SMALL BUSINESS CORPORATION
Transforming the MSME landscape

DISCLOSURE ON MATERIAL RISK FACTORS AND MEASURES TAKEN TO MANAGE SUCH RISKS

A. Risk Management Policy

The Small Business Corporation (SBCorp) is committed to a systematic and comprehensive approach to effective management of potential opportunities and adverse effects, by achieving best practice in the area of risk management.

B. Enterprise Risk Management Framework

The Enterprise Risk Management (ERM) Framework of SBCorp was formally established with approval by the Governing Board of the ERM Manual through Board Resolution No. 2282, s. 2016 dated 10 March 2016.

Financial institutions are in the business of taking risks. SBCorp – as the organization charged primarily with the responsibility of implementing comprehensive policies and programs to assist micro, small and medium enterprises (MSMEs) by way of providing access to finance – has risk taking as an integral part of its business. Its ability to manage risks thus allows it to live up to its mandate as provided for under Republic Act No. 9501, otherwise known as the Magna Carta for Micro, Small and Medium Enterprises.

As a government financial institution attached to the Department of Trade and Industry, SBCorp aligns itself to national goals and objectives for MSME development as outlined in the MSME Development Plan. This provides the context by which SBCorp's ERM System operates.

SBCorp's Governing Board and Senior Management effectively drives Enterprise Risk Management, with the former being charged with approving and overseeing the implementation of the institution's strategic objectives, risk strategies and corporate governance while the latter manages day to day affairs. Together, they set the tone for managing risks across the enterprise which is shared at all levels of the organization.

The engine driving SBCorp's ERM vehicle is the linkage between its Strategic Planning, Risk Management and Capital Management Processes. This is anchored on four (4) key components, namely: 1) Risk Organization and Governance; 2) Processes and Policies; 3) Data and System Infrastructure; and, 4) Risk Measurements. These components undergo a continuous cycle of improvement where design translates to implementation and is regularly monitored for enhancement.

Thus, ERM is subject of an iterative process and takes on a dynamic form that adjusts to the ever changing risk environment and responds to both internal and external factors and changes in its business model.

C. Enterprise Risk Management Roles and Responsibilities

The following key principles guide SBCorp's approach to Enterprise Risk Management:

1. Board Risk Oversight Committee

The role of the Risk Oversight Committee is to set the direction and overall risk strategies. It provides oversight to Management, led by the President and CEO, ensuring that risks are managed across the organization in a timely and appropriate manner.

2. President and CEO

The President and CEO (PCEO) maintains ultimate accountability for the management of the organization's risks, including issuing directives for their management. The PCEO also authorizes and owns the ERM Policy and issues final approval of the ERM risk appetite statements.

3. Risk Management Committee

This refers to the existing Management Committee, with the participation of the Chief Risk Officer. It is a management-level committee chaired by the PCEO. It is tasked to oversee the development and implementation of processes used to analyze, prioritize, and address risks across the organization. These risks include the typical risks faced by a financial institution (e.g., credit, market, and operational risks), along with emerging risks that could impede SBCorp's ability to achieve its strategic objectives. The Risk Management Committee is broadly responsible for ensuring that risks are managed to create value and in a manner consistent with established risk appetite and risk tolerance levels.

4. Group Heads

Group Heads (GHs), collectively called as Middle Management, serves as the ultimate risk owners. Groups will adopt and follow the ERM Framework and the ERM Policy and participate in enterprise-wide risk management efforts and perform risk management activities within their respective offices. GHs are responsible for implementing consistent risk management practices in alignment with this policy. It will be the responsibility of the GHs to disaggregate the enterprise-level risk appetite statements into unit-specific risk limits, where applicable. They will also assist the ERM Unit in creating ad-hoc risk analysis teams to serve as Subject Matter Experts during the risk identification and analysis process.

5. Chief Risk Officer

The Chief Risk Officer (CRO) serves as the principal advisor to the PCEO on all risk matters that could impact the Corporation's ability to perform its mission. The CRO is responsible for the design, development and implementation of the ERM program at SBCorp. The CRO, in conjunction with the ERM Unit, will lead the Corporation in conducting regular enterprise risk assessments of business processes or programs at least annually and will oversee the identification, assessment, prioritization, response, and monitoring of enterprise risks. The CRO will take an active role in strategic planning and integration of risk management principles across the enterprise.

6. ERM Unit

This refers to the existing Enterprise Risk Management Group. The Unit leads ERM activities under the supervision of the CRO. Such activities include developing and maintaining ERM policies, processes, procedures, tools, and information systems; leading efforts to perform enterprise risk identification, assessment, prioritization, reporting, and monitoring; and, establishing ERM communication at all levels and for gathering data and developing risk reports.

D. Management of Material Financial Risks

SBCorp is exposed to a variety of financial risks such as market risk (including currency risk, interest rate risk and price risk), credit risk, and liquidity risk. The financial risks are identified, measured and monitored through various control mechanisms to assess adequately the market circumstances to avoid adverse financial consequences to the Corporation. This is to ensure that the Corporation performs its mandate as a Government Financial Institution (GFI) and not merely duplicates what the private sector and other GFIs are already doing. This is to likewise optimize the utilization of National Government investments by not contributing to the cycle of poverty and debt for small business owners.

The Corporation's risk management policies for each financial risk factor are summarized below:

1. Credit Risk

In view of its mandate to safeguard the interest of the public and contribute to the promotion of stability in the economy, SBCorp manages credit risk at all relevant levels of the organization. The Corporation defines credit risk as the risk that the loans granted to borrowers and/or other financial institutions will not be paid when due, thereby causing the Corporation to incur financial losses.

SBCorp therefore exercises prudence in the grant of loans over its exposures to credit risk, taking into consideration the developmental objectives of the Corporation as mandated by the Magna Carta for MSMEs. This is managed through the implementation of the borrower risk rating and monitoring of loan covenants in the loan agreements. The borrower risk rating is being used, among others, as basis for determining credit worthiness of loan applicants. Further, the Corporation mitigates such credit risks through the acceptance of eligible collaterals as secondary form of payment.

2. Market Risk – Interest Rate Risk and Foreign Exchange Risk

The Corporation anticipates, measures, and manages its interest rate sensitivity position to ensure its long-run earning power, build-up of its investment portfolio and avoid economic losses. Special emphasis is placed on the change in net interest income/expense that will result from possible fluctuations in interest rates, changes in portfolio mix and tenor.

The Corporation manages its currency risk against foreign exchange rate fluctuations on its foreign currency denominated borrowings through a Foreign Exchange Risk Cover (FXRC) secured from the Department of Finance at a given cost for the term of the loan. The Corporation's exposure to market risk for changes in interest rates relates primarily to the Corporation's loans from various financial institutions.

3. Liquidity Risk

The Corporation seeks to manage its liquidity profile to be able to finance capital expenditures and service maturing debts. To cover its financing requirements, the Corporation intends to use internally generated funds and available long-term and short-term credit facilities.

As part of its liquidity risk management, the Corporation regularly evaluates its projected and actual cash flows and institutes liquidity risk controls. It also continuously assesses conditions in the financial markets for opportunities to pursue fund raising activities, in case any requirements arise. Fundraising activities may include bank loans and capital market issues.