Risk Management

Introduction

There are many risks in the markets in which Bank Danamon operates. A range of factors, some of which are beyond the Bank's control, can influence performance. In many of its businesses, Bank Danamon constantly and deliberately assumes financial risk in a calculated and controlled manner.

Bank Danamon believes in Enterprise Risk Management as an approach to manage all risks. This requires a proactive, systematic risk management and disciplined process covering all risks in all activities - Credit Risk, Market Risk, Liquidity Risk and Operational Risk. Risks such as Reputation Risk, Legal Risk and Compliance Risk are managed as part of Operational Risk.

An Integrated or Enterprise Risk Management culture is firmly entrenched throughout the Bank. The Bank's management takes a holistic approach to risk management based upon sound principles and values, encompassing a well-defined risk strategy, proper board structures, active working committees with clear roles, responsibilities, authorities and levels of delegation. Risk management is assessed in terms of key performance indicators. It is disseminated through detailed policy manuals and documentation and is independently audited and assessed.

Risks and methods defined

The risks inherent in operating the bank day to day are summarised under a number of different categories as follows:

Credit risk is defined by a borrower's ability to meet repayment, interest or other obligations due to the Bank. Credit risk is managed using established policies and procedures covering the origination, underwriting, maintenance and collection of all credits to ensure the risk profile is within an acceptable range. Such ranges are defined by portfolio limits for the bank as a whole and separately for each business line. Portfolio limits take into account individual business plans and capabilities, industry or other concentrations and trends, economic conditions, product profitability and expected credit losses.

A credit risk management function within each line of business ensures there is proper segregation of duties between management authorised to grant credit up to a limit based on an individual's experience and track record and the nature of business requirements and the Integrated Risk Group who independently assess and regularly review individual credits. A further independent review is undertaken by Internal Audit.

Bank Danamon's Credit Risk Management benchmarks itself against international practice, commonly understood "best practices" in the field of Credit Risk Management. Compliance with relevant Bank Indonesia regulations is of highest priority, as is compliance with all other laws and regulations. In anticipation of the introduction of Basel II guidelines in Indonesia, we are currently working towards compliance with Basel II principles, which we expect to reach in the course of 2007.

Market risk otherwise known as price risk, is associated with instruments traded in various financial markets. Value at risk or VaR is used to measure market risk to ensure that the Bank has sufficient capital to meet the minimum Capital Adequacy Ratio set by Bank Indonesia. It is an estimation of the potential maximum loss as a result of price risk with a 99% confidence interval. In other words 99% of the time our maximum potential losses will be less than this amount. Our bank uses VaR based limits in managing the overall risk exposure.

Market risks are monitored and measured daily based on established pricing models. Trading and investment positions are marked to market every day. The Bank's risk management group maintains a conservative approach, ensuring that all positions are within the limits set for risk appetite and risk tolerance. The market risk policy is reviewed and updated on a monthly basis to conform with new Bank Indonesia and Basel II requirements. The Bank further reviews market risk through the regular application of fictitious but plausible unfavourable scenarios (stress tests), which could cause substantial changes to the price of any underlying assets or instruments being held or traded. These specific stress tests complement the VaR assessment.

Liquidity risk is defined as the ability of the Bank to fund or meet its liabilities when they fall due on a day-to-day basis. Bank Danamon's overriding premise requires that the Bank be adequately funded under any and all circumstances. A liquidity framework exists through which management can clearly distinguish between liquidity requirements for trading activities and liquidity requirements for traditional banking activities. At all times the maturities of both assets and liabilities are monitored to ensure the Bank is able to meet all its obligations without having to liquidate assets early, and face potentially penal rates in so doing.

The Asset and Liability Committee (ALCO) is responsible for managing the interest rate & liquidity risk occurring in the Banking (non-trading positions) Book. The Market and Liquidity Risk Division supports the ALCO and reports to the Head of Integrated Risk Management who reports directly to the President Director.

Operational risk is the risk of direct or indirect loss resulting from inadequate or failed internal processes and generally refers physical or technology driven events, human error or deliberate action, legal risk and the occurrence of fraud. There were no material cases of fraud outstanding as of December 31st 2005 (please also refer to page 69 "Outstanding Litigation"). A systematic operational risk management framework is in place to ensure all operational risks are properly identified and controlled in a timely manner and regular comprehensive self-assessment checks are in place in all key areas of the Bank. Further independent reviews of the effectiveness and integrity of controls are carried out with a brief to make improvements at every step.

Bank Danamon manages operational risk following rules and regulations issued by Bank Indonesia and benchmarking itself against international best practice.

Business Continuity Planning

In 2005 the Bank examined and began the process of implementing Business Continuity Management (BCM) and Business Impact Analysis (BIA). Benchmarking to an international bank, strategies are being developed to manage high risk events. A BCM team has been formed, developing a framework, methodology, policy and plan for business continuity should a high risk event occur. Training in BCM was provided by third party professionals.

Managing of Risk

The improvements and changes effected in 2005

All risk positions are carefully reviewed, on a regular basis including daily and intra-day examinations. In addition monthly comprehensive reviews are undertaken of all likely risks and of the risk parameters themselves to ensure they are still relevant. External factors and trends in markets, in business sectors and the economy as a whole are also evaluated. The risk assets are identified and measured (portfolio stress-test) in the regular portfolio meeting, which was attended by senior officers in risk management. The result was reviewed by the Risk Management Committee in the monthly Integrated Risk Meeting.

New policy manuals and procedures were established for all businesses and activities, such as: a Risk Management Policy Manual which was issued by Credit Risk Management as part of the Good Corporate Governance framework, KYC policies & procedures which were revised to strengthen anti money laundering, and policies on Product Transparency. Clearly defined product approval processes have been established. Any new product or activity requires prior approval by all relevant authorities in Bank Danamon, including Risk Management, Legal, Compliance and Accounting to ensure compliance with all relevant laws, external regulations and Bank Danamon's internal standards and procedures. Existing processes are reviewed periodically. As in the past, processes and methodologies of affiliated companies will be reviewed, evaluated and amended if necessary.

A new application system - Central Liability System - was established by Credit Risk Management in 2005 for better monitoring and controlling the risks. This application system has functionalities for setting, monitoring and managing all bank-wide limits and exposures. The system captures Corporate, Commercial, and SME bank-wide exposures against various counterparties, including on and off balance sheet items, and permits flexible ways of analysing the exposure and monitoring against limits. It enables bank wide credit risk management and business units to control credit limits within the bank across the products and customers by providing/capturing limits and exposures from product processors.

For market risk management, Bank Danamon uses the Summit system for front, middle and back office functions. Straight-Through-Processing (STP) is used for foreign exchange instruments and semi-manual settlement for bonds, money markets and derivatives transactions. To minimize credit risk due to failed transactions, all trades must have appropriate settlement risk limits that are administered by the Market and Liquidity Risk Division.

To manage and monitor the operational risks, operational risk event and loss data was tracked with new systems as prepared for the implementation of Basel II. The Bank is now able to monitor all conventional branches. Moreover, quarterly control self-assessments were exercised by all units with operational risk. The measured key process tables and scoring methodology were improved to strengthen controls. The results identifies a map of high risk units, causes, and their improvement program. This monitoring report with all other parameters generated Risk profile reports for management and Bank Indonesia.

Risk Management Committees

Crucial frequent and robust testing of the overall risk management architecture is a central function of management committees in their role to assess the quality and effectiveness of the bank's risk management. Their duties, composition and frequency of meeting are described below:

Risk and Audit Committee (RAC) of the Board of Commissioners

Risk and Audit Committee (RAC) carries overall responsibility for the reviewing the development and monitoring the implementation of risk management, risk and credit policies, risk and credit strategy and the risk tolerance level of the bank, including limits imposed on certain borrowers, industries and market segments. Implicit in these responsibilities is to ensure potential losses can be identified and mitigated in advance.

Membership of RAC - Board of Commissioners

No.	Name	Function
1	Milan R. Shuster	Commissioner / Chairman
2	Harry A.S. Sukadis	Commissioner
3	Manggi Taruna Habir	Commissioner
4	Liew Cheng San Victor	Commissioner
5	Setiawan Kriswanto	Audit Committee member
6	Hadi Indraprasta	Audit Committee member

The RAC of the Board of Commissioners met 20 times in 2005.

Integrated Risk Management Committee (IRMC)

Integrated Risk Management Committee is a committee established to implement an effective risk management and to ensure the application of the risk supervision through determination of risk tolerance, limit, and the strategy of risk management.

IRMC members

No.	Name	Function
1	Tejpal Singh Hora	Integrated Risk Head / Chairman
2	Sebastian Paredes	President Director
3	Jerry Ng	Vice President Director
4	Anika Faisal	Compliance & Legal Director
5	Rene Burger	Corporate Banking & Financial Institution Head
6	Lam Kun Kin	Treasury and Capital Market Head
7	Ali Yong	Transaction Services Head
8	Wolf A. Kluge	Credit Risk Management Head
9	Gan Peng Hoei	Market & Liquidity Risk Management Head
10	Donnaria Silalahi	Operational Risk Management Head
11	Restiana Linggadjaya	Internal Audit Head

The Integrated Risk Management Committee met 11 times in 2005.

Portfolio Risk Management Committee (PRMC)

Portfolio Risk Management Committee is responsible for monitoring bank wide risk assets portfolio, recommending portfolio limits, assessing risk exposures, evaluating the potential losses under different stress test scenarios and relating it to the capacity of the Bank's capital to sustain the risks.

PRMC members

No.	Name	Function
1	Tejpal Singh Hora	Integrated Risk Head / Chairman
2	Sebastian Paredes	President Director
3	Wolf A. Kluge	Credit Risk Management Head
4	Stevy Salindeho	Corporate Banking & FI Credit Risk Head
5	Lim Geok Sim	SMEC Credit Risk Head
6	Rafael Melendez	Consumer Credit Risk Head
7	Farmawaty Tan	Mass Market Credit Risk Head
8	Bambang Kuswijayanto	Syariah Credit Risk Head
9	Restiana Linggadjaya	Internal Audit Head

The Portfolio Risk Management Committee met 11 times in 2005.

Business Credit Committees (BCC)

Responsible for the approval of credit proposals and quality of the underwriting standards within any business, BCC members are delegated discretionary limits, based upon their skill and experience. All credits must be approved by at least 2 members of the BCC, one of whom must have a limit to approve the credit.

Asset and Liability Committee (ALCO)

ALCO is responsible for setting out the strategy and policy for managing the Bank's Banking Book risks relating to interest rates and liquidity. ALCO also monitors and manages the mismatches between assets and liabilities. The appropriate action prescribe by ALCO is executed by Treasury.

ALCO members

No.	Name	Function
1	Lam Kun Kin	Treasury & Capital Market Head / Chairman
2	Sebastian Paredes	President Director
3	Jerry Ng	Vice President Director
4	Tejpal S. Hora	Integrated Risk Head
5	Vera Eve Lim	Chief Financial Officer
6	Rene Burger	Corporate Banking & Financial Institution Head
7	Alfin Tolib	Treasury Division Head
8	Harjanto Tjandra	ALM Head
9	Ali Yong	Transaction Services Head
10	Gan Peng Hoei	Market and Liquidity Risk Management Head

The Asset and Liability Committee met 9 times in 2005.

Operational Risk Committee (ORC)

Reviewing operational issues arising in the course of normal business, the ORC initiates corrective action where warranted and disseminates adjustments and changes to policy throughout the Bank. The regular meetings were conducted to bring up and solve major operational issues.

ORC members

No.	Name	Function
1	Tejpal Singh Hora	Integrated Risk Head / Chairman
2	Donnaria Silalahi	Operational Risk Mgt. Head
3	Ali Yong	Transaction Services Head
4	Restiana Linggadjaya	Internal Audit Head
5	Atul Rasikbhai Patel	Operations Head
6	Bijono Waliman	Internal Control Unit Head
7	Dini Herdini	Legal Head
8	Hadi Wibowo	Mass Market Operations Head
9	Juwono Akuan Rokanta	SMEC Credit Support & Administration

The Operational Risk Committee met 6 times in 2005.

As part of Integrated Risk Management, especially for protecting the Bank against money laundering and other illegal practices, Bank Danamon also has Know Your Customer Committee who oversees the "know your customer programme". This committee is lead by the Compliance Director and involving the heads of business units.

Integral to the Bank's pursuit of highest standard, specialized training is conducted for those who disseminate best practice in risk management through out the Bank.

Nine Risk Management trainers gained certification from Badan Sertifikasi Manajemen Risiko in 2005.