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GUIDELINES ON ENTERPRISE RISK MANAGEMENT FOR COMMERCIAL BANKS

AUGUST, 2024

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1.0 AUTHORITY

The Bank of Sierra Leone (BSL) empowered under section 65 of the Bank of Sierra Leone Act 2019 and section 53 of the Banking Act 2019, hereby issues these Guidelines on Enterprise Risk Management.

These Guidelines shall be read in conjunction with the Guidelines on Corporate Governance for Commercial Banks and Financial Holding Companies 2023.

2.0 APPLICATION

These Guidelines shall apply to all commercial banks and financial holding companies licensed to conduct banking business in Sierra Leone by the Bank of Sierra Leone under the Banking Act 2019.

3.0 INTERPRETATION

In these Guidelines, unless the context otherwise requires:-

"**Risk Appetite Framework (RAF)**" is the overall approach, including policies, processes, controls, and systems through which risk appetite is established, communicated, and monitored. It includes a risk appetite statement, risk limits, and an outline of the roles and responsibilities of those overseeing the implementation and monitoring of the RAF. The RAF should consider material risks to the commercial bank or financial holding company, as well as to the institution's reputation vis-à-vis depositors, investors, and customers. The RAF should be aligned with the commercial bank or financial holding company's strategy.

"**Risk Appetite Statement (RAS)**"is the articulation in written form of the aggregate level and types of risk that a commercial bank or financial holding company may accept, or avoid, to achieve its business objectives. It includes qualitative statements as well as quantitative measures expressed relative to earnings, capital, risk measures, liquidity and other relevant measures as appropriate. It should also address more difficult-to-quantify risks such as reputation and conduct risks as well as unethical practices.

"**Risk Capacity**" is the maximum level of risk the commercial bank or financial holding company can assume given its current level of resources before breaching constraints determined by regulatory capital and liquidity needs, the operational environment (e.g. technical infrastructure, risk management capabilities, expertise) and obligations, also from a conduct perspective, to depositors, shareholders, fixed income investors, as well as other customers and stakeholders.

"**Risk appetite**" is the aggregate level and types of risk a commercial bank or financial holding company is willing to assume within its risk capacity to achieve its strategic objectives and business plan.

"**Risk limits**" are the quantitative measures based on forward-looking assumptions that allocate the commercial bank or financial holding company's aggregate risk appetite statement (e.g. measure of loss or negative events) to business lines, legal entities as relevant, specific risk categories, concentrations, and as appropriate, other levels.

"**Risk profile**" is the point-in-time assessment of a commercial bank and financial holding company's gross and, as appropriate, net risk exposures (after taking into account mitigants) aggregated within and across each relevant risk category based on forward-looking assumptions.

"**Risk Management Framework**" is the totality of systems, structures, policies, processes, and people within a commercial bank or financial holding company that identifies, measures, evaluates, monitors, reports, and control or mitigates all internal and external sources of material risks.

"**Risk Management Strategy**" is a document that provides an overview of how the risk management framework addresses each material risk for the commercial bank or financial holding company, with reference to the relevant policies, standards, and procedures.

"**Material Risks**" are those that could have significant impact; financial and non-financial, on the Commercial bank or financial holding company.

"**Risk Culture**" is a commercial bank's or financial holding company's norms, attitudes and behaviors related to risk awareness, risk-taking and risk management, and controls that shape decisions on risks. Risk culture influences the decisions of management and employees during day-to-day activities and has an impact on the risks they assume.

4.0 OBJECTIVES

The main objective of these Guidelines is to enhance the regulatory architecture by explicitly incorporating a robust Enterprise Risk Management Framework that is coherent with supervisory expectations as set in the Corporate Governance Guidelines for Commercial Banks and the Risk Based Supervisory Framework for Financial Institutions in Sierra Leone. Other specific objectives include;

i. An Enterprise Risk Management Framework enables a commercial bank or financial holding company to identify, analyze and manage the current and emerging material risks within its business.

ii. (Effective approaches to risk management provide meaningful information that appropriately supports decision-making and oversight at each level within the commercial bank or financial holding company.

iii. The Enterprise Risk Management Framework will ideally support a commercial bank and financial holding company in:

a. facilitating a sound risk culture;

b. identifying, analyzing and understanding each of the material risks at all levels of the commercial bank or financial holding company;

c. ensuring that appropriate strategies, policies, effective internal controls and other mitigants are in place and operating effectively;

d. providing reliable and meaningful risk information, that is, reporting to decision-makers;

e. ensuring that there is adequate oversight of the risk profile and management framework.

iv. Enhance the role of the board in its oversight of risk management policies and their implementation by senior management;

v. Highlight the role of senior management in ensuring that sound policies, effective procedures and robust systems are established;

vi. Enhance risk governance at commercial banks and financial holding companies thereby complementing the expectations set by BSL in the Corporate Governance Guidelines and the Risk Based Supervisory Framework for Financial Institutions in Sierra Leone;

5.0 ENTERPRISE RISK MANAGEMENT

5.1 The Role of the Board and Senior Management

(a) The Board of a commercial bank or financial holding company is ultimately responsible for the enterprise risk management framework and oversight of its operation.

In particular, the Board shall ensure that:

(i) it sets the risk appetite within which it expects management to operate and approve the institution's risk appetite statement and risk management strategy (RMS);

(ii) it forms a view of the risk culture in the commercial bank or financial holding company, and the extent to which that culture supports the ability of the institution to operate consistently within its risk appetite, identify any desirable changes to the risk culture and ensure the commercial bank or financial holding company takes steps to address those changes.

(b) Senior Management of the commercial bank or financial holding company monitors and manages all material risks consistent with the strategic objectives, risk appetite statement and policies approved by the Board.

(c) The operational structure of the commercial bank or financial holding company facilitates effective risk management.

(d) Policies and processes are developed for risk-taking that are consistent with the RMS and the established risk appetite.

(e) sufficient resources are dedicated to risk management; and

(f) it recognises uncertainties, limitations and assumptions attached to the measurement of each material risk.

6.0 ENTERPRISE RISK MANAGEMENT FRAMEWORK (ERMF)

(a) A Commercial Bank or financial holding company shall maintain an ERMF that enables it to appropriately develop and implement strategies, policies, procedures and controls to manage different types of material risks and provides the Board with a comprehensive view of material risks.

(b) The ERMF shall be consistent with the business plan required under 6.4 below.

(c) The ERMF shall provide a structure for identifying and managing each material risk to ensure the commercial bank or financial holding company is being prudently and soundly managed, having regard to the size, business mix and complexity of its operations.

(d) The ERMF shall, at a minimum, include:

(i) a RAF and RAS, including risk limits.

(ii) an RMS.

(iii) a business plan.

(iv) policies and procedures supporting clearly defined and documented roles, responsibilities, and formal reporting structures for the management of material risks in the commercial bank or financial holding company.

(v) a designated risk management function that meets the requirements of 6.6 below.

(vi) a management information system(s) (MIS) that is adequate under normal circumstances and in periods of stress, for measuring, assessing, and reporting on all material risks in the commercial bank or financial holding company; and

(vii) a review process to ensure that the ERMF is effective in identifying, measuring, evaluating, monitoring, reporting, and controlling or mitigating material risks.

(e) The ERMF shall include forward-looking scenario analysis and stress testing programs, commensurate with the commercial bank or financial holding company's size, business mix and complexity, which are based on severe but plausible assumptions.

(f) The MIS shall provide the Board and senior management with regular, accurate and timely information concerning the commercial bank or financial holding company's risk profile. The MIS shall be supported by a robust data framework that enables the aggregation of exposures and risk measures across business lines, prompt reporting of limit breaches, and forward-looking scenario analysis and stress testing. Data quality shall be adequate for timely and accurate measurement, assessment and reporting on all material risks across the commercial bank or financial holding company and shall provide a sound basis for making decisions.

6.1. Material risks

The ERMF shall, at a minimum, address:

(i) credit risk

(ii) market risk

(iii) liquidity risk

(iv) operational risk

(v) strategic risk

(vi) regulatory and compliance risk

(vii) ML/FT risk; and

(viii) other risks that, individually or in combination with different risks, may have a material impact on the commercial bank or financial holding company.

6.2. Risk Appetite

6.2.1 A commercial bank or financial holding company shall develop and establish an effective Risk Appetite Framework (RAF).

6.2.2 The RAF shall:

(a) establish a process for communicating its content within the institution as well as sharing non-confidential information to external stakeholders (e.g., shareholders, depositors, fixed income investors).

(b) be driven by both top-down board leadership and bottom-up involvement of management at all levels and embedded and understood in the institution.

(c) facilitate embedding risk appetite into the institution's risk culture.

(d) evaluate opportunities for appropriate risk-taking and act as a defense against excessive risk-taking.

(e) allow for the RAS to be used as a tool to promote robust discussions on risk and as a basis upon which the board, risk management and internal audit functions can effectively and credibly debate and guide management recommendations and decisions.

(f) be adaptable to changing business and market conditions so that, opportunities requiring an increase in the risk limit of a business line or legal entity could be met while remaining within the agreed risk appetite, but subject to approval by the board and senior management;

6.2.3 A commercial bank or financial holding company must maintain an appropriate, clear, and concise risk appetite statement that addresses its material risks. The Board shall be responsible for setting the risk appetite of the institution and must also approve the risk appetite statement.

6.2.3.1. An effective RAS shall:

(a) include key background information and assumptions that inform the commercial bank or financial holding company's strategic and business plans at the time they were approved.

(b) be linked to the commercial bank or financial holding company's short-term and long-term strategic, capital, and financial plans, as well as compensation programs.

(c) establish the amount of risk the commercial bank or financial holding company is prepared to accept in pursuit of its strategic objectives and business plan, taking into account the interests of its depositors and the fiduciary duty to shareholders, as well as capital and other regulatory requirements.

(d) determine for each material risk the maximum level of risk that the commercial bank or financial holding company is willing to operate within, based on its overall risk appetite, risk capacity, and risk profile.

(e) include quantitative measures that can be translated into risk limits applicable to business lines and legal entities as relevant, which in turn shall be aggregated and disaggregated to enable measurement of the risk profile against risk appetite and risk capacity.

(f) include qualitative statements that articulate clearly the motivation(s) for taking or avoiding certain types of risks across retail and wholesale markets, and establish some form of boundaries or indicators (e.g., non-quantitative measures) to enable monitoring of these risks.

(g) ensure that the relevant strategy and risk limits of each business line and legal entity align with the institution's risk appetite statement; and

(h) be forward-looking and subject to scenario and stress testing to ensure that the commercial bank or financial holding company understands what events might push the institution outside its risk appetite and/or risk capacity.

6.2.3.2. The RAS shall, at a minimum, convey:

(a) the degree of risk that the commercial bank or financial holding company is prepared to accept in pursuit of its strategic objectives and business plan, giving consideration to the interests of depositors and other stakeholders (risk appetite);

(b) for each material risk, the maximum level of risk that the commercial bank or financial holding company is willing to operate within, expressed as a risk limit and based on its risk appetite, risk profile and capital strength (risk tolerance);

(c) the process for ensuring that risk tolerances are set at an appropriate level, based on an estimate of the impact in the event that risk tolerance is breached, and the likelihood that each material risk is realised.

(d) the process for monitoring compliance with each risk tolerance and for taking appropriate action in the event that it is breached; and

(e) the timing and process for review of the risk appetite and risk tolerance.

6.2.4. Risk limits should:

(a) be set at a level to constrain risk-taking within risk appetite, taking into account the interests of customers (e.g. depositors, other stakeholders) and shareholders as well as capital and other regulatory requirements, in the event that a risk limit is breached and the likelihood that each material risk is realised;

(b) be established for business lines and legal entities as relevant and generally expressed relative to earnings, capital, liquidity or other relevant measures (e.g., growth, volatility);

(c) include material risk concentrations at the commercial bank or financial holding company or group-wide, business line and legal entity levels as relevant (e.g. counterparty, industry, country/region, collateral type, product);

(d) not be overly complicated, ambiguous, or subjective; and

(e) be monitored regularly.

Reference to market best practices and benchmark risk limits shall not be strictly based on comparison to peers or default to regulatory limits.

6.3. Risk Management Strategy (RMS)

6.3.1 A Commercial Bank or financial holding company shall maintain an RMS that addresses each material risk listed under 6.1 approved by the Board.

6.3.2 The RMS is a document that describes the strategy for managing risk and the key elements of the ERMF that give effect to this strategy. At a minimum, an RMS shall:

(a) describe each material risk identified, and the approach to managing these risks;

(b) list the policies and procedures dealing with risk management matters.

(c) summarise the role and responsibilities of the risk management function.

(d) describe the risk governance relationship between the Board and its committees with respect to the ERMF; and

(e) outline the approach to ensuring officials and staff of the commercial bank or financial holding company have awareness of the ERMF as it relates to their role and for instilling an appropriate risk culture across the institution.

6.4. Strategic Business Plan

6.4.1 A Commercial Bank or financial holding company shall maintain a written plan that sets out the approach for the implementation of its strategic objectives (strategic business plan).

6.4.2 The strategic business plan shall be a rolling plan of at least three years' duration that is reviewed at least once a year, with the results of the review reported to the Board. The strategic business plan shall cover the entirety of the institution and be approved by the Board.

6.4.3 A commercial bank or financial holding company shall identify and consider the material risks associated with its strategic business plan and shall explicitly manage these risks through the ERMF, including how changing these plans affects the institution's risk profile.

6.5. Policies and procedures

6.5.1 The policies and procedures required under subparagraph 6.3.2(b) shall include:

(a) the process for identifying and assessing material risks and controls;

(b) the process for the validation, approval and use of any models to measure components of risk;

(c) the process for establishing, implementing and testing mitigation strategies and control mechanisms for material risks.

(d) the process for monitoring, communicating, and reporting risk issues, including escalation procedures for the reporting of material events and incidents.

(e) the process for identifying, monitoring, and managing potential and actual conflicts of interest.

(f) the mechanisms in place for monitoring and ensuring ongoing compliance with all prudential requirements;

(g) the process for review and ensuring consistency across the ERMF, including the components identified under 6.5.1(d);

(h) the process for establishing and maintaining appropriate contingency arrangements (including robust and credible recovery plans where warranted) for the operation of the ERMF in stressed conditions; and

6.5.2 A commercial bank or financial holding company shall review each policy or procedure at least once a year. It shall state the date of the last review, and who was responsible for the review.

6.6. Risk Management Function

6.6.1 A commercial bank or financial holding company shall have a designated risk management function that, at a minimum:

(a) Shall be responsible for assisting the board committees and senior management of the institution to maintain the ERMF.

(b) Shall be appropriate to the size, business mix and complexity of the institution.

(c) Shall be operationally independent.

(d) has the necessary authority and reporting lines to the board committees and senior management to conduct its risk management activities in an effective and independent manner;

(e) Shall be resourced with staff who have clearly defined roles and responsibilities, and who possess appropriate experience and qualifications to exercise those responsibilities;

(f) Shall have access to all aspects of the institution that have the potential to generate material risk, including information technology systems and systems development resources; and

(g) Shall be required to notify the Board of any significant breach of, or material deviation from, the ERMF.

6.6.2 A Commercial Bank shall designate a person to be responsible for that function, referred to in these Guidelines as a Chief Risk Officer (CRO). The CRO shall be involved in, and have the authority to provide guidance to, activities and decisions that may materially affect the commercial bank or financial holding company's risk profile.

6.6.3 The CRO shall be independent of business lines, other revenue-generating responsibilities, and the finance function. The CRO shall not be the Chief Executive Officer (CEO), Chief Financial Officer or Head of Internal Audit.

6.6.4 The CRO shall have a direct reporting line to the CEO and direct, regular and unfettered access to the Board and the Board Risk Committee.

6.7. Compliance Function

6.7.1 A commercial bank or financial holding company shall have a designated compliance function that assists senior management in effectively managing compliance risks. The compliance function shall be adequately staffed by appropriately trained and competent persons who have sufficient authority to perform their role effectively and have a reporting line independent from business lines.

6.8. Review of the ERMF

6.8.1 A Commercial Bank shall ensure that compliance with, and the effectiveness of, the ERMF is subject to review by internal and external audit at least once a year. The results of this review shall be reported to the Board Audit Committee.

6.8.2 A Commercial Bank or financial holding company shall, in addition to 6.8.1, ensure that the appropriateness, effectiveness and adequacy of the ERMF shall be subject to a comprehensive review by operationally independent, appropriately trained, and competent persons (this may include external consultants) at least every three years. The results of this review shall be reported to the Board Risk Committee.

6.8.3 The scope of the comprehensive review shall take into consideration the size, business mix and complexity of the commercial bank or financial holding company, the extent of any change to its operations or risk appetite, and any changes to the external environment in which the institution's operates.

6.8.4 The comprehensive review of the ERMF shall, at a minimum, assess whether:

(a) the framework is implemented and effective.

(b) it remains appropriate, taking into account the current business plan.

(c) it remains consistent with the Board's risk appetite.

(d) it is supported by adequate resources; and

(e) the RMS accurately documents the key elements of the ERMF that give effect to the strategy for managing risk.

6.8.5 Where a material change to the size, business mix and complexity of the operations is identified outside the review required in 6.8.4, the Commercial Bank or financial holding company shall assess whether any amendment to, or a review of, the ERMF is necessary to take account of the developments at that time.

6.9. Risk Management Declaration

6.9.1 The Board of a commercial bank or financial holding company shall make an annual declaration to BSL on risk management of the institution that shall satisfy the requirements set out in Attachment A to this document. The declaration shall be signed by the chairperson of the Board and the Chairperson of the Board Risk Committee.

6.9.2 The Board of a Commercial Bank shall qualify the risk management declaration of the institution, if there has been any significant breach of, or material deviation from, the ERMF or the requirements set out in Attachment A to this document. Any qualification shall include a description of the cause and circumstances of the qualification and steps taken, or proposed to be taken, to remedy the problem.

6.9.3 Unless otherwise approved by BSL, a Commercial Bank or financial holding company shall submit the risk management declaration to BSL within three months of the end of a calendar year.

6.10. Notification requirements

6.10.1 A commercial bank or financial holding company shall on adoption, and following any material revisions, submit to BSL a copy of;

(a) risk appetite framework and statement.

(b) strategic business plan.

(c) policies and procedures; and

(d) risk management strategy as soon as practicable, and no more than 10 business days, after Board approval.

6.10.2 A commercial bank or financial holding company shall notify BSL as soon as practicable, and no more than 10 business days, after it becomes aware:

(a) of a significant breach of, or material deviation from, its ERMF; or

(b) that the ERMF of the institution did not adequately address a material risk.

6.10.3 A commercial bank or financial holding company shall notify BSL as soon as practicable, and no more than 10 business days, after it becomes aware of any material or prospective material changes to the size, business mix and complexity of the institution.

6.10.4 Where a Commercial Bank or financial holding company conducts business in a jurisdiction outside Sierra Leone, it shall notify BSL as soon as practicable, and no more than 10 business days, after it becomes aware that its right to conduct business in that jurisdiction has been materially affected by the law of that jurisdiction or its right to conduct business has ceased.

7.0 EFFECTIVE DATE

These Guidelines shall become effective on the date of their publication in the Gazette.

Attachment A - Risk Management Declaration

1. For the purposes of Section 6.9 of these Guidelines, the Board of a Commercial Bank or financial holding company shall provide BSL with a risk management declaration of the institution stating that, to the best of its knowledge and having made appropriate enquiries, in all material respects:

    (a) the commercial bank or financial holding company shall put in place systems for ensuring compliance with all prudential requirements.

    (b) the systems and resources that are in place for identifying, measuring, evaluating, monitoring, reporting, and controlling or mitigating material risks, and the ERMF, are appropriate to the commercial bank or financial holding company, having regard to the size, business mix and complexity.

    (c) the risk management and internal control systems in place are operating effectively and are adequate having regard to the risks of the commercial bank or financial holding company they are designed to control.

    (d) the commercial bank or financial holding company shall have an RMS that complies with this Prudential Standard, and has complied with each measure and control described in the RMS.

    (e) the commercial bank or financial holding company is satisfied with the efficacy of the processes and systems surrounding the production of financial information.