Treasury Risk Management & Guidelines

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Agenda

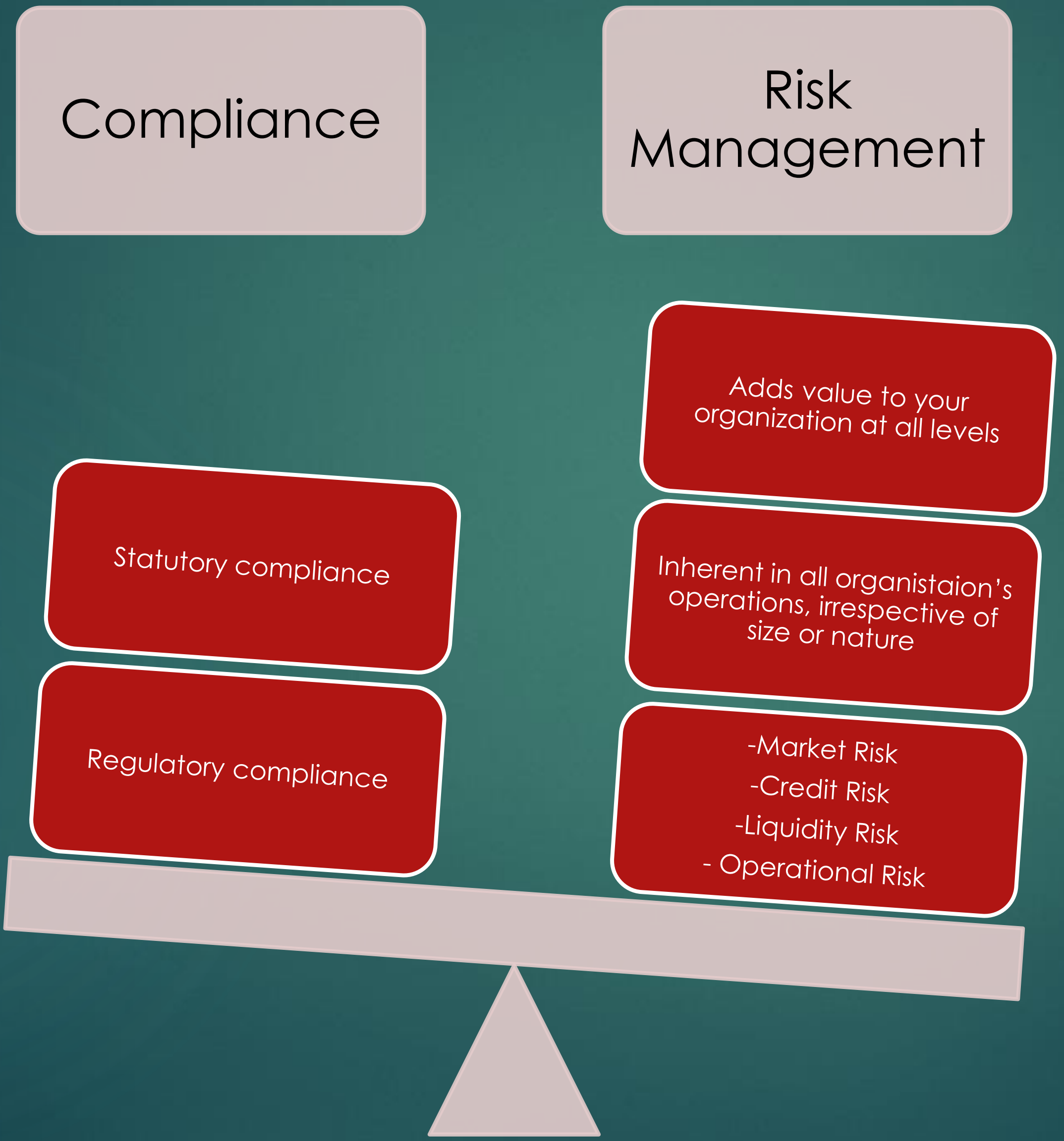
- Overview
- Market Risk
- Credit Risk
- Liquidity Risk
- Operational Risk
- Q&A

Overview

Overview

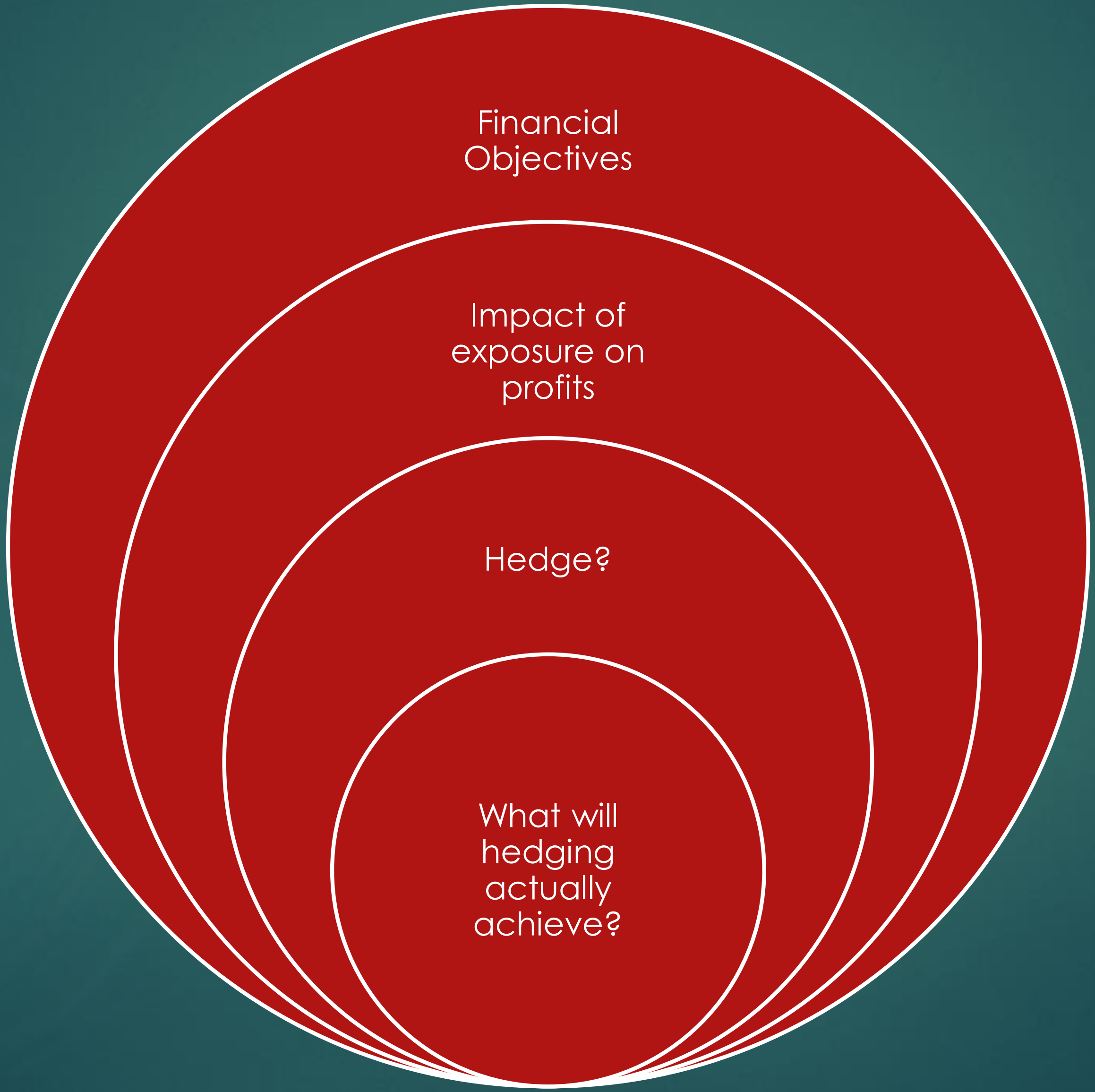
- Address some of the key issues surrounding major financial risks facing an organization
- Use of financial instruments
- Risk Management issues associated with Treasury & Financial Instruments
- Doesn’t not cover commodity and energy risks

Risk or Compliance?



- Risks can be
  - Increased
  - Eliminated
  - Shared with financial institutions
- Financial Instruments can be used to Hedge Market Risks
- BEWARE!! Financial Instruments can in turn create operational risk!

Identifying Risk



Board's Role

Establish consistent & clear risk management policy. Risk Limits to be mapped to risk appetite

Approve limits & Authorities. Clear communication to all concerned

Management strategies & implementation policies to be consistent with Board's authorization

Senior Managers to be involved in policy setting for treasury & risk management goals

Market Risk

Market Risk

- Movement in value due to change in price, creating a positive or negative value for the organization.
- Variability in price is undesirable.
- Remove currency variability by
  - Buying foreign goods & services in local currency; OR
  - Use currency instruments (FX forwards, Options etc.)
    - Hedging through Forwards provides certainty, but takes away opportunity to participate in favorable movements in exchange rates
    - Hedging via buying options gives the flexibility to participate in upsides. (Financial Insurance)
- Off Shore Borrowings in an organization may expose it to
  - Interest Rate Risk and/or
  - Currency Risk
- Cross Currency Swaps to allow both foreign currency & interest rates to be locked in.
- Interest Rate Risk (on floating rate loans) can be hedged through Interest Rate Swaps / options.

Points to be considered

- Risk Identification should be as early as possible in a transaction lifecycle.
- Risk Measurement Methodologies should be able to measure the risks adequately.
- Stress Tests & "What if" analysis undertaken regularly. (eg. VAR, scenario analysis etc)
- Suitable mix of fixed and floating interest rates
- Foreign exchange & Interest Rate risk hedging policy
- Mechanism for policy review and board reporting on any breaches of market risk policy or limits.

Credit Risk

Credit Risk

- Counterparty Risk – risk that your counter party defaults before or on settlement date.
- Risk to be assessed while dealing with both corporate clients and financial institutions.
- Tools to assess and rate credit risk
  - Third party Credit rating agencies (CRISIL, ICRA, CARE, DNB, ETC.)
  - In house risk manager reports
  - Credit history of the counterparty
- Credit limits to be assigned based on counter party credit rating
- Also includes country/ political/sovereign risk. i.e. governments' legislative change and is usually beyond the control of either party.

Points to be considered

- What are the processes in place to determine credit risk?
- Capacity to measure credit exposure.
- Process for handling collateral received or paid (security in the form of tangible asset, BG, performance guarantees etc)
- Establishing settlement limits for each counterparty
- Reliance on credit rating by an external agency
- Board to be informed of any breaches or credit or settlement limits.

Liquidity Risk

Liquidity Risk

- Two types
  - Risk of not being able to deal in market due to lack of liquidity
  - Funding risk – not having adequate funds when needed
- Managed by
  - detailed historical and projected cash flows for a rolling 12 month period.
  - Deriving a funding plan based on the cash flow forecast
  - Setting up bank limits for funding requirements
    - Key is to diversify funders and currency
  - Maintaining a Cash War chest (based on organization's cash flows)

Points to consider

- What processes are in place to manage liquidity risk?
- What impact to financial instruments have on cash flows?
- How much Cash Limits to be established?
- How much funding Lines (committed) are in place?
- Are these sources diversified?
- Spread maturities of Debt to avoid bunching up of maturities?
- Are the stress scenarios stressful enough
- How much of cash war chest is to be maintained
- Inform Board periodically of liquidity stress issues in timely manner.

Operational Risk

Operational Risk

- Most varied of al major risks
- Loss due to failure of people, processes or systems, or due to an event beyond control like fire, floods etc.
- For accounting and finance professionals operating risks include accounting and valuation risk.
- Managed through
  - Policies, detailed procedures and qualified and trained staff
  - Set up a Business Continuity Plan and Disaster Recovery Plan.
  - Insurance Policies for possible operational risks

Points to be considered

- Mapping to staff qualification and experience to relevant jobs
- Risk and controls to be built in the organization DNA.
- Segregation of duties to be ensured to avoid frauds and errors.
- Proper risk assessment and purchase of adequate Insurance Covers.
- Incident reporting and management culture and practice to eb inculcated.
- Board to be informed on periodic basis of incidents posing operational risk from time to time.

Questions & Answers

Thank You