Risk Management and Internal Controls

The Bank is exposed to a range of risks, which if not managed, may affect our ability to deliver on our mandates.

As the country's central bank, the Bank's financial risk exposure comes from activities and operations that impact our balance sheet, such as our holding and management of international reserves. These include exposure to market risk whereby movements in exchange rates, interest rates and other market prices have the potential to adversely affect the value of our investments. The Bank is also exposed to credit risk, the potential for loss arising from default of an issuer or a counterparty.

We are exposed to non-financial risks arising from our day-to-day operations and a wide range of external factors. These include operational events that can disrupt our operations or cause systemic implications. The Bank is also exposed to reputational risk from the conduct of staff, engagement with stakeholders and events relating to our operations and policy decisions.

To systematically address these risks, the Bank has put in place a risk management framework that helps ensure that we conduct our operations and activities prudently and responsibly. We adopt an integrated and cohesive approach towards risk management, ensuring that significant risks confronting the organisation are identified, assessed, monitored and managed effectively.

In addition to formal structures and processes, the Bank emphasises a strong risk culture that promotes risk awareness and open communication on risk. Our aim is for all staff – at all levels and from all across the organisation – to be able to identify, understand, escalate and act on risks facing the Bank.

Our risk governance structure emphasises a shared responsibility for risk that begins with business units and is reinforced through strong risk management and control functions. The Board – supported by the Board Risk Committee – has overall responsibility on risk governance and oversight. The Board also sets the "tone from the top" in fostering a sound risk culture.

Management is responsible for implementing sound risk management frameworks and practices across the functions and operations of the Bank. This is discharged through the Risk Management Committee (RMC) and Reserve Management Committee. These committees meet regularly to deliberate on strategic and critical risks faced by the Bank. The Financial Risk Management Committee and the Operational Risk Management Committee support the RMC in providing oversight on the management of financial and operational risks respectively.

To support the Board and Management in discharging their risk oversight, responsibility within the organisation for addressing and managing risk is clearly assigned through a "three lines of defence" model. Each of the three lines has an important part to play to effectively manage risks.

Delivering on our mandates requires the Bank to take on risks. We recognise that we cannot eliminate all risks. Rather, we seek to operate within our Board-approved risk appetite and tolerance. We also evaluate the costs, benefits and other trade-offs involved in controlling or mitigating risks. For this purpose, a process for identifying, assessing, prioritising, reporting and monitoring our financial, operational and reputational risk exposures is in place.

To manage financial risks, the Bank closely monitors its market, liquidity and credit risk exposures, and has in place risk limits and controls. In our international reserves portfolio, investments are guided by a Board-approved diversified investment benchmark that outlines the Bank's long term appetite for risk and returns. Deviation from the benchmark is controlled using risk limits, clearly defined decision authorities and investment guidelines. The Bank also has in place a credit risk framework that outlines permissible investments and activities. For the Bank's general operations such as budgeting, procurement and payments, governance and controls are in place to ensure that the Bank allocates its expenditures and manages its finances prudently.

To manage non-financial risks, the Bank has put in place structures to identify and monitor risks on an ex-ante or pre-emptive basis. These include tools for the first line to conduct risk assessments, monitor risk levels and conduct simulations based on scenarios. These tools aid the Board and Management in ensuring that there are effective and adequate safeguards to mitigate the risks that the Bank is exposed to. An incident reporting system also complements these tools by facilitating systematic escalation of risk incidents, which in turn enables the organisation to respond more quickly to operational incidents, including business disruptions. A consistent framework for analysing the impact and likelihood of risks enables the Bank to identify and respond expediently to risk of disruptions that may have systemic implications, supported by business continuity and crisis management plans that are regularly updated.

Managing risks during the pandemic

The Covid-19 pandemic posed new challenges that tested the Bank's resilience as an organisation. The Bank swiftly implemented measures to ensure we would be able to deliver on our mandates. This entailed managing risks in four areas, namely, the safety and well-being of staff, continuity of critical functions, vulnerabilities posed by remote working, and reputational risks arising from policy decisions (Diagram 1). Valuable experiences from the crisis were used to review and strengthen our risk management

Diagram 1: Risk Management Focus Areas during COVID-19

Source: Bank Negara Malaysia

practices and crisis preparedness, so that we will be better prepared to face future challenges.

Business continuity and crisis management
All critical systems and functions continued to operate smoothly without any major disruption. These included critical functions such as treasury operations, currency management and payment systems. Staff in these critical functions were divided into three recovery teams, and split operations were activated at the onset of the crisis. Pre-identified isolation sites were also provided to staff who may have been exposed to higher risk of infection. Effective and clear lines of communication were established, including with relevant authorities[1]. This enabled swift transmission of information, timely escalation of critical issues, and quick decision-making.

Managing health risk
Keeping the staff safe was a priority for the Bank (for more information on the way the Bank adapted its working arrangements, refer to the chapter on People). Public-facing functions and processes such as press conferences, meetings, BNM LINK and Museum and Art Gallery operations were migrated online. We also introduced initiatives to support staff's well-being. These included provision of counselling and mental health programmes, online training and learning, as well as regular virtual engagement with the Bank's leaders.

Information security, cyber security and technology risk management
The Bank remained vigilant against cyber risks. In 2020, we continuously improved and strengthened our information security controls for remote access and information sharing to manage risks associated with working from home. The controls aimed to mitigate risk of data loss, exposure to technology risk and cyber threats. We continued our efforts to inculcate a more robust cyber security awareness culture among staff.

Reputational risk management
We focused on stakeholder management and communication strategies to manage the risks arising from the policies to assist individuals and businesses affected by the pandemic. The strategies were useful to help the public understand our policies and increase their efficacy. We utilised various communication channels, including social media in our outreach efforts. Engagement with stakeholders played a key role in supporting the effective implementation of policy measures in response to the pandemic. This included regular engagements with the financial industry and affected borrowers in implementing and fine-tuning the relief and recovery funds established by the Bank, as well as the loan repayment assistance measures to help borrowers in need.

Internal audit

The Board Audit Committee (BAC) is responsible for reviewing the effectiveness of the Bank's internal controls and compliance with legal and regulatory requirements. It provides oversight over the internal audit function of the Bank. It is also responsible for the integrity of our financial statements.

The Internal Audit Department provides independent assurance to the BAC on the adequacy and effectiveness of the Bank's governance, risk management and internal control processes. The department conducts regular assessments on the activities of the Bank and entities related to the Bank, to identify and address risks. An audit plan is developed each year and reviewed quarterly to ensure that audit activities reflect changes in the Bank's risk profile and emerging risks. Apart from providing assurance, the department also participates as an independent observer in several of the Bank's key projects and committees to help ensure that internal controls and governance arrangements are consistently upheld. Audit activities are conducted in conformance to the requirements of the Institute of Internal Auditors' International Standards for the Professional Practice of Internal Auditing. The principles espoused by the Committee of Sponsoring Organizations of the Treadway Commission are embedded in the audit approaches for assessing the Bank's control environment.

The Internal Audit Department also provides the Minister of Finance with an independent quarterly report on the Bank's international reserve management activities. This is to assure the Minister that the international reserves have been managed effectively in accordance with established policies and guidelines approved by the Board.

[1] These include the National Security Council, Royal Malaysian Police and Ministry of Health.

Diagram 2: Audit Focus Areas

AUDIT FOCUS AREAS 2020

INFORMATION & CYBER SECURITY MANAGEMENT

- *Automated Cash Centre – Information Technology and Operations Technology*
- *RENTAS SWIFT*
- *RENTAS Information Security Management System*
- *SWIFT Treasury*
- *SWIFT Transaction Control Services*
- *Digital & Technology Sector – Securities Services Systems (FAST & RENTAS eSSDS)*
- *Digital & Technology Sector – Procurement and Vendor Management*

OPERATIONAL AUDITS

- *Insurance Development*
- *Monetary Stability Sector Administration Unit*
- *Organisational Security Management*
- *Investment Operations and Financial Market (Monetary Policy Implementation and Management of Equities)*
- *Currency Management and Operations (Surprise Currency Verifications)*
- *Automated Cash Centre (Operations Audit)*
- *Finance (Fixed Income & Equity, Payment Operations and Business Technology and Systems)*
- *Legal*
- *Payment Oversight*

THE BANK'S PREPAREDNESS FOR THE PANDEMIC

- *Split Operations at Recovery Centre*
- *Safety & Health Risk Assessment*
- *Business Continuity Plan Arrangements and Practices*

KEY RISK AREAS ARISING FROM THE PANDEMIC

- *Policy Making*
- *Discharge of Statutory Responsibilities*
- *Stakeholder Engagement*
- *Business Continuity*
- *Payment and Procurement*
- *Cyber and Technology*
- *Human Capital Management*
- *Compliance*

RELATED ENTITIES

- *The South East Asian Central Banks (SEACEN) Research and Training Centre*
- *International Centre for Education in Islamic Finance (INCEIF)*

Source: Bank Negara Malaysia

Audit priorities in 2020 were adapted and aligned to account for the changes in the Bank's priorities and risk arising from the pandemic. Audits conducted during the year focused on the Bank's cybersecurity and technology infrastructure, stakeholder engagement, human capital management, policy formulation, and compliance with legal and regulatory requirements (Diagram 2). Several measures were also undertaken to improve the audit framework and assessments. These included introducing continuous off-cycle audit engagements, greater use of technology and data analytics in audit assessments and assessments on value for money to help improve the effectiveness and efficient use of resources. Good practices observed in audit assessments across the Bank were also shared to improve quality of controls.

Conclusion

The pandemic has further reinforced the need for risk management and internal governance arrangements to be both pragmatic and agile to respond to emerging threats. This involves consistently aligning our risk management philosophy with best practices, specifically in risk analytics, technology and cybersecurity. It also entails strengthening the risk culture throughout the Bank. Prudent risk management is key to ensure the Bank is effective in discharging our mandates and responsible in managing our resources.

References

Enterprise Risk Management

Governance & oversight

Risk Oversight

Board

Board Risk Committee (BRC)

Risk Management Committee (RMC), Reserve Management Committee (ReMC)

1st line of defence	2nd line of defence	3rd line of defence
Risk ownership	Risk function	Audit function

Policy & process

Risk Informed Decision Making Process

Step 1 – Risk identification → Step 2 – Risk assessment → Step 3 – Prioritisation & treatment → Step 4 – Monitoring & reporting → Risk Profile

Enterprise Risk Management Framework

Risk Appetite and Tolerance

Financial Risk	Operational Risk	Business Continuity Management	Reputational Risk
Market risk, liquidity risk and credit risk	Risk arising from people, process, systems and external events	Risk arising from business disruptions and system failures	Risk of loss of reputation

Tools

Scenario Analysis	Risk Control Self Assessment	Business Impact Analysis
Stress Testing	Incident Reporting	Business Continuity Plan
	Information Asset Profiling	Crisis Management Plan

Risk Impact & Likelihood Parameters

Key Risk Indicators

Effective practices

Risk culture assessment

Continuous training and awareness programmes

Source: Bank Negara Malaysia

Risk Management Governance Structure

Board of Directors

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Board Risk Committee*

Reserve Management Committee**

- Responsible for risks and investment strategies in the management of the Bank's international reserves
- Reviews risks emanating from the global economic and financial markets outlook, and the implications for the Bank's investment strategies and financial position

Risk Management Committee**

- Responsible for the overall management of risks faced by the Bank
- Ensures that strategic and critical risks are appropriately addressed

Operational Risk Management Committee***

- Provides oversight on the management of operational risks faced by the Bank and ensures that the risks are adequately managed

Financial Risk Management Committee***

- Provides oversight on the management of financial risks faced by the Bank and ensures that risks are adequately managed

Crisis Management Team***

- Provides oversight on the Bank's Business Continuity Management
- Ensures crisis preparedness
- Coordinates the Bank's response to operational disruptions

* Chaired by an Independent Non-Executive Director of the Bank
** Chaired by Governor
*** Chaired by a Deputy Governor

Source: Bank Negara Malaysia