

# **Risk Management Policy**



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## 1. Policy Objectives and Background

### 1.1. Policy Background

CDC's mission is to support the building of businesses throughout Africa and South Asia, to create jobs and to make a lasting difference to people's lives in some of the world's poorest places. Risk is an inherent component of CDC's activities. The ability to effectively identify, assess, measure, respond, monitor and report on risk in activities is critical to the achievement of CDC's mission and objectives.

### 1.2. Policy Objective

The objective of this policy is to set out the principal risk types that may face CDC group, CDC's appetite for these risks, and how CDC will manage these risks.

### 1.3. Policy Sponsor and Maintenance

The COO is the sponsor of this policy and is responsible to review and maintain this policy and submit it to the Board Risk Committee for review and recommendation to the Board for approval at a minimum once every two years.

## 2. Risk Types and Risk Appetite

CDC accepts that a level of risk is necessary in order to do business. CDC has identified five main categories of risk that it may face:

- Investment Risk
- Development Impact Risk
- Environmental and Social Risk
- Business Integrity Risk
- Operational Risk

In addition to these risk types, CDC has identified reputational risk as a risk that it faces, which could be a consequence of any of the five main risk categories. These risks are further defined and sub-categorised in the CDC Risk Taxonomy, which sets out the risk likelihood scale and risk impact definitions for each risk category. CDC assesses individual risks based on their impact and likelihood. These risks are then mapped to a risk appetite grid to determine whether the risk is within or outside appetite as set by (and periodically reviewed by) the Board of Directors. The risk appetite describes the amount of each risk that CDC is willing to take in order to achieve its objectives. The CDC Risk Taxonomy is reviewed periodically to ensure it remains consistent with the risk appetite set by the Board.

CDC's present risk appetite is set out below.

<b>Impact</b>	<b>Extreme</b>	Medium	High	High	High
	<b>Major</b>	Medium	Medium	High	High
	<b>Moderate</b>	Low	Medium	Medium	High
	<b>Minor</b>	Low	Low	Medium	Medium
		<b>Unlikely</b>	<b>Possible</b>	<b>Likely</b>	<b>Frequent</b>

### 2.1. Investment Risk

CDC's Memorandum of Associations states that in carrying out its mission it is expected to "achieve attractive returns for shareholders". The financial risks at CDC are the risks of underperformance or unacceptable volatility of the investment portfolio return versus the chosen return to be achieved over the long term, including due to changes in foreign currency exchange rates.

The inherently risky nature of the markets and projects in which CDC invests means high volatility in portfolio returns is accepted. However, a long term target return is periodically agreed between CDC's management, Board and shareholder. CDC should seek to earn a long-term return greater than this target, currently 3.5% per year. Failure to achieve this target, measured on a long term basis, is a major risk to CDC and CDC's appetite for this risk is minimal.

### 2.2. Development Impact Risk

Development impact is at the heart of CDC's mission and the primary reason for its existence. Development impact risk is the risk that CDC will fail to achieve its development objective to create jobs and make a lasting difference to people's lives in some of the world's poorest places. Failure to achieve significant development impact is therefore a major risk to the viability of CDC's work and CDC's appetite for this risk is minimal.

### 2.3. Environmental and Social Risk

CDC invests in countries and sectors where Environmental and Social (E&S risks) may be inherently high as a result of an absence of legislation and/or ineffectual oversight and implementation of national and international E&S laws and regulations.

E&S risks in CDC investments cover risks associated with direct and indirect (including through supply chains) impacts, as well as cumulative and induced impacts.

E&S performance is increasingly material to businesses and failure to assess, mitigate and manage such risks can result in (i) loss of market access and business opportunities, (ii) increased staff turnover, labour problems and reduced production efficiency, (iii) reduced ability to attract finance and investment, (iv) regulatory action, and (v) inability to operate as a result of community concerns about the behaviour and impacts of a company. All of the preceding can result in reputational risks to investee companies and CDC.

### 2.4. Business Integrity Risk

This is the risk that the reputation, franchise or image of CDC is adversely affected by business integrity incidents at CDC or at companies in which CDC has invested capital.

The Board has minimal appetite for the disruption and reputation damage associated with a major public business integrity incident and expects this risk to be mitigated with strong controls.

### 2.5. Operational Risk

This is the risk of loss or other damage to CDC resulting from inadequate or failed processes, people and systems at CDC or from external events impacting CDC.

The reputational risk from a public airing of a major operational incident at CDC is not acceptable to the Board. The residual risk needs to be managed such that the possibility of a £10 million financial impact is remote, c. 1% or 1 in 100 years where measurable. The necessary cost base to achieve this is accepted.

## 3. Behaviours and Culture

The culture and behaviours of staff at CDC are critical to ensuring effective risk management.

The requirements are set out CDC's policies and procedures, including for example in the Business Integrity Manual and HR Policies and Procedures. Regarding risk management, the key requirements are:

- Risk and risk management is considered in business decision making
- CDC management and staff are expected to disclose and take appropriate action to mitigate known risks

## 4. Governance and roles and responsibilities

**Board** – The Board is responsible for setting overall risk appetite and approving risk management policies.

**Board Risk Committee** – The Board Risk Committee is established to oversee risk management and make recommendations to the board on risk management policy and risk appetite. The Board Risk Committee is also responsible for reviewing the principal risks facing CDC and escalating risk matters to the Board.

**Management** – Management is responsible for implementation of the risk management policy and framework within their respective areas of responsibility. Management is responsible for monitoring levels of risk and developing action plans to reduce risks to within appetite if appropriate and escalating risk matters to the Board Risk Committee for their consideration. Management may assign responsibility for the management of specific risks to individuals within the firm, referred to as 'Risk Owners'. Management is also responsible for setting 'tone at the top' in respect of risk management culture.

**Three lines of defence** – Within the company, CDC generally adopts a ‘three lines of defence’ model to managing risk. However, the size of the organisation means that in some cases there is overlap between the first and second lines of defence. This risk is mitigated by ensuring independent oversight from the Internal Audit function.

- 1st line – the functions that own and manage risk (operational management)
- 2nd line – the functions that oversee risk (risk management and compliance functions)
- 3rd line – functions that provide independent assurance

The CEO and COO, as members of senior management with responsibility for risk management are viewed as above the three lines of defence.

The designation of functions or individuals within a particular line of defence is not intended to prohibit team working and collaboration between teams or to suggest a ‘hierarchy’ between teams.

	1 <sup>st</sup> Line	2 <sup>nd</sup> Line	3 <sup>rd</sup> Line
Investment Risk	- Investment Teams - CIO	- Investment Committees (Investment Decisions) - Finance Department (Valuations) - CIO (Portfolio construction) - Risk Management	- Internal Audit - External Audit
Development Impact Risk	- Investment Teams - Operations Teams - CIO	- Investment Committees - DI Team - Risk Management	- Internal Audit - External auditor of DI grid scores
Operational Risk	- Investment Teams - Operations Teams - Finance Teams - CIO	- Risk Management	- Internal Audit
Reputational Risk	- Investment Teams - Operations Teams - CIO	- Investment Committees - E&S Team - BI Team - Risk Management	- Internal Audit

## 5. CDC’s risk management framework

CDC’s management is responsible for developing and implementing a framework to identify, assess, measure, respond, monitor and report on risk within CDC’s activities. CDC’s risk framework consists of the following key components:

- **Aims and objectives** – CDC’s corporate objectives and individual / team objectives are defined each year. They provide the basis for determining CDC’s risk appetite.
- **Policies and procedures** – policies set the rules under which CDC will operate and procedures describe how these policies need to be implemented, including setting out the key controls in place to mitigate risk.
- **Risk registers** – risk registers document the risks facing CDC, the controls in place to mitigate those risks and assess the impact and

likelihood of the risk occurring. If risks are assessed as being outside appetite, mitigation plans are developed to reduce the level of risk.

- **Key risk indicators** – key risk indicators are metrics used to provide an early signal of increasing risk exposures. They allow CDC to identify risk trends and take action before events occur.
- **Incident management** – incident management and analysis allows CDC to ensure appropriate action is taken when incidents occur (when risks crystallise), validate the contents of the risk registers and determine whether action is required to avoid reoccurrence of similar incidents in future.
- **Risk reporting** – reporting on identified risks to management and the board, including emerging risks and those that require action.
- **Internal Audit monitoring** – independent monitoring of the implementation of the risk framework to ensure it is adequately designed and operating effectively.

Further detail on each component of the risk management framework is set out in internal procedures manuals.