

Risk Management Governance Structures and Accountability

The accounting authority of the Rural Housing Loan Fund (RHLF) is its Board of Directors. The control of the business and management of risk is exercised through the risk management framework of the company. The Board annually reviews and approves the risk management framework, as part of the Corporate and Strategic Plans submitted to the Executive Authority.

The Board delegates its responsibility for overseeing the management of risks pertaining to the company's business to the Audit Committee.

The RHLF executive management team is responsible for identifying and managing risks inherent to the operations of the company. The executive management reports quarterly to the Audit and Risk Committee on all key risks identified and any actions taken to address these risks.

The internal audit function is outsourced to Outsourced Risk and Compliance Assessment (ORCA), who independently audits the adequacy and effectiveness of the company's risk management, internal controls and corporate governance processes. The internal auditors report their findings directly to the Audit and Risk Committee.

KEY RISK CATEGORIES

1. Strategic Risk

Strategic risk relates to the risk that the company fails to deliver on its mandate. This risk can be broken down into the following:

1.1 Corporate strategy risk:

Corporate strategy risk revolves around the processes to ensure that the company achieves both financial performance and non-financial goals.

1.2 Business strategy risk:

Business strategy risk revolves around the processes that ensure management translates the statement of direction and intent generated at the board level into concrete objectives and strategies.

1.3 Functional strategy risk:

Functional strategy risk revolves around the processes that ensure that the annual objectives and short-term strategies are developed in their related functional areas.

Control of these risks is managed directly by the RHLF Board. The strategy and objectives are aligned with the RHLF mandate via the annual Corporate and Strategic Plan. The Corporate and Strategic Plan is approved by the Executive Authority and RHLF has strong governance and reporting structures in place to monitor performance against it.

2. Credit Risk

Credit risk arises when a counterparty to a financial transaction fails to meet its obligations in terms of the agreed terms and conditions of the contract. This can happen either because the counterparty is experiencing financial distress or there is a decrease in the fair value of the ceded securities. RHLF incurs credit risk in its lending and investing activities.

Credit risk is one of the company's most material risks and is managed in accordance with comprehensive policies and procedures that ensure adequate identification, measurement, monitoring, control and reporting of credit exposure.

The RHLF Board has approved the following credit / investment limits:

- Equity investments may not exceed 10% of total capital
- No single equity exposure may exceed 2% of total capital
- No single debt exposure may exceed 15% of total capital

Risk Management Governance Structures and Accountability *(continued)*

The RHLF Board has appointed a Credit and Development Committee (BCC) made up of non executive directors, to manage the credit risk associated with loans and advances. All transactions relating to new loans and advances facilities must be approved by the BCC.

Transactions relating to equity investments are approved by the RHLF Board, subject to final approval by the Executive Authority in terms of the Public Finance Management Act.

Credit risk relating to cash and short term deposits are managed by the RHLF executive management. Counter party risk is managed by ensuring that the company's cash equivalents and short-term deposits are placed with high credit quality financial institutions rated as at least A1 or better in terms of short-term credit ratings by at least two recognised rating agencies.

The credit risk management process

The credit risk management process starts at the company's Corporate and Strategic planning phase, when the company's risk appetite is reviewed in line with the company's developmental mandate. Key considerations are:

- RHLF's ability to continue to deliver impact in terms of its mandate
- Retain strategic flexibility
- Avoid losses that could materially affect delivery in terms of the mandate
- Current and future economic outlook that affects RHLF and its intermediaries.

RHLF has implemented a thorough risk acceptance process for all potential new intermediaries to ensure that they have an acceptable credit risk relative to the risk / reward inherent in the transaction. All new clients are subjected to a detailed due diligence prior to submitting the request to the BCC.

RHLF takes a consistent approach in identifying, measuring, recording, monitoring and managing credit

risk in its portfolio of intermediaries. The approach can be summarised as follows:

- **Account management:**

All intermediaries who are accepted into the portfolio are subjected to continuous monitoring and analysis. Ongoing account management, via the client executives, is aligned to clear credit policies and to inform the RHLF of changes in credit profiles of the various intermediaries.

- **Internal risk categorisation:**

RHLF applies an internally developed risk categorisation process to provide early warnings of unacceptable credit risk.

The process uses both objective and subjective measures to classify intermediaries into various risk categories. It also reviews the fair value of the ceded securities by evaluating relevant information supplied by the intermediary on a monthly basis.

- **Risk reviews:**

RHLF 's risk manager performs various risk reviews, ranging from general risk reviews to reviews of specific issues, at all the intermediaries in the RHLF portfolio.

- **Portfolio management:**

On a monthly basis the RHLF executive management meet with the client executives and the risk manager to review the performance of all the intermediaries in the RHLF portfolio. At these meetings the internal risk categorisation is discussed and update with the latest available information. This meeting also reviews and discusses potential frets to current clients and the market as a whole.

- **Board Credit and Development Committee**

The internal risk categorisation report combined with a summary of each intermediaries performance is presented and discussed at every BCC meeting.

Risk Management Governance Structures and Accountability *(continued)*

• **Board Audit and Risk Committee**

The internal risk categorisation report is reviewed and discussed at each meeting of the RHLF Audit and Risk Committee.

Loans and receivables are stated net of specific impairments. An impairment of loans and receivables is made if there is objective evidence that the company will be unable to collect all amounts due on a claim according to the original contractual terms. Loans and receivables are subjected to regular evaluations that take cognizance of, inter alia, past experience, the customer's overall risk profile and payment record and the realizable value of any collateral.

Impairment is measured and allowances for credit losses are established for the difference between the carrying amount and advances and its estimated recoverable amount. The estimated recoverable amount is the present value of expected future cash flows excluding those which may result from restructuring, liquidation or collateral held. All impaired loans and receivables are reviewed on a regular basis and any changes to the amount and timing of the expected future cash flows compared with previous estimates can result in a change to the charge for impairment of loans and receivables in the statement of comprehensive income.

The carrying value of impaired financial assets is reduced directly only when a write off takes place. In all other circumstances an allowance account is used for movement of carrying value. No amounts are ever written off directly against the allowance account

3. Market Risk

Market risk is the risk of a decrease in the fair value of a portfolio of financial instruments caused by an adverse movement in market values. This would include the following:

- Foreign exchange rate risk
- Interest rate risk.

RHLF has a limited exposure to Euro / Rand exchange rate.

This is as a result of a small Euro balance in an offshore bank account. The balance imitated from Euro payments received from Kreditanstalt für Wiederaufbau (KfW) as part of their funding arrangement.

Loan receivables are made to clients to fund end user loans. The repayment term of loan advances are linked to the repayment term of the underlying end user loans. Interest rates are determined by one of the following methods:

- Pricing of the Bond Exchange of South Africa yield curve for the same maturity plus a risk margin.
- Pricing of the Repo rate as set by SARB plus a risk margin.
- Pricing of the Prime lending rate in SA plus a risk margin.

The company's loans and receivables include loans with fixed rates of interest and loans which have an underlying reviewable margin above a fixed rate. The rates applicable to the loans with a reviewable margin are adjusted when such a review deems this necessary. The rates applicable to fixed interest rate loans are based on agreed market rates at the date of the disbursements and remain fixed for the full term of the loan.

The company is neither exposed to significant interest rate risk nor is it exposed to significant cash flow risk. This arises from the manner in which disbursements are priced to clients. The interest rate on each disbursement is fixed for the period of the loan but each disbursement is priced according to prevailing market interest rates thereby tracking the yield curve.

RHLF currently has only one long term interest bearing loan from the Development Bank of Southern Africa. The interest rate on this loan is fixed for the term of the loan.

4. Liquidity Risk

Liquidity risk is the risk that RHLF may have insufficient funds or marketable assets available to fulfil future cash flow obligations on time. RHLF currently has a strong capital bases and sufficient cash and short term investments.

Risk Management Governance Structures and Accountability *(continued)*

In terms of the loan agreement with the Development Bank of Southern Africa, RHLF is also subject to a liquidity requirement to hold liquid funds amounting to the maximum of 6 months of disbursements and 6 months of operating expenditure or 30% of total capital.

RHLF's liquidity management process is based on short and long term cash flow forecast.

5. Compliance Risk

Compliance risk relates to negative impact resulting from non compliance with applicable legislation and regulations. This risk further exposes RHLF to fines, civil claims, loss of authorisation to operate and inability to enforce contracts.

Compliance risk is managed through identifying, assessing, advising, monitoring and reporting on regulatory compliance risk at both executive management and Board levels.

Training is provided to staff and management to ensure that there is compliance with all prevailing laws and company procedures.

6. Operational Risk

Operational risk is the risk of direct or indirect loss resulting from inadequate or failed internal process, people or systems.

The risk is managed mainly through the systems of internal control, based on approved policies and procedures, and adequate segregation of duties and delegated authorities.

Operational risk includes fraud and financial misconduct, as well as risk pertaining to legal, human resources, information technology and business continuity.

The Audit and Risk Committee assists the RHLF Board by ensuring that the company maintains adequate accounting records, internal controls and systems that provide reasonable assurance on the integrity and reliability of

the financial information and to safeguard the company's assets.

The effectiveness of these internal controls and systems is monitored by internal audits.

The internal audit function is provided by an independent service provider. The internal audit is performed in terms of the company's internal audit charter that is reviewed annually. The internal auditors reports directly to the chairperson of the Audit and Risk Committee. The Audit and Risk Committee conducts its own assessment of the effectiveness of the internal audit function.

The Audit and Risk Committee approves the annual internal audit plan. The plan is based on the key risks identified in the review of enterprise wide risk. All business activities are subjected to the internal audit.

RHLF has a fraud prevention plan in place. This plan is reviewed and approved by the Board as part of the annual Corporate and Strategic Plan. During the year under review no incidents of fraud, financial misconduct or irregular activities were reported.

RHLF does have a disaster recovery plan in place to ensure that the company will be able to function in the event of a disaster. All electronic data is backed up every day and a copy of backed up data is stored of site on a weekly basis.

7. Reputational Risk

Reputational risk relates to the risk that RHLF's image could be damage. Any such damage could impair the company's ability to retain and generate future business.

RHLF manages this risk through the following:

- Always maintaining a strong focus on external stakeholders.
- Effective management of media and public queries.
- Ongoing evaluation and management of significant risk types highlighted above.