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<u>CIRCULAR TO ALL FINANCIAL INSTITUTIONS</u>

Risk Management Guidelines

In line with Bank of Uganda's move to adopt a risk-based approach to supervision which focuses on assessing each financial institution's risk management systems that are in place to identify, measure, control and monitor the levels and types of risks assumed, all financial institution are hereby enjoined to develop their own comprehensive Risk Management Programme (RMP) tailored to their particular needs and circumstances. To assist financial institutions in this undertaking, Bank of Uganda is issuing an initial set of Risk Management Guidelines for the most common risks in the financial system.

Risk is the potential that events, expected or unexpected, may have an adverse impact on the financial institution's capital or earnings. Financial institutions are subjected to a wide array of risks in the course of their operations. It should also be recognized that most financial risks are subject to complex interdependencies, i.e., a financial institution engaged in foreign currency business is normally exposed to foreign exchange rate risk but will also be exposed to liquidity and interest rate risk if the institution carries open positions or mismatches in its forward book. In this connection, the RMP should at least cover the basic risk: credit risk, liquidity risk, interest rate risk, foreign exchange risk and operational risk. In addition, financial institutions are encouraged to identify the different types of risks arising from primary business activities or major product lines using a Functional Risk Matrix form, a sample of which appears in section 8 of the Risk Management Guidelines.

For each particular risk, RMP should include risk identification, risk management, risk control and risk monitoring. In addition, the following elements of a sound risk management system should also be incorporated in a financial institution's RMP(1) active board and senior management oversight, (2) adequate policies, procedures and limits; (3) adequate risk monitoring and management information system; and (4) adequate internal controls. Special emphasis should be given to risks arising from off-balance sheet business such as letters of credit, guarantees, forward foreign exchange transactions, swaps, options and other derivative products. The risks associated with off-balance sheet business are no different from on-balance sheet business and as such should be regarded as an integral part of the financial institution's overall risk profile.

Bank of Uganda recognizes that the primary responsibility of understanding and managing risks assumed by a financial institution is vested with its board of directors. At the organizational level, however, overall risk management should be assigned to an independent Risk Management Committee or Risk Manager reporting directly to the board of directors. The Risk Management Committee or the Risk Manager shall take full responsibility for evaluating the overall risk faced by a financial institution and determining the level of risks that will be in the best interest of the financial institution.

Every financial institution shall submit to Bank of Uganda a copy of its RMP including the mandate of its Risk Manager or the mandate and membership of its Risk Management Committee on or before 31st March 2003.

Bank of Uganda shall review the adequacy of the RMP of each financial institution through off-site analysis, on-site examinations or risk assessment visits.

Updated on RMP shall likewise be submitted to Bank of Uganda within 15 days from its implementation date.

J. Bagyenda (Mrs)
Ag. EXECUTIVE DIRECTOR, SUPERVISION

C.C. Governor
C.C. Ag. Deputy Governor