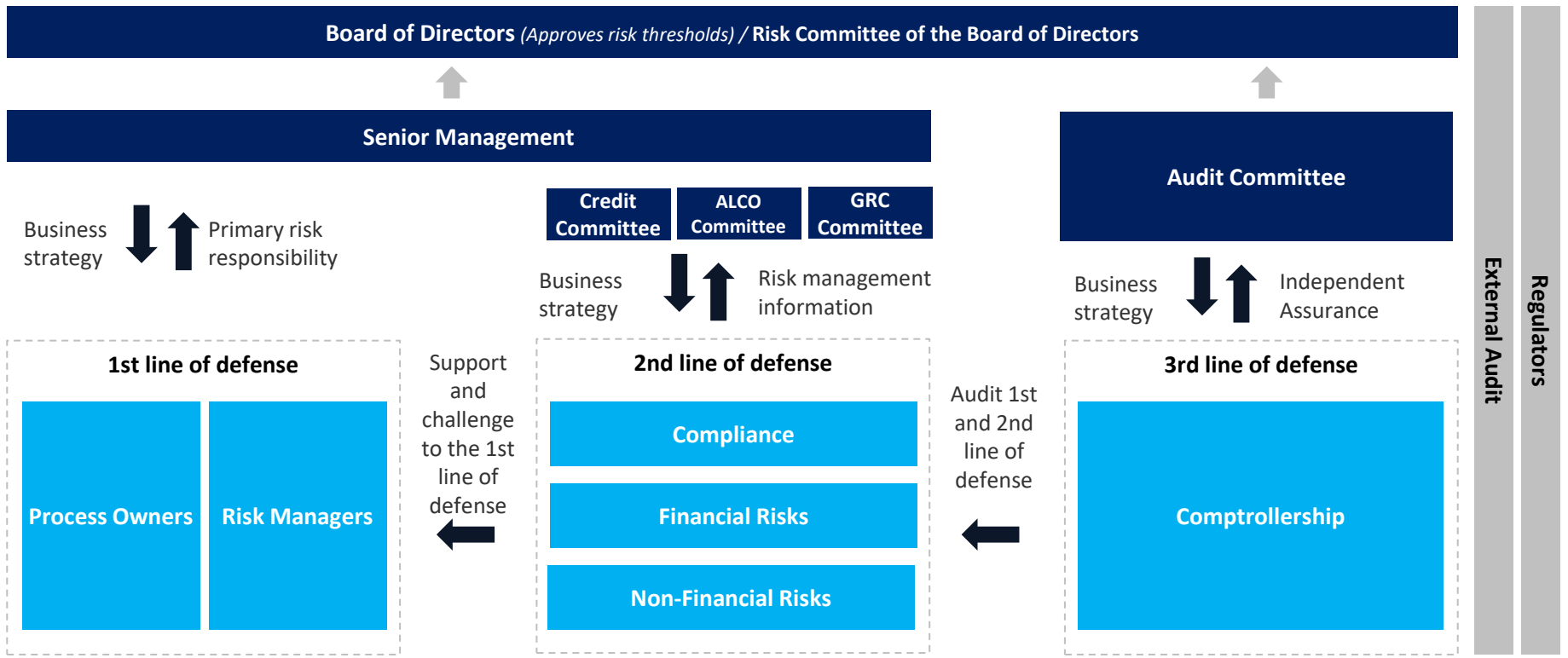


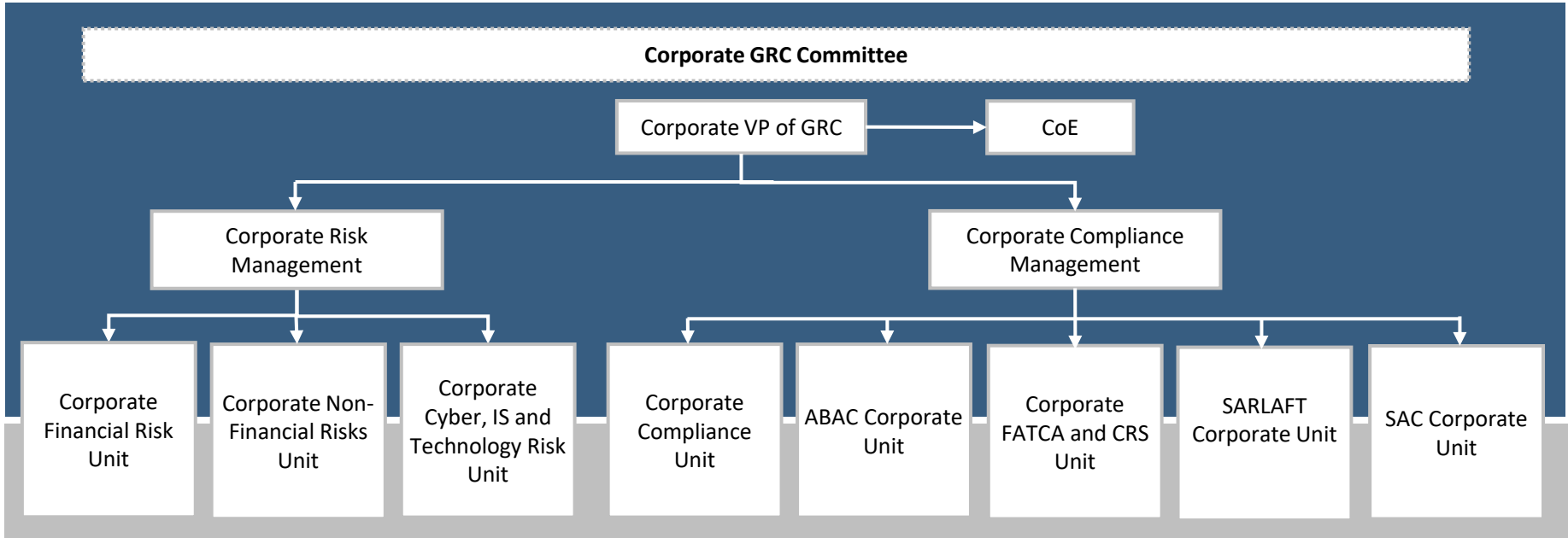
## Financial Risks

Governance, Risk and  
Compliance  
Corporate Vice-Presidency

The three lines of defense (3LoD) model provides a risk management framework by defining management, supervision and control responsibilities, the 3LoD are articulated as follows:



Based on the design of the Corporate Governance, Risk and Compliance Model, we established and developed a series of initiatives, the most relevant of which was the definition of the structure to support the model.



- With this structure, we consolidated our position as one of the first companies in the Group to have a Comprehensive Risk and Compliance Management.
- Currently, 2LoD is made up of highly qualified people with extensive experience to lead the challenges we face.

Each Affiliate and Subsidiary has its own structure, which is under the direction of the Corporate VP of GRC.

■ Corficolombiana ■ Financial Affiliates



## **Risk**

Risk is the combination of the possibility of occurrence of uncertain events and their consequences in the future.

## **Market Risk**

Market risk is defined as the possibility of incurring losses associated with a decrease in the value of an asset due to fluctuations in its market price.

## **Liquidity Risk**

Liquidity risk has two different meanings. The first is understood as the possible losses that may be generated by *"The inability to fully and timely fulfill payment obligations on the corresponding dates, due to insufficient liquid resources and/or the need to assume excessive funding costs."* Secondly, it is understood as the risk that an asset may have to be sold at a price lower than the market price due to scarce supply and demand.

## **Credit and Counterparty Risk**

Credit Risk is the possibility that the entity incurs losses and decreases the value of its assets as a result of a debtor or counterparty breaching its obligations.

## **Treasury**

Treasury is defined as the areas responsible for customer relations and commercial aspects, negotiation or trading, compliance and recording of treasury operations.

## **Back Office**

This is the area in charge of performing the operational aspects of the treasury. For example, the closing and registration in the securities trading systems, the closing and accounting registration and final authorization of operations; in other words, it is the area in charge of the completion and fulfillment of operations.

## **Middle Office:**

This area is in charge of risk measurement and analysis, periodic review and evaluation of the valuation methodologies of financial instruments and verification of compliance with the policies and limits established by the applicable regulations and by the entity's administrators.

## **Front Office**

This is the area in charge of negotiation, customer relations and/or commercial aspects of treasury.

## **Financial Instrument**

A financial instrument is an asset that grants its buyer the right to receive capital or future income from the seller. They can be issued by any economic unit (company, government, etc.).

## Types of Financial Assets

- Bank Deposits
- Fixed Income (Bonds, CDTs, Public Debt, Promissory Notes, Securitizations)
- Variable Income (Stocks, Indices)
- Derivatives
- Currencies
- Investment Funds

## Fixed Income Instrument

These are debt issues made by states and companies aimed at a broad market. The term fixed refers to the term to maturity of the bonds and not to the price, which is subject to market fluctuations, although not as pronounced as in the case of shares.

## Variable Income Instrument

Variable income instruments are especially those that are part of equity, such as company shares. The term "variable" is related to the variation that may occur in the amounts received as dividends or variations in market value. Therefore, dividends may be in cash or in shares.

## Derivative Instrument:

A derivative is a financial instrument whose value depends on (or is derived from) the value of another more basic or underlying variable and whose fulfillment or settlement occurs at a later time.

## Underlying

An underlying of a derivative financial instrument is a directly observable variable such as an asset, price, exchange rate, interest rate or index, which, together with the par value of and payment terms, serves as the basis for structuring and settling a derivative financial instrument.

## Discount Rate.

Discount rate is that used to calculate the present value of the cash flows in the valuation process.

## Forward Price or Rate

The forward price or rate is the price or rate at which the exchange is agreed in the future such that at the time of the creation of the agreement there is no exchange of money between the parties.

## Spot Rate or Spot Price

The spot rate or spot price of a commodity, bond or currency is the price that is agreed upon for immediate transactions (purchases or sales).

## Internal Rate of Return (IRR)

The discount rate at which the net current value or net present value (NCV or NPV) equals zero. The IRR can be used as an indicator of the profitability of a project: the higher the IRR, the higher the profitability; thus, it is used as one of the criteria for deciding on the acceptance or rejection of an investment project.



## Market Risk

The most common measure used for market risk is **VaR or Value at Risk**. VaR is the measure of the maximum expected loss that can be incurred on an asset.



## Liquidity Risk

The most common measure is the **Liquidity Risk Indicator LRI** which measures the level of liquid assets required to cover liquidity requirements and needs for different time bands.



## Credit and Counterparty Risk

The most common measure is the **Expected Loss (EL)**, which is defined as the expected value of credit risk loss over a given time horizon, resulting from the probability of breach, the level of exposure at the time of breach and the severity of the loss.

The main objective in the management of financial risks is to identify, measure, control and monitor the market, credit and liquidity risk to which the entity is exposed in the development of its authorized operations, including treasury operations, taking into account its structure and size.

## WHAT TO DO

### Stages:

- Identify
- Measure
- Monitor
- Control

## HOW TO DO IT

### Elements :

- Policies
- Organizational Structure
- Methodologies
- Process
- Training and dissemination strategies
- Documentation

## WHO IS RESPONSIBLE

- Board of Directors
- Risk Committee
- Risk Unit
- Internal Control and Statutory Audit
- Front Office



## What should be included

Definition by type of risk

Contemplate the stages

Define risk factors

Guidelines on new products or markets

Establish Roles and Responsibilities

Set limits

## Measurement Policies

Define calculation model

Policy versus Level of Confidence

Calibration periodicity of measurement models

## Monitoring Policies

Define the management reporting system

To whom should they be addressed

Periodicity

Policy Excesses and Exceptions, Powers

Investment Valuation	Market Risk	Liquidity Risk	Credit and Counterparty Risk
<ul style="list-style-type: none"> <li>Chapter I “Classification, valuation and accounting of investments”.</li> </ul>	<ul style="list-style-type: none"> <li>Chapter XXI “Rules relating to the market risk management system”.</li> </ul>	<ul style="list-style-type: none"> <li>Chapter VI “Liquidity risk management rules”.</li> </ul>	<ul style="list-style-type: none"> <li>Chapter II “Credit risk management”.</li> </ul>
<ul style="list-style-type: none"> <li>External Circular 006, 033 and 039 of 2012 “Regulation of the price provider scheme.”</li> </ul>	<ul style="list-style-type: none"> <li>Annex 1 (EC, Officials E., Senior O. Coop. and SCB)</li> <li>Annex 2 (Trust Companies, AFPs, Portfolio Managers, FICs)</li> <li>Annex 3 (General Insurance)</li> </ul>	<ul style="list-style-type: none"> <li>Annex 1 (EC, Officials E., Senior O. Coop.</li> <li>Annex 2 (SCB)</li> <li>Annex 3 (Trust Companies and open FICs without permanence covenant)</li> </ul>	<ul style="list-style-type: none"> <li>Chapter XXVII of the CBCF Rules relating to counterparty risk management</li> </ul>

