Guideline on Credit Risk Management, Guideline on Standardised Approach to Credit Risk, Guideline on Credit Concentration Risk, Guideline on Credit Impairment Measurement and Income Recognition, Guideline on Country Risk Management and Guideline for the write-off of non-performing assets.

Risk measurement and monitoring

- Credit risk measurement by banking entities consists of appraising the track record of customers as appropriate for the prediction of likely future behaviours of existing accounts. Credit facilities granted are guided by the credit standing, source of repayment and debt servicing ability of the borrower. As a fundamental credit principle, the banking entities do not generally grant credit facilities solely on the basis of the collateral provided. Collateral is taken whenever possible to mitigate the credit risk assumed while additionally, being monitored periodically depending on the type, liquidity and volatility of the collateral value.

- Ultimately, entities assess whether individual business areas provide sufficient contribution to the targeted risk-return profile. The aim is to ensure that capital allocation generates an optimum return. This is achieved by channelling risk capital from low-return to high-return business areas, commensurate with risks shouldered. Banking entities measure credit risk capital requirements by applying appropriate risk weights to both on-balance sheet and off-balance sheet exposures in line with regulatory requirements. With respect to MCB Ltd, the capital adequacy indicators and the return on capital levels for the individual risk categories of portfolios are regularly monitored by its RMC against the overall risk-bearing capacity of the Bank. The objective is to ensure that the latter, at all times, maintains adequate capital to provide for its growth and to support a reasonable measure of unexpected losses. The Bank has established a credit rating framework that enables the extensive usage of ratings for its corporate and institutional portfolios, not only in respect of loan approval but also in relation to credit review and monitoring as well as for the purpose of the stress testing and limits determination exercises. In the same vein, at the level of foreign banking entities, relevant credit risk metrics are measured and reviewed against set limits by the respective Boards and/or RMCs on a quarterly basis.

Risk and capital management report

Banking cluster: Risk-weighted assets

Risk-weighted on-balance sheet assets	Jun 20			Jun 19
	Amount	Weight	Weighted Assets	Weighted Assets
	Rs m	%	Rs m	Rs m
Cash items	3,273	0 - 20	66	98
Claims on sovereigns	101,250	0 - 100	3,327	3,038
Claims on central banks	60,440	0 - 100	7,312	11,239
Claims on banks	46,102	20 - 100	15,997	15,001
Claims on non-central government public sector entities	2,176	0 - 100	0	0
Claims on corporates	192,819	20 - 150	179,768	163,142
Claims on retail segment	12,376	75	7,977	8,061
Claims secured by residential property	32,793	35 - 125	13,060	14,786
Claims secured by commercial real estate	16,016	100 - 125	18,893	19,166
Fixed assets/other assets	15,303	100 - 250	22,088	17,719
Past due claims	10,258	50 - 150	12,666	11,467
Total			**281,154**	**263,718**

Non-market related off-balance sheet risk-weighted assets	Jun 20					Jun 19
	Nominal Amount	Credit Conversion Factor	Credit Equivalent Amount	Weight	Weighted Amount	Weighted Amount
	Rs m	%	Rs m	%	Rs m	Rs m
Direct credit substitutes	2,243	100	2,126	0 - 100	2,035	9,201
Transaction-related contingent items	37,360	50	18,425	0 - 100	17,470	11,884
Trade related contingencies	26,534	20 - 100	6,702	0 - 100	6,516	7,049
Outstanding loans commitment	7,050	20 - 50	3,275	0 - 100	3,275	2,687
Total					**29,296**	**30,821**

Market-related off-balance sheet risk-weighted assets	Jun 20						Jun 19
	Nominal Amount	Credit Conversion Factor	Potential Future Exposure	Current Exposure	Credit Equivalent Amount	Weighted Assets	Weighted Assets
	Rs m	%	Rs m	Rs m	Rs m	Rs m	Rs m
Interest rate contracts	30,128	0 - 1.5	419	679	1,098	570	117
Foreign exchange contracts	21,417	1 - 7.5	239	260	499	264	154
Total						**833**	**271**

	Jun 20	Jun 19
	Rs m	Rs m
Total credit risk-weighted assets	**311,283**	**294,809**

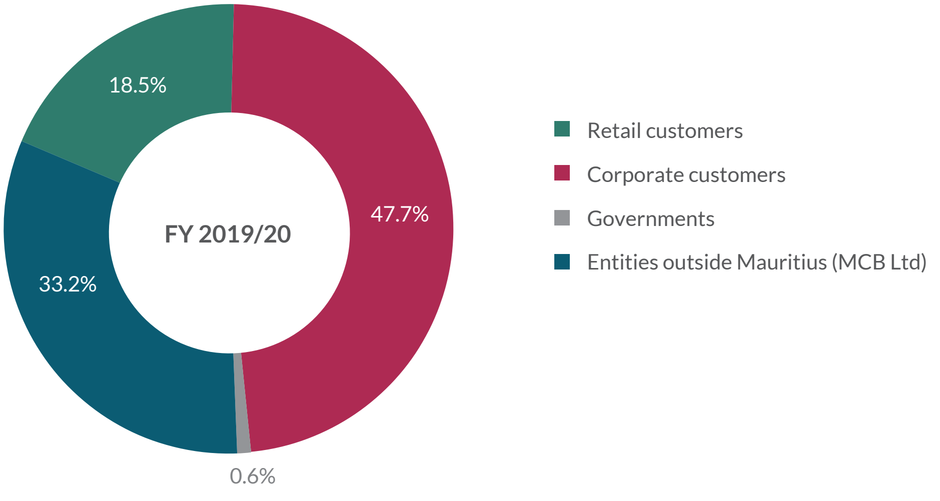
Risk mitigation and management

- The credit risk management framework enables the entities to manage credit risk within the limits of their defined risk appetite, to develop risk-response strategies and to optimise risk-taking by anticipating and acting on potential opportunities or threats. This framework encompasses the following: (i) comprehensive credit policies; (ii) clear segregation of the decision-making authority for the approval of loans; (iii) effective identification, measurement and management of credit risk; (iv) portfolio management to ensure capital adequacy; and (v) regular reporting to Management and committees on pertinent risk characteristics/trends.

- Credit risk exposures are managed through robust credit assessment, structuring and monitoring process. The latter involves the daily monitoring of credit limit excesses as well as the review of all exposures, the frequency of which is increased in accordance to the size and likelihood of potential credit losses to ensure the timely detection of possible problem loans. Exposures showing signs of deterioration are placed on a watch list for closer scrutiny where appropriate. Several credit mitigation techniques are adopted by the banking entities in the course of their activities. These include security/collateral, netting, guarantees, credit insurance and political risk covers. Exposures arising from foreign exchange and derivatives are mainly mitigated through agreements e.g. the International Swaps and Derivatives Association (ISDA) Master Agreements and Credit Support Annex (CSA) documentation.

- The banking entities are intent on diversifying their lending portfolios by setting relevant exposures limits to ensure that their performances are not negatively impacted, for instance, by a large sectoral exposure default. It is the policy of the Group's entities to limit credit risk exposures and concentrations within the constraints of their capital base, while complying with regulatory stipulations, notably relating to aggregate large exposures and single borrower limits. Stress tests are, in some instances, performed on portfolios to ensure that sufficient capital is held to withstand any loss arising from significant exposure to a sector, single customer and group of closely-related customers.

Banking cluster: Loans and advances by customer segment



Risk and capital management report

Concentration of exposures at MCB Ltd

Bank of Mauritius Guideline on Credit Concentration Risk

Credit concentration limits (% of Bank's Tier 1 capital)	Regulatory requirements	MCB Ltd 30 June 2020
Aggregate credit exposure to any single customer	Not exceed 25%	19.6%
Aggregate credit exposure to any group of connected counterparties	Not exceed 40%	30.3%
Aggregate large credit exposures* to all customers and groups of connected counterparties	Not exceed 800%	372.5%

*Note: *Refer to exposures over 10% of the financial institution's Tier 1 capital*

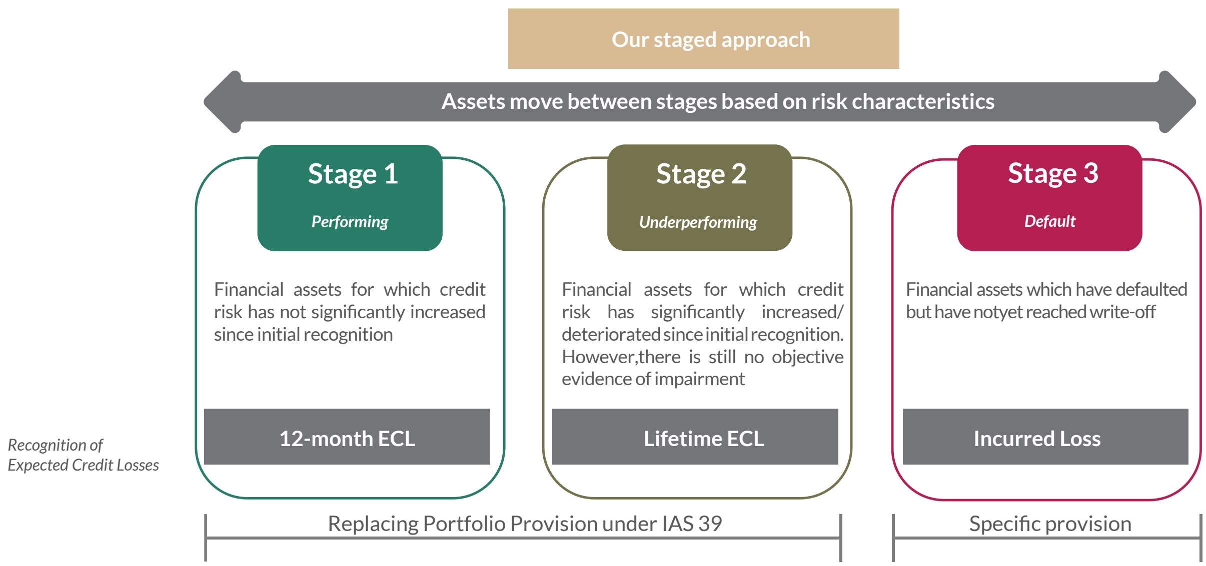
Gross exposure as at 30 June 2020	Total gross exposure	Risk capital consumed	*Risk capital consumed as a % of total credit risk capital*
	Rs bn	Rs bn	%
Top 5 customers / customer groups	61.4	6.0	14.5
Total large credit exposures	190.7	12.6	30.7

- With regard to the determination and review of impairment and provisioning levels, the banking entities undertake their respective exercises on a regular basis, while being subject to appropriate oversight. The entities adhere to relevant regulatory stipulations, alongside aligning themselves to advocated standards. At the level of MCB Ltd, the exercise is undertaken on a quarterly basis and involves the collaboration of several stakeholders. After being reviewed and agreed upon by the RMC as well as validated by the Board, the figures are submitted to the Bank of Mauritius (BoM). The BoM Guideline on Credit Impairment Measurement and Income Recognition aims at aligning regulatory prudential rules as regard asset classification and provisioning requirements with international accounting norms (i.e. IFRS 9). The aim is to ensure that financial institutions have adequate processes for determining allowance for credit losses in a timely manner and the carrying amounts of credit portfolio recoverable values. While ensuring adherence to prudential norms which define credit as impaired if it is past due for more than 90 days, the Bank also assesses facilities granted to clients as being impaired on case-by-case basis above a certain materiality threshold. Furthermore, loans are written off by the Bank when the prospect of recovery is poor and the loss can be reasonably determined, with MCB complying with the BoM guideline for the write-off of non-performing assets. While MCB Ltd continues to adhere to key principles therein, it is worth noting that – as part of support measures to allow commercial banks continue supporting enterprises facing cash flow and working capital difficulties in the context of COVID-19 – BoM has put on hold the Guideline on Credit Impairment Measurement and Income Recognition.

MCB Ltd: Adherence to IFRS 9 requirements

- In measuring Expected Credit Losses (ECL), three main parameters are considered and estimated, namely: (i) Probability of Default (PD), which represents the likelihood of a default event occurring; (ii) Loss Given Default (LGD), which denotes the estimated losses in the event that a default event occurs; and (iii) Exposure at Default (EAD), which reflects the exposure at risk at a point of default. In addition, IFRS 9 requires that allowance be made of forward-looking information in the calculation of ECL, taking into consideration past, actual and future insights on customer behaviours and macroeconomic indicators.

- A three-stage approach to the impairment calculation of financial assets is applied under IFRS 9. To determine the staging status of the asset, IFRS 9 requires an assessment of whether or not there has been a significant increase in credit risk since initial recognition. This dictates the basis on which its ECL is calculated, as illustrated below.



- In determining whether there has been significant increase in credit risk or credit deterioration, an entity considers reasonable and supportable information that is relevant and available without undue cost or effort. At MCB, quantitative and qualitative information are taken into account, based on the Bank's historical customer experience and credit risk assessment. A financial asset is credit impaired and is in Stage 3 when (i) contractual payments or accounts in excess are past due by more than 90 days; and/or (ii) other quantitative and qualitative factors indicate that the obligor is unlikely to honour its credit obligations.

- MCB segmented its financial assets into nine portfolios for ECL calculation, which are described as follows: (i) Retail: housing loans, other secured loans, unsecured and revolving facilities, SMEs; and (ii) Wholesale: corporate, financial institution, sovereign, project finance, and Energy & Commodities.

  - **Retail:** PD, LGD and EAD parameters are calculated on a portfolio-based approach, i.e. facilities having homogeneous characteristics are assumed to have similar risk behaviours and can reasonably be assigned same parameter values.

  - **Wholesale:** MCB uses a combination of internal models and external benchmarking for the calculation of PDs, LGDs and EADs. Internal historical default rates and losses have been used to calibrate PDs and LGDs respectively. For portfolios where MCB has historically experienced low or no default, external benchmarking has been used for calibrating corresponding ECL parameters. Of note, PDs leverage ratings model for all wholesale portfolios, which is mapped to an Internal Master Rating Scale. As for EAD calculation, either amortisation schedules or historical data and regulatory credit conversion factors have been used as EAD ratios.

Risk and capital management report

As highlighted before, MCB Ltd witnessed a major increase in its Expected Credit Losses in FY 2019/20, reflecting the difficult context.

ECL as at 30 June 2019

Stages	Retail portfolios	Wholesale portfolios				
		Corporate	Financial institution	Project finance	Sovereign	Energy & Commodities
	Rs m	*Rs m*	*Rs m*	*Rs m*	*Rs m*	*Rs m*
Stage 1						
Exposures	50,431	126,449	50,752	14,861	100,956	70,760
Expected Credit Losses	106	1,209	179	176	31	115
Coverage ratio (%)	0.2	1.0	0.4	1.2	0.0	0.2
Stage 2						
Exposures	440	12,781	0	268	0	3,288
Expected Credit Losses	17	528	0	6	0	91
Coverage ratio (%)	3.9	4.1	-	2.4	-	2.8
Stage 3						
Exposures	1,836	5,176	69	688	0	1,575
Incurred losses	483	1,408	0	141	0	464
Coverage ratio (%)	26.3	27,2	0.2	20.5	-	29.5

ECL as at 30 June 2020

Stages	Retail portfolios	Wholesale portfolios				
		Corporate	Financial institution	Project finance	Sovereign	Energy & Commodities
	Rs m	*Rs m*	*Rs m*	*Rs m*	*Rs m*	*Rs m*
Stage 1						
Exposures	48,527	135,981	53,271	8,905	135,728	76,858
Expected Credit Losses	427	1,220	46	199	28	111
Coverage ratio (%)	0.9	0.9	0.1	2.2	0.0	0.1
Stage 2						
Exposures	1,733	26,465	0	241	0	6,647
Expected Credit Losses	356	3,093	0	45	0	224
Coverage ratio (%)	20.6	11.7	-	18.8	-	3.4
Stage 3						
Exposures	2,340	5,826	0	57	0	1,489
Incurred losses	555	2,156	0	5	0	281
Coverage ratio (%)	23.7	37.0	-	8.6	-	18.9

Notes:
(i) Stage 1 comprises both on- and off-balance sheet exposures while stages 2 and 3 comprise only on-balance sheet exposures
(ii) Incurred losses do not include interest in suspense on loans and overdrafts
(iii) Stage 3 exposures exclude credit impaired investments fair valued through other comprehensive income
(iv) Figures in the above tables have been audited

Country risk management at MCB Ltd

General approach

- The Bank applies a coherent approach and a comprehensive framework to formulate its risk tolerance and determine exposures assigned to markets, alongside adhering to the Bank of Mauritius Guideline on Country Risk Management and the recentlyreleased Guideline on Cross-Border Exposure.

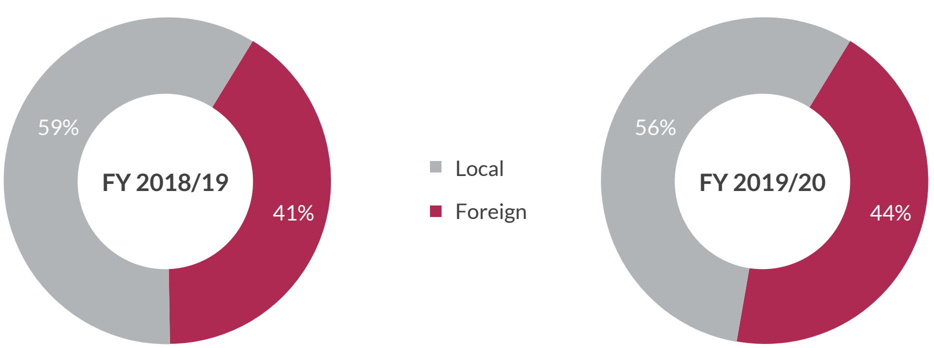
- With a view to fostering sound country risk management, the Bank lays emphasis on the following: (i) the thoughtful and regular determination and review of its risk appetite, after making allowance for the evolving operating environment and its strategic ambitions; (ii) diversified exposures across countries and sectors; (iii) undertaking activities in a selective and, in some cases, opportunistic manner, while favouring areas that the Bank is well accustomed to and for which it nurtures strategic competencies and technical expertise; and (iv) ensuring that its deals are appropriately selected, structured and ring-fenced (with specialised people handling complex deals), backed by the application of a series of risk mitigants and robust methodologies.

Risk measurement and monitoring

- MCB Ltd articulates a coherent risk appetite framework, with business units guided by clearly-established parameters and limits to assist them tap into markets. Target risk profiles are set at Bank level as well as for each portfolio and are complemented by target maturity profiles, consequently ensuring that its credit exposure portfolio is at all times balanced in terms of its risk profile.

- The Bank carefully monitors country risk events, including macroeconomic developments, sovereign credit worthiness, and specific occurrences such as social unrest, nationalisation and expropriation of assets, foreign exchange controls and currency depreciation/ devaluation. Foreign country exposure limits are set by the Bank on the basis of (i) its current exposures and growth ambitions; (ii) assigned capital for international exposures; (iii) the prevailing economic and market environments and sizes of economies under review; (iv) sovereign ratings; (v) its areas of expertise as far as its business involvement is concerned; and (vi) its knowledge of the economies. The Bank ensures the proactive monitoring of country risk exposures against country limits and sub-limits that have been set, while promptly reviewing such levels in case of unexpected events. MCB Ltd established a list of 'priority countries' to focus on appealing business opportunities identified therein, whilst the Bank also set up a list of 'restricted countries'. No limits are set up for the latter countries, with activities only conducted with approval of the RMC.

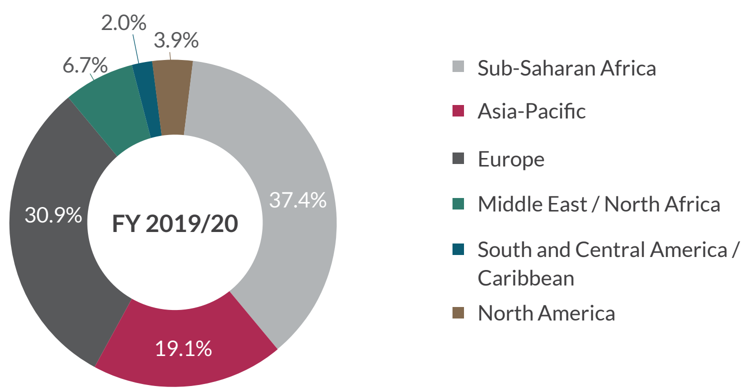
Distribution of MCB Ltd's customer loan portfolio



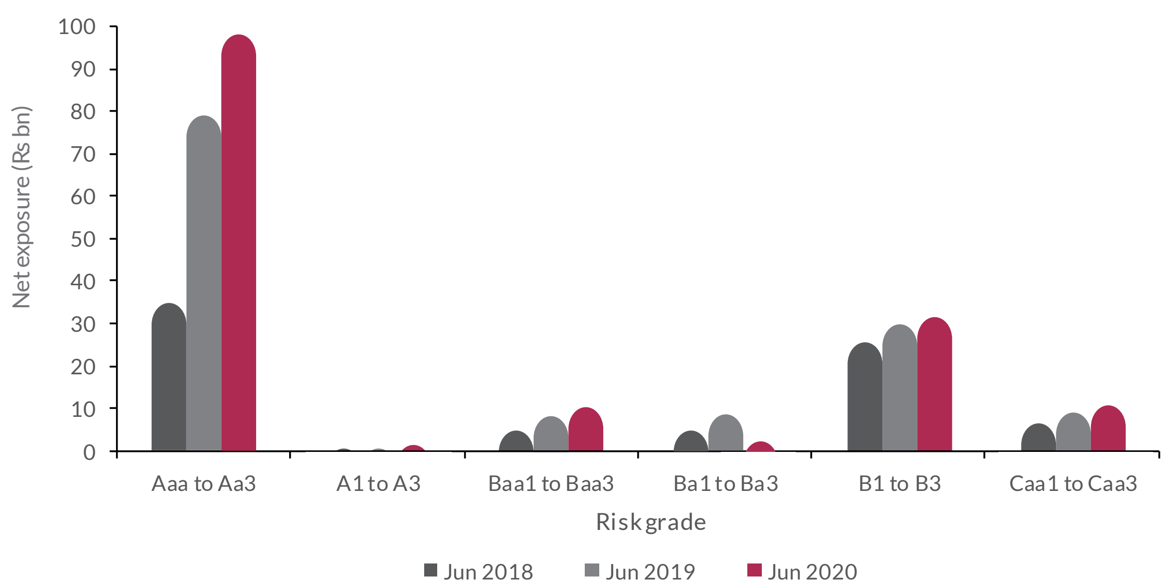
Risk and capital management report

Total risk-weighted exposures by region

(Excluding Mauritius)



Country risk exposures



Note: For each country, the worst of the ratings assigned by Moody's, Standard & Poor's and Fitch Ratings has been selected and converted into a Moody's equivalent rating

Market risk

General approach

- The banking entities of the Group seek to minimise the risk of losses in on- and off-balance sheet positions arising from activities undertaken in or impacted by financial markets. This includes both market price risk and ancillary risks such as liquidity and funding (liability) risks. The entities ensure that an appropriate framework is in place to systematically identify, assess, monitor, control and report, within pre-defined limits, the market risk exposures across their trading and banking books.

- At the level of MCB Ltd, the market risk management approach and framework of the Bank is aligned with applicable Bank of Mauritius Guidelines as well as internationally recommended practices. The Market Risk Policy purview encapsulates both the trading and banking books. It sets out the policies, principles and main functional responsibilities in relation to the management of market risk and liquidity risk. As stipulated in the Guideline on Measurement and Management of Market Risk and the Guideline on Liquidity Risk Management respectively, the Policy ensures that market risk origination, settlement and control are appropriately segregated and that liquidity risk oversight is conducted independently of the risk-taking units. Of note, the Policy ensures that the broad principles set out in the FX Global Code are complied with. The latter is a set of global principles of good practice, which have been developed – by means of the partnerships forged between central banks and market participants from different jurisdictions worldwide – to provide a common set of guidelines to promote the integrity and effective functioning of the wholesale foreign exchange market. The Risk Monitoring Committee (RMC) approves and reviews the Market Risk Policy. It meets at least quarterly and on an ad hoc basis when required and reviews a summary of market risk and liquidity risk exposures and metrics, while assessing regulatory and other developments affecting both the traded and non-traded books of the Bank. The Market Risk BU undertakes the monitoring and management of market risks, while providing financial position and risk analysis information to the Asset and Liability Committee and RMC.

- Our foreign banking subsidiaries operate within the precinct of their Market Risk Polices which put forward the relevant processes and controls to mitigate interest rate, foreign exchange as well as funding and liquidity risks faced. Market risk sanctioning mandates are delegated to Management for the conduct and monitoring of relevant day-to-day operations and activities. They are assisted by the Global Markets and Treasury Management SBU of MCB Ltd in the deployment of their undertakings. The latter function services both their foreign exchange and money market requirements by delivering advisory services through direct access to its traders, who share their views about market trends and provide notifications on relevant updates.

Risk measurement and management

Interest rate risk

- In the banking book, the entities are mainly exposed to repricing risk in its banking book on account of the reset date of its on-and off-balance sheet assets not coinciding exactly with that of its on-and off-balance sheet liabilities. The resulting mismatch is monitored through the conduct of interest rate risk gap analysis on both an earnings and economic value impact basis. This source of risk is limited through the application, in most cases, of floating interest rates that are linked to an index.

- MCB Ltd also incurs interest rate risk in the trading book by virtue of (i) its primary dealership status in the local Government and/or BoM securities market; (ii) its trading positions in international fixed income securities; and (iii) the holding of net open positions in derivatives that are subject to daily revaluation. To constrain its exposure to interest rate risk in the trading book, the Bank sets DV01 limits. Basically, the latter, which is a measure of the impact of price volatility on portfolio value, aims at limiting the loss in dollar terms of a parallel upward shift of one basis point in applicable interest rates.

Foreign exchange risk

- The entities are subject to foreign exchange (FX) risk from an on-balance sheet perspective, i.e. as a result of imbalances witnessed between the foreign currency composition of their assets and liabilities. The risk to which they are exposed can also be viewed from an off-balance sheet angle through the Bank's outstanding positions, mainly in respect of foreign exchange forwards. Exposure to FX risk is monitored against both regulatory stipulations and internal targets, which are, especially, applied to metrics such as the net foreign risk exposure in any single currency and the aggregation of the net foreign exchange risk exposure.

Risk and capital management report

Liquidity and funding risk

- The entities manage the liquidity profile of their balance sheet through both short-term liquidity management and long-term strategic funding, while covering both local and foreign currencies. Towards this, the entities operate mutually supporting lines of defence.

Cash flow management
• The entities create a time ladder of continuous assets and liabilities cashflows, while avoiding undue accumulation of cashflows in any time segment, especially those expected to fall due in the close future. • They use cash and liquidity gap profiles in both local and significant foreign currencies to monitor the impact of projected disbursements by lines of business. • They undertake the behavioural analysis of its non-maturity current and savings balances so as to assign an actuarial maturity profile which reflects the stickiness of such account balances.
Liquid assets buffer maintenance
• The entities hold a stock of high quality and unencumbered assets that it can rapidly dispose of in case required. The aim is to meet unexpected outflows of funds or substitute expected inflows of funds (such as loan instalments) that do not eventually materialise at little or no loss in market value.
Funding management
• The entities maintain diversified liability bases across different categories of depositors, alongside also covering a spectrum of short to medium term funding. • While it pursues its efforts to mobilise FCY deposits as a primary and relatively stable source of funding, to underpin its regional diversification endeavours, MCB Ltd remains committed to continuously optimising and diversifying its short and medium-term funding profile. Alongside exercising close scrutiny of market developments and investor sentiment, we are committed to entering into international wholesale markets whenever required, while capitalising on its technical experiences as well as the relationships developed by dedicated teams dealing with financial institutions and banks. At the end of the day, the key consideration for the Bank is to diligently manage the funding and maturity profile of its balance sheet in order to ensure that it can successfully deploy its strategic endeavours over the short and longer runs.

Liquidity ratios computed at MCB Ltd

Liquidity Coverage Ratio (LCR)

- In alignment with Basel III rules, the objective of the LCR is to promote the short-term resilience of a bank's liquidity risk profile by ensuring that it maintains an adequate stock of unencumbered High Quality Liquid Assets (HQLA) in order to meet its liquidity requirements. As per regulatory stipulations in the Mauritian banking system, the LCR is computed as the ratio of the stock of unencumbered HQLA to the net cash outflows over the next 30 days in the event of an acute liquidity stress scenario. Under the transitional arrangements set by the BoM, the minimum regulatory ratio rose to 100% as from 31 January 2020 for MUR, material foreign currencies and consolidated LCR. To denote the dynamic nature of liquidity, the reporting timeframe was also increased since July 2019 from month-end to fortnightly basis.

Net Stable Funding Ratio (NSFR)

- Under Basel III, the NSFR aims to promote the resilience of a bank over a longer time horizon by requiring the latter to fund its activities with sufficiently stable sources of funding so as to mitigate any future funding stress. The NSFR effectively recognises a bank's maturity transformation role in the credit creation and resource allocation process. It seeks to limit the bank's overreliance on short-term wholesale funding or the running of large funding gaps meant to sustain rapid balance sheet growth.

Operational risk

General approach

- The banking entities of the Group aim to identify, mitigate and manage operational risks across their activities, processes and systems in line with the defined risk tolerance. The objective is to underpin the continuity of their operations and anchor a solid platform to provide customers with seamless services.

- Towards determining the operational risk tolerance levels, the entities set risk acceptance and mitigation limits in respect of the principal categories of operational risk as appropriate. Operational risk sanctioning mandates and day-to-day oversight responsibilities are entrusted to Management. The latter is responsible for the application and effectiveness of the operational risk policy. The key duties are to (i) ensure compliance with underlying objectives set in terms of the management of such types of risk; and (ii) foster the development, implementation and documentation of internal controls and processes.

- The operational risk management framework is anchored on adapted policies which are approved by the Audit Committee of each banking entity. At the level of MCB Ltd, the Operational Risk Policy of the Bank formulates the principles and methodologies for the management of operational risk at the Bank. It sets out a framework covering advocated rules and norms on the local and international fronts, best practices and standards as well as the relevant roles and responsibilities within the Bank. The latter's operational risk management approach is governed by regulatory requirements, including the Bank of Mauritius Guideline on Operational Risk Management and Capital Adequacy Determination.

Risk and capital management report

Risk measurement and monitoring

- The determination of the risk exposures is anchored on the regular review of the operational risk inherent in internal processes and client solutions, with monitoring thereof performed against acceptable tolerance limits.

- With respect to MCB Ltd, it applies the Alternative Standardised Approach for calculating and reporting its operational risk capital charge.

Risk mitigation and management

- At the level of MCB Ltd and as described in its Operational Risk Policy, the responsibility for implementing the Operational Risk Management Framework is entrusted to Senior Management. The Operational Risk BU is responsible for the implementation of policies for the identification, assessment and management of related risks. From a more holistic angle, operational risk management forms part of the day-to-day responsibilities of the Leadership team and employees at all levels of the organisation. Operational risk mitigation relies on appropriate policies, processes and systems, backed by the clear segregation of duties, dual control as well as the regular verification and reconciliation of transactions. The control environment is also based on an appropriate risk culture which is fostered through risk awareness sessions targeting relevant audiences. An overview of both operational risk and Business Continuity Management is provided to new staff at the onset of their career through induction courses. The Operational Risk Management Framework relies on three primary lines of control as depicted below.

- The management of operational risks by the foreign banking entities is also underpinned by recourse to specific tools and systems that are adopted by MCB Ltd, notably the incident reporting system, as tailored to the subsidiaries' business realities. In addition, staff leverage training courses, whereby the Technology SBU as well as the Anti-Money Laundering/Fraud Prevention BU from MCB Ltd provide assistance on specific risk management needs.

Risk ownership	Risk control	Independent assurance
Business units	Audit Committee/IORC/ Operational Risk BU	Internal/External Audit
• Implement internal control procedures • Identify inherent risks in products, activities, processes and systems • Initiate actions and apply mitigation strategies • Report risk incidents	• Oversee the implementation of policy • Implement integrated risk framework • Report on inherent and residual risks • Monitor corrective actions • Promote Operational Risk Culture within the Bank	• Verify the effectiveness of the overall operational risk framework

Business Continuity Management (BCM)

General approach

- The banking entities of the Group adopt a robust and proactive approach to Business Continuity Management to ensure that they continue to conduct their operations and deliver products and services in case of unforeseen events or business disruptions at acceptable pre-defined levels.

- The entities aim to minimise the potential damage that such disruptions can cause to people and business activities, while setting forward to safeguard their reputation and the interests of key stakeholders by effectively planning for and responding to incidents.

Framework and initiatives

- The Business Continuity Management framework of the banking entities is encapsulated in their respective BCM policies. The latter outline the applicable governance structure as well as the roles and responsibilities of each actor involved in the BCM programme. As an integral part of the Operational Risk Management Framework in place, the BCM framework is centrally coordinated and controlled by the entities' Risk functions, in collaboration with relevant support functions. A dedicated Crisis Management Team consisting of key members of Management shoulders central command during a crisis. Specific business segments, through designated business continuity champions, are the BCM process owners and are responsible for designing, reviewing and maintaining up-to-date recovery plans at their respective levels, in alignment with entities' specificities.

- With the outbreak of the COVID-19 virus across our presence countries, the operational preparedness levels of the banking entities were put to test. Their Pandemic Preparedness Plan was activated, with key initiatives successfully executed in order to ensure continuity of activities during these uncertain times and amidst lockdown periods. Actions deployed also helped to safeguard the safety and health of employees and clients, backed by (i) guidance and direction of the Crisis Management Team of each entity and that of MCB Group as a whole, with support emanating from dedicated crisis-related tactical and operational teams; and (ii) the dissemination of clear and coherent procedures and guidelines to ensure compliance by relevant parties and stakeholders. On another note, the banking entities conduct regular Disaster Recovery simulation exercises to test the operability of critical systems hosted on servers that are located at dedicated sites. The exercise confirmed the Recovery Time Objectives identified for the entities' critical activities and consolidated their ability to resume their critical operations from their Disaster Recovery site.

Permanent control

General approach

- The banking entities of the Group are committed to effectively supervising transactions and processes embedded in their regular activities, backed by adequate control mechanisms and procedures. The permanent control/internal control approach is governed by several rules and standards prevailing locally, notably (i) regulatory requirements and guidelines; (ii) guidance provided and principles formulated by the Committee of Sponsoring Organization of the Treadway Commission (in the case specifically of MCB Ltd), which is a joint initiative to combat corporate fraud and was established in the US by private sector organisations; and (iii) relevant Basel requirements. The entities adhere to dedicated internal control policies, which formulate the key principles and underlying governance framework underpinning the efficient development, deployment and monitoring of control activities undertaken by different sections of the organisation. The applicable framework sets out the relevant roles, responsibilities and reporting mechanisms to assist in fostering sound and stable operations within the entity.

Risk and control measurement and management

- The determination of risk exposures is anchored on the regular review of the operational controls applicable to processes and client solutions, with the entities actively monitoring the applicability and effectiveness of actions deployed. Regarding MCB Ltd, information on operational control events is recorded in a centralised database, which enables systematic root cause and trend analysis for necessary corrective actions and to strengthen the adequacy and effectiveness of the internal control mechanism.

- Internal control forms part of the day-to-day responsibilities of Management and employees at different levels of the banking entities. The internal control mechanism relies on appropriate processes and systems, backed by clear segregation of duties, dual control and regular verification and reconciliation of transactions. The control environment is based on an appropriate risk culture, fostered through risk awareness sessions targeting relevant audiences. Internal control deficiencies are managed in a timely and effective manner through adherence to established procedures and proper monitoring of reinforcement measures implemented.

- During the period under review, actions have been taken to further improve the application of the internal control framework and relevant processes across the banking entities. With the advent of the COVID-19 pandemic, the operational processes were reviewed to adjust to Work From Home conditions and realities, with adequate controls defined to monitor whether new procedures are being adhered to. Furthermore, dedicated awareness sessions have been conducted to enhance our staff's social engineering awareness with a view to enabling them properly and promptly recognise and react to social engineering attacks.

- In the case of MCB Ltd, following the implementation of a Permanent Control framework to ensure that critical controls are performed and are effective, the dedicated team of Business Risk Correspondents across key SBUs and the network of Business Risk Champions regularly report events observed to the Risk SBU, while ensuring timely escalation of findings to Heads of SBUs, IORC and Audit Committee. Our foreign banking entities have further embedded Permanent Control framework and processes as part of the ongoing and dynamic exercise to strengthen the internal control set-up, alongside adhering to clearly-defined procedures and dashboards for controlling and mitigating the effects of operational risks faced. The introduction of compliance certificates to be submitted monthly by business units provides assurance that the identified controls are functioning adequately.

Information risk

General approach

- The entities adopt a dedicated approach to uphold their information security, alongside ensuring that they are prepared to respond to potential cyber-attacks and threats to its information assets in a timely and effective manner. They conduct regular assessments to identify issues that can potentially harm their assets, with adequate mitigating controls being deployed.

Risk mitigation and management

- Risk management by the banking entities implies the regular conduct of information risk assessments so as to identify issues that can potentially harm the organisation's information assets and recommend adequate mitigating controls.

- At MCB Ltd, the Information Risk Management (IRM) BU is responsible for developing and maintaining information security policies, in line with the evolving operating landscape as well as requirements set by the authorities and other stakeholders. The key objective is to ensure that an adequate level of security is maintained to protect private and confidential information held by the Bank. To mitigate and manage risks faced, several processes have been assigned to assist in identifying and analysing the business need to access logical information, restrict the information deployed to the relevant requirements as well as monitor and control access to such information. The pertinence of any major information security expenditure is evaluated and discussed at several hierarchical levels before finally escalating to Senior Management and, if needed, to the Board for approval.

- The banking entities are guided by road-maps that have been developed in order to ensure that policies and processes to effectively cope with challenges posed by increasing cyber threats are continuously geared up. At the level of MCB Ltd, several initiatives have been deployed to strengthen and ensure the robustness of its information security: (i) the Bank enhanced its security events monitoring and response capabilities, which have been regularly tested; (ii) MCB Ltd's critical infrastructure (which includes customer-facing applications) has been independently tested and assessed from a cyber security perspective; (iii) actions have been taken to enhance the staff's cyber security awareness in order to recognise and properly react to cyber-attacks; (iv) cyber-attacks on the organisation have been simulated in order to test and enhance its defences and response capabilities; (v) the Bank's compliance to laws and regulations relating to data protection has been regularly assessed with a view to identifying any gaps and gearing up its capabilities to adhere to relevant stipulations; (vi) the set of critical controls underpinning MCB Ltd's cyber security resilience were continuously monitored; and (vii) the risk assessment framework and information security management systems and processes were upgraded to foster alignment with internationally-recognised standards. As for our foreign banking entities, dedicated initiatives were taken to enhance the protection of critical information pertaining to the bank and its customers, in line with relevant laws and regulations. Main examples are as follows: (i) adoption of updated information security policies so as to provide a framework for ongoing and future undertakings; (ii) conduct of information security awareness campaigns for both employees and clients; (iii) independent assessment of the entities' information systems to address information security vulnerabilities; (iv) implementation of regular controls to proactively identify and address any vulnerabilities witnessed; and (v) systematic upgrade of information systems and infrastructure in place.

Compliance risk

General approach and objectives

- The compliance strategy of the Group seeks to ensure consistency between the conduct of business operations and the observance of relevant laws, rules and standards of good market practices, through continued identification of compliance-related risks, and ongoing assessments and understanding of such risks as well as the design of adequate controls. The aim is to shield the organisation from legal/regulatory sanctions as well as financial/reputation losses.

- The approach is to foster a compliance-oriented culture with a view to supporting business lines in delivering fair outcomes for customers and preserving the organisation's reputation, while helping to achieve business development objectives.

Risk mitigation and management

- The entities of the Group seek to ensure that its core values and standards of professional conduct are maintained at every level and within all their activities and operations. Towards this end, they adhere to the Group's policies while also ensuring they comply with all relevant local legal requirements. They adopt dedicated systems and processes so as to properly identify and prevent any risks of non-compliance while ensuring that they are sufficiently equipped in order to live up to the increasingly stringent regulatory environment and effectively cope with greater scrutiny by regulators and law enforcement authorities. In order to guarantee that their objectives are met in a consistent and judicious manner, they perform regular monitoring exercises, to ensure compliance with policies and procedures and ascertain that controls are operating in a sound and effective way. In a nutshell, compliance risk management is anchored in the following core principles:

Core principles guiding compliance risk management

- Paying continuous attention to and undertaking regular reviews of ongoing developments as regard local and relevant international laws and regulations, accurately understanding their impact and coming up with necessary responses;
- Upholding a governance framework that ensures adequate oversight, and accountabilities by Management and the Board;
- Fostering a compliance control mechanism to pave the way for standardised processes and operations;
- Adopting a risk-based due diligence approach and methodology to underpin appropriate scrutiny and monitoring of activities
- Conducting enterprise-wide money laundering and terrorist financing risk assessment exercises to evaluate inherent risks faced and the effectiveness of the control environment designed to mitigate such risks
- Maintaining a set of policies to promote strong ethical behaviour by staff as well as to prevent and manage conflicts of interests;
- Promoting the awareness of Directors, Management and staff on requirements arising out of new/amendments to laws and regulations and other compliance-related matters;
- Providing adequate training to the compliance officers to ensure that they have the necessary knowledge and skills to accomplish their duties;
- Maintaining close working arrangements and communication with business lines through the dissemination of compliance-related information, provision of advisory services and delivery of dedicated training courses to staff;
- Fostering trusted relationships with regulatory and supervisory bodies by maintaining productive and value-adding dialogue with them to uphold effective two-way communication.

- In relation to their Anti-Money Laundering /Combating the Financing of Terrorism (AML/CFT) obligations, the banking entities of the Group ensure that adequate processes, systems and controls are in place to render their services inaccessible to criminals, including money launderers and terrorists or their financiers, alongside paving the way for detecting suspicious activities. While fostering continuous staff awareness, the entities *inter alia* ensure that employees are given appropriate training on AML/CFT and fraud prevention topics to help them identify suspicious transactions. A Financial Crime Risk Management system has been implemented for underpinning the oversight of anti-money laundering. Moreover, the entities adhere to a Whistleblowing Policy, whereby an alternative reporting process is established for use by all employees in confidence, without the risk of subsequent retaliation, victimisation, discrimination or disadvantage. The Whistleblowing Framework at the organisation is designed to assist employees deemed to have discovered malpractices or impropriety.

- The compliance frameworks of our banking entities have been reinforced through the adoption of continuous permanent control mechanisms. Our overseas banking entities are assisted by the Compliance function of MCB Ltd via the following forms:

Key areas of support by MCB Ltd to overseas entities

- Compliance risk assessments: It extends support to the Compliance Officers of the foreign entities in the performance of compliance risk assessments and through compliance-related training provided to them
- Money Laundering and Terrorist Financing Enterprise Wide Risk Assessment: It conducts risk assessments for selected entities
- Advisory services: It maintains an open line of communication with afore-mentioned Compliance Officers and encourages them to seek advice/guidance whenever they are in need of same
- Staff training: It provides AML/CFT training to staff of the entities when called for, in addition to reviewing materials that the Compliance Officers have prepared for the purpose of staff training
- Compliance monitoring: It elaborates compliance monitoring programmes whereby the Compliance Officers have to perform compliance tests, prepared at the level of the Compliance BU, to ascertain adherence to procedures
- Project execution: It assists entities embarking on the implementation of IT tools to ensure compliance risk management
- Other areas: It reviews operational procedures to ensure that they meet set standards and that all applicable legal and regulatory requirements are incorporated therein. Its services are also solicited for the implementation of international applicable legal requirements and the resolution of regulatory-related matters

Risk Assurance: Internal Audit

General approach

- The aim of internal audit at the Group level is to assess the policies, methods and procedures in place at the organisation in order to cater for their adequate application. Independent assurance is provided on the quality and effectiveness of internal control, governance and risk management systems and processes, thus helping to protect the organisation and its reputation.

- The established framework of the internal audit activity is risk-based. As a key thrust, the banking entities of the Group aim to gather the necessary audit and risk insights in order to support their strategic orientations.

Strategy and objectives

- The foreign banking entities of the Group rely on their locally-based internal auditors, alongside leveraging the services provided by the Internal Audit SBU of MCB Ltd to, amongst others, disseminate internal audit best practices and standardise the quality of related audit work. While factoring in the work done by the locally-based internal auditors, the Internal Audit SBU carries out regular assignments to assist these entities to better manage their risks as well as improve the quality of their control systems and processes, with advice being delivered on different aspects in line with the nature of projects being executed. In line with its continuous efforts to enhance its efficiency levels, the function increased the use of data analytics as part of the audit execution exercise, which has proved to be helpful in the current context, whereby international travel has not been possible.

- In line with good governance principles, the Internal Audit SBU of MCB Ltd reports to the Audit Committee, which approves and monitors the internal audit plan and recommendations. Internal audit findings and agreed action plans are reported to the Audit Committee and Board of relevant subsidiaries, with matters escalated to the Audit Committee of MCB Group Ltd if required. The key pillars which the function relies upon to roll out a disciplined approach to evaluate and improve the effectiveness of risk management and control processes are: (i) the implementation of regularly updated audit work programmes addressing, as far as possible, identified residual audit risks; (ii) increased usage of data analytics; and (iii) automation of tasks namely relating to reports preparation, working papers and follow-up of recommendations. The Internal Audit SBU continues to invest in the upskilling of its team members, with professional certifications being encouraged. Based on its assessments, the Internal Audit function is presently not aware of any significant area of the Bank where there are no internal controls. The function does not believe that there are deficiencies in internal controls that could give rise to risks that could eventually jeopardise the operations of the Bank.

Capital management

The framework

In line with regulatory rules, Basel requirements and industry best practices, the capital management objective of the banking cluster, which is aligned with Group-level directions, is to ensure that adequate capital resources are available to operate effectively, foster sustained business growth, preserve or enhance credit ratings and cope with adverse situations. Capital management policies and practices aim to maintain a strong capital position that is consistent with stakeholder expectations and requirements.

Backed by the adoption of a forward-looking approach and a sensible governance framework, banking entities determine the level and composition of capital after making allowance for multiple factors. They include the legal and regulatory landscape across countries, the business environments, the Group's strategic orientations, conditions prevailing across economies and financial markets, etc.

Our process

Commensurate with the strategic orientations, risk appetite and risk management framework approved by the Board of MCB Group Ltd, the entities operating under the banking cluster abide by their internal policies and practices for undertaking their capital management initiatives, including (i) capital planning and allocation across business segments and geographies wherever applicable; (ii) capital reporting, budgeting and analysis; and (iii) management of capital consumption against budgets. For instance, MCB Ltd is guided by its Internal Capital Adequacy Assessment Process (ICAAP) in determining the capital planning exercise and formulating the risk appetite. This provides the framework to ensure that adequate capital is kept beyond core minimum requirements to support business activities.

Internal Capital Adequacy Assessment Process of MCB Ltd

Framework	• The ICAAP framework has been developed and applied at the Bank pursuant to the issue of the Bank of Mauritius (BoM) Guideline on Supervisory Review Process in April 2010. • The key objectives of ICAAP are as follows: (i) to provide an informative description of the methodology and procedures that the Bank uses to assess and mitigate its risks; and (ii) to make sure that adequate capital resources are kept to support risks faced beyond core minimum requirements. The ICAAP document, which is reviewed periodically, delineates the process through which the Bank assesses the required minimum capital to support its activities. It seeks to ensure that MCB remains well capitalised after considering material risks.
Assessment and planning	• Through the ICAAP, the Bank assesses its forecast capital supply and demand relative to its regulatory and internal capital targets under various scenarios. The Bank's capital plan is defined every year during the budgeting and strategic planning exercise, while financial year risk appetite limits are set by the Board. As for the Bank's exposures, they are monitored on a quarterly basis against those limits, with related insights being reported to the RMC. • The capital plan includes a crisis management plan. The latter makes allowance for various measures that should help to rapidly mobilise additional capital if the need arises, with discussions thereon being held at Board level.

Risk and capital management report

Stress testing at MCB Ltd

Framework

Risk identification

- To detect and address existing or potential vulnerabilities such as unidentified and Bankwide risk concentrations or interactions among various types of risk, many of which may be overlooked when relying purely on statistical risk management tools based on historical data

Risk assessment

- To promote a deep understanding of organisational vulnerabilities on the back of forward-looking risk assessments; this helps to make risk more transparent via an estimation of scenario-based losses and to prevent the development of any false sense of security about the Bank's resilience
- To evaluate the significance of risk faced during different phases, notably (i) during periods of favourable economic and financial conditions given the subsequent lack of visibility over potentially negative future developments; and (ii) during periods of business expansion when innovation leads to new products and services for which no historical data is available for forecasting future trends

Risk mitigation

- To facilitate development of risk mitigation or contingency plans across stressed conditions
- To spur debates on and the awareness of the various risk aspects of our client portfolios among Management, helped by (i) a well organised surveying of the operating context; (ii) an identification of the most important risk factors; and (iii) a scanning of the horizon for potential stressful events

Performance

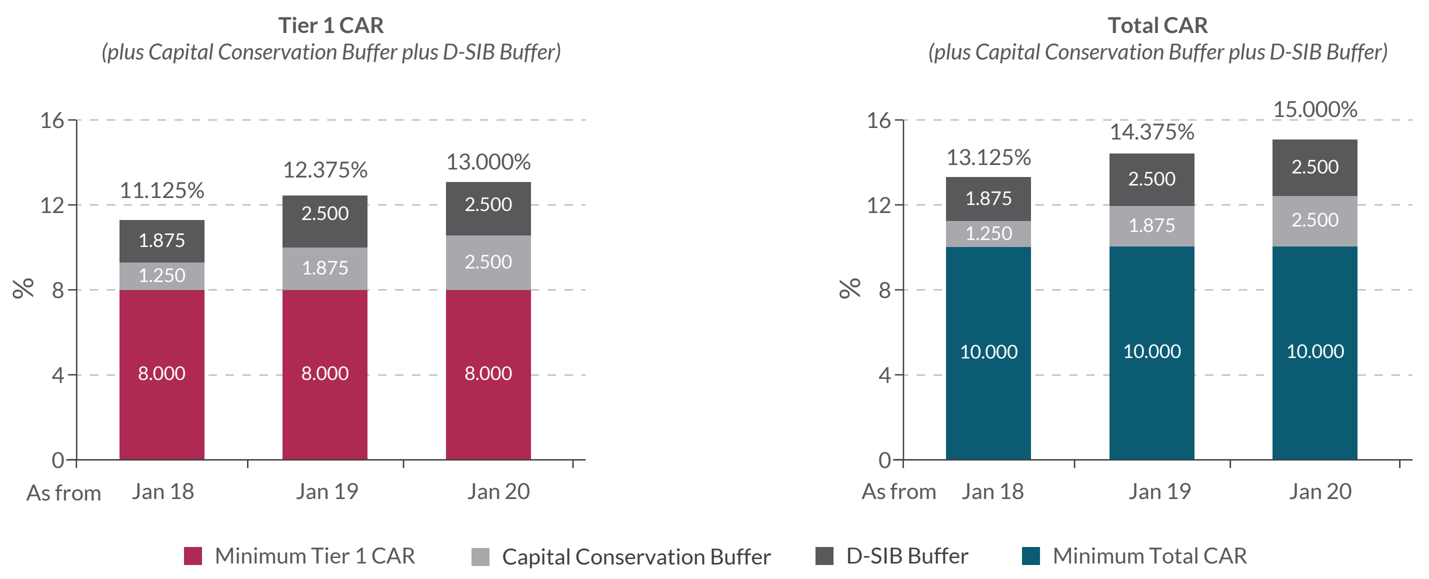
In FY 2019/20, the Bank conducted stress testing under various historical and stress test scenarios to assess the impact of unfavourable scenarios on its capital position. Examples are provided hereafter. The scenarios are regularly reviewed and fine-tuned to ensure that they remain relevant to the Bank's risk profile, activities as well as prevailing and forecasted economic conditions. The stress test results are reported and discussed at the RMC and the Board prior to being submitted to the BoM. Barring extreme cases, our recent analyses revealed that the Bank's capital adequacy ratio does not fall below the regulatory requirements in any of the nine scenarios below.

Scenario 1	External risk - Brexit
Scenario 2	Reputation risk - MCB Ltd credit rating downgrade
Scenario 3	Concentration risk - Two domestic conglomerates default
Scenario 4	Concentration risk - Three large single foreign clients default
Scenario 5	Shocks in the local tourism sector
Scenario 6	Domestic property market crash
Scenario 7	Liquidity risk - Withdrawal of USD current account deposits
Scenario 8	Liquidity risk - Withdrawal of Global Business Licence depositors
Scenario 9	Interest rate risk - 2% increase in interest rates

Our capital position

The banking subsidiaries of the Group foster strict compliance with mandatory stipulations set by the regulators of their jurisdictions. In respect of MCB Ltd, the Bank uses the Basel II Standardised Approach to manage its credit and market risk exposures, with the Alternative Standardised Approach used for operational risk. As for determination of its capital resources, the Bank adheres to the BoM Guideline on Scope of Application of Basel III and Eligible Capital. It also complies with the Guideline for dealing with Domestic- Systemically Important Banks (D-SIB). Under the latter, banks are required to hold a capital surcharge or D-SIB buffer ranging from 1.0% to 2.5% of their risk-weighted assets depending on their systemic importance. The assessment for determining domestic-systemically important banks is carried out on a yearly basis on end-June figures. As per the assessment carried out by the Central Bank, MCB Ltd features among the five banks that have been determined to be systemically important in our jurisdiction, based on the assessment of five factors, namely size, exposure to large groups, interconnectedness, complexity and substitutability.

Minimum regulatory ratios applicable to MCB Ltd



Note: To provide additional flexibility to banks to support economic stakeholders, households and individuals impacted by the COVID-19 outbreak, the Bank of Mauritius deferred the capital conservation buffer of 2.5% which was effective as from 1 January 2020 to 1 January 2021 such that banks will be required to maintain a capital conservation of 1.875% until 31 December 2020. In addition, the regulatory risk weights on certain categories of exposures including retail and residential mortgages were reviewed.

Risk and capital management report

Minimum regulatory ratios applicable to the foreign banking entities

	MCB Seychelles	MCB Maldives	MCB Madagascar
As at 30 June 2020	%	%	%
Capital adequacy ratio	12.0	12.0	8.0
Tier 1 ratio	6.0	6.0	-

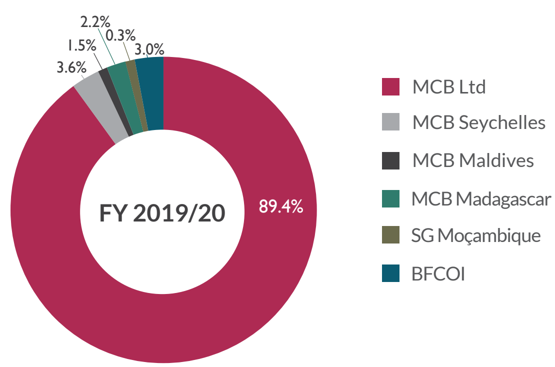
Performance of the consolidated banking cluster

During FY 2019/20, the banking entities have maintained their respective capital adequacy ratios comfortably above the applicable regulatory requirements. The capital adequacy ratio of the banking cluster – as measured at the level of MCB Investment Holding Ltd on a consolidated basis – increased by 90 basis points to reach 17.0% as at June 2020. The capital base was primarily made up of core capital, with the Tier 1 ratio standing at 15.9% as at June 2020, up from 15.1% a year earlier. The following illustrations depict the capital adequacy ratios posted by the banking cluster and shed light on the distribution of risk-weighted assets by entity.

Distribution of capital metrics

	Banking cluster	
	Jun 19	Jun 20
	Rs m	Rs m
Capital base	**52,327**	**57,726**
Tier 1	49,235	53,990
Tier 2	3,092	3,736
Risk-weighted assets	**325,512**	**340,366**
Capital adequacy (%)	**16.1**	**17.0**
of which Tier 1	*15.1*	*15.9*

Risk-weighted assets by entity



Capital adequacy	MCB Ltd	MCB Seychelles	MCB Maldives	MCB Madagascar
	%	%	%	%
Capital adequacy ratio				
As at 30 June 2019	16.6	15.2	40.0	17.2
As at 30 June 2020	17.5	15.1	46.0	17.0
Tier 1 ratio				
As at 30 June 2019	15.7	13.2	28.6	13.7
As at 30 June 2020	16.5	13.3	35.7	13.6

Non-banking clusters

- While adhering to good corporate governance principles, entities within the non-banking cluster of the Group adopt appropriate risk management frameworks that allow for an effective identification and management of risks they face in the course of their respective business activities.

Non-banking financial cluster

- Certain subsidiaries of MCB Capital Markets Ltd (MCBCM) are regulated by the Financial Services Commission. MCBCM, which complies with the National Code of Corporate Governance for Mauritius (2016), seeks to implement best practice risk management standards. The ultimate responsibility for managing risks rests with the Board of each subsidiary and material issues are escalated to the main Board via the Risk & Audit Committee. To ensure strong governance, several sub-committees have been set up to oversee critical areas of MCBCM's operations. An example is the management and administration of Collective Investment Schemes (CIS), where MCBCM has appointed a CIS Supervisory Committee with the responsibility to review and assess all aspects relating to CIS management, including risk, investment and administration.

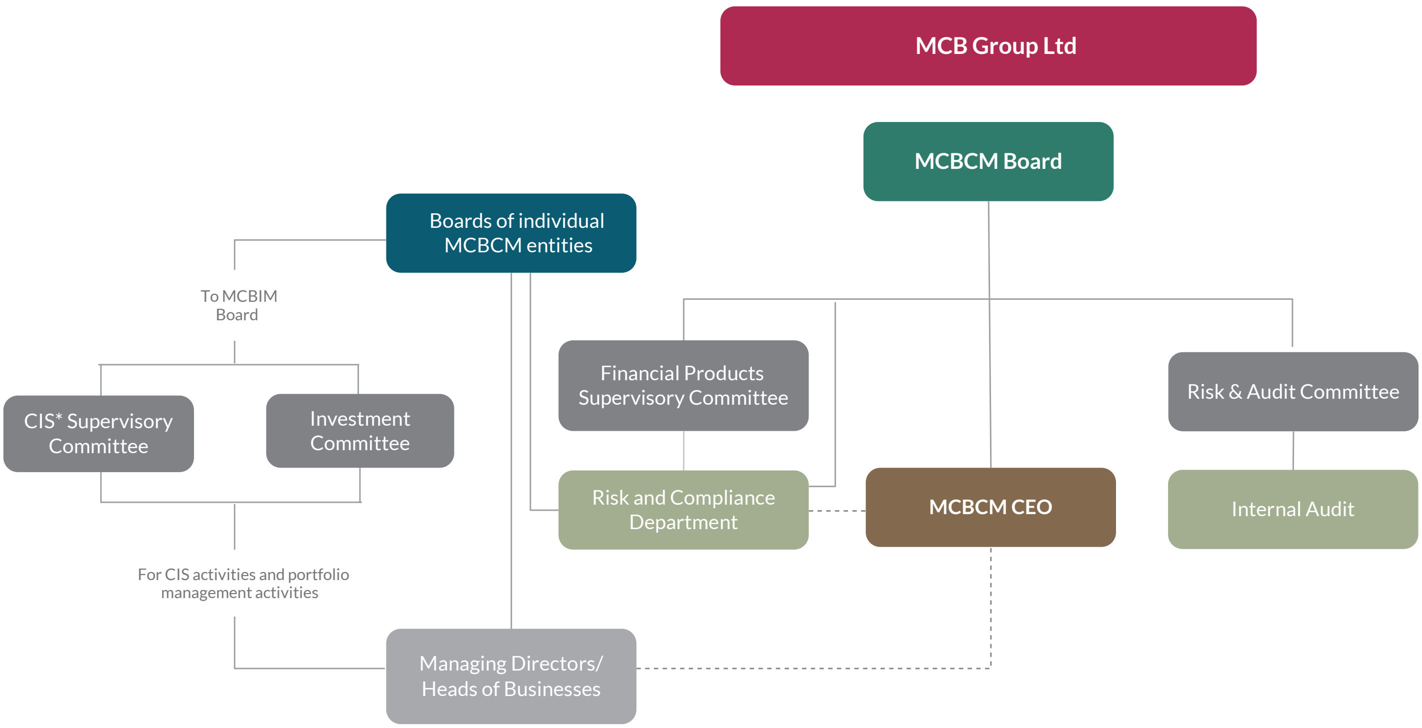
- MCBCM recognises that financial products are becoming increasingly complex and regulated. Accordingly, it has strengthened its governance framework through the establishment of a Financial Products Supervisory Committee, that comprises all independent directors of MCB Investment Management Ltd, and is responsible to oversee all new product launches.

- An Investment Committee meets on a quarterly basis and scrutinises the portfolios and investment management processes of MCB Investment Management. A Risk & Audit Committee has also been set up as a sub-committee of MCBCM.

- Day-to-day risk management is delegated to the management team of each MCBCM subsidiary and to MCBCM's Risk & Compliance (R&C) function, whose primary responsibilities are to *inter alia*: (i) assess all legal and regulatory obligations of MCBCM's businesses, ensuring compliance with all applicable laws, regulations and policies; (ii) provide risk-related advice, recommendations and compliance assurance to members of the boards and committees of MCBCM; (iii) coordinate of all risk management and compliance matters; and (iv) investigate client complaints and any breaches of applicable laws, regulations and procedures.

- The Head of R&C reports directly to the Chief Executive Officer of MCBCM and also has direct reporting lines to certain Boards of subsidiaries and sub-committees of MCBCM in line with best practice. R&C submits a compliance report to the Boards of relevant MCBCM entities every six months, and has the discretion to escalate critical issues on a more frequent basis, as necessary. All entities of MCBCM are subject to annual independent internal and external audits. The Risk & Audit Committee meets at least twice a year to review *inter alia* R&C's risk report, audit findings, progress on previously identified issues and the audited financial statements of all legal entities. The MCBCM governance framework is set out below.

Risk and capital management report



** Relates to Collective Investment Schemes*

Key principles and considerations for risk management

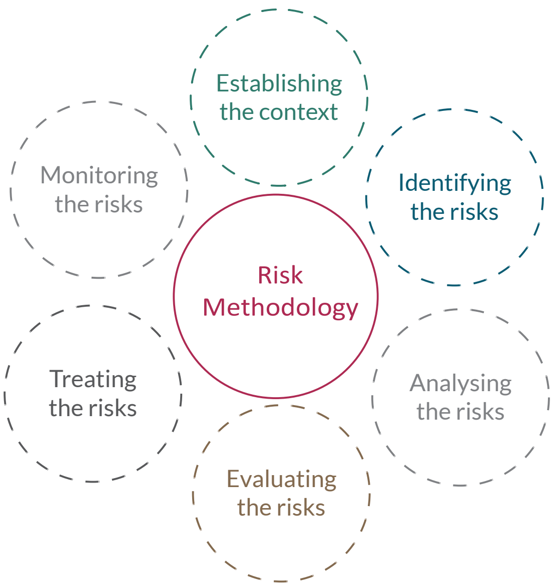
Legal and regulatory

- Recognising the need to adhere to international governance codes and standards, MCBCM has put in place a framework to manage its legal and regulatory risks. This is summarised below:

  - Regular review of applicable laws and regulations to identify compliance gaps;
  - Active involvement of MCBCM's Risk & Compliance and legal teams in the development of new products and services to ensure that they are in compliance with applicable laws and regulations prior to being launched;
  - Monitoring of changes to the legal and regulatory frameworks and initiation of corrective actions as necessary; and
  - Bi-annual monitoring exercises undertaken by the Risk & Compliance team to assess the level of compliance with laws and regulations, particularly with respect to anti-money laundering.

Operations (people, processes and systems)

- A significant proportion of R&C's resources is allocated to the management of operational risks. The methodology, which places particular emphasis on high volume businesses, is set out below.



- The initial stage of the above methodology includes *inter alia* formal reviews of procedures and processes, analysis of complaints and incident reports and review of new products and services. The output is then used to update MCBCM's risk maps, which address all material risks faced by the business and their pre-control ratings. These risks are eventually re-assessed taking into account existing controls and additional controls that are required to arrive at a post-control rating. Any residual post-control risks deemed material will lead to a re-design of the relevant controls until such risks are adequately addressed, mitigated or eliminated.

Financial risks

- MCBCM, through its brokerage business, offers underwriting services to corporate clients and is thus subject to financial risks. Such risks are managed by a formal process that involves:
  - A technical assessment of all requests for underwriting by a group comprising MCBCM's Chief Financial Officer, Head of Risk and Compliance, Head of Legal and the Managing Director of MCB Stockbrokers;
  - A two-tiered approval process, with the first level approval being provided jointly by the CEO of MCBCM and the Chairperson of the Board of MCB Stockbrokers, and the second level approval provided by the management of MCB Group.

Risk and capital management report

- MCBCM, through its brokerage business, also acts as market-maker or liquidity provider in respect of certain securities listed on the Stock Exchange of Mauritius (SEM). Relevant safeguards have been implemented to ensure that any risks arising from this activity are properly mitigated.

- MCBCM, through various subsidiaries, is involved in the structuring, issuance and management of Credit Linked Notes (CLNs). The latter are long-dated debt instruments but have been structured so as to provide targeted investors with regular exit windows hence improving the liquidity of these financial products. Associated financial risks being borne by MCBCM require some degree of active funding and liquidity management, mainly through adequate levels of capitalisation and access to appropriate funding and credit lines.

Other investments cluster

Elsewhere, in line with principles determined at Group level, risk management policies and structures have, in varying capacities, been designed in order to ensure that business activities are carried out in a sound manner, depending on the types of market undertakings being engaged into as well as the range and depth of risks faced. Fundamentally, the Board of each entity has the ultimate responsibility to ensure that risks are properly identified and managed, with relevant functions being mandated to provide clear and coherent assistance to help it in the fulfillment of its duties. In the process, the entities adhere to coherent and robust control mechanisms that enable them to achieve strategic objectives in a sustained and sound manner, backed by a thorough investigation of clients' risk profiles and the diversification of undertakings where applicable. The Internal Audit function of MCB Ltd, having a Group wide mandate, provides assurance over these controls systems and reports on those via the Audit Committee and/or Board of each individual entity. The findings are consolidated and presented to the MCB Group Audit Committee for an integrated view of the effectiveness of risk management, control and governance processes.

Jean-Louis MATTEI
Director
Chairperson Risk Monitoring Committee

Pierre Guy NOEL
Chief Executive