Risk Management Report

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Risk management

Risk is broadly defined as the possibility that an uncertain event or outcome results in adverse variations in profitability or in losses. Risks might also negatively impact the strength of the Group's balance sheet, its market capitalisation or its brand and reputation. In the process of performing its function as a financial intermediary, the Group is exposed to various categories of risk, such as credit risk, asset and liability management risk (including market and liquidity risk), operational risk and other risks (such as strategic risks, financial risks of climate change, compliance risk).

Within its risk appetite and tolerance limits and in accordance with its strategic objectives, the Group takes on and manages risks, and controls and monitors them prudently. The Group actively, comprehensively and systematically manages risk and promotes a strong risk and control culture across all business areas. The established risk management process comprises four core elements:

- Identification of risks across all business activities
- Assessment and measurement of risks, including stress testing
- Limitation, mitigation and transfer of risks
- Effective controls, monitoring and reporting.

Risk governance structure

The Board of Directors is ultimately responsible for determining the Group's risk strategy, risk appetite and corresponding tolerance levels. It has established an effective internal control system that: (i) ensures that material risks are assessed and controlled; (ii) oversees the Group's risk profile to ensure it is correctly monitored and managed; and (iii) ensures that the risk management framework and strategies are correctly implemented.

The Group has put in place regulations that govern the risk management and control processes to ensure that all material risks are recorded and supervised. These processes are supported by a framework of approved internal regulations, which set out the principles guiding the Group's attitude to risk and the amount of risk it is willing to take on.

The Group has set up a risk appetite framework, which includes integrated tolerance limits to control overall risk-taking. It contains a diverse set of quantitative metrics and qualitative statements covering various risk categories and serves as a decision-making tool for the Management Board. As part of the Group risk policy, it is reviewed at least annually by the Board of Directors and takes into account strategic objectives and business plans. The risk profile is assessed relative to the Group's risk appetite, and risk exposures are monitored relative to risk tolerance limits on a regular basis. Summary reports are reviewed by the Audit and Risk Committee and reported to the Board of Directors.

Four working committees have been set up. Members of the Management Board are required to attend regular committee meetings:

Committee	Risk category
Credit Committee	Credit risk
Asset & Liability Committee (ALCO)	Asset & liability management, market & liquidity risk, capital management
Risk & Controllership Committee (RCC)	Risk management framework, internal control system, compliance & operational risk management, information security, data privacy, business continuity management, other risks
Sustainability Committee	Sustainability, related opportunities and risks, monitoring of environmental, social, and governance (ESG) trends and ratings, climate-related risks

The Group's risk and control framework operates along the three lines model:
- First line: business functions are responsible for ensuring that a risk and control environment is in place and maintained as part of day-to-day operations
- Second line: control functions provide independent control and oversight of risks
- Third line: the internal audit function evaluates the overall effectiveness of the control environment and provides additional independent assurance.

This three lines model ensures that direct accountability for risk decisions, implementation and oversight of risk management, and the independent control of the effectiveness of risk management are segregated. Internal regulations further detail the expected principles of risk management and control for various risk categories.

Credit risk

Credit risk is the risk to earnings or capital that may arise from the possibility that a borrower or counterparty may fail to honor their contractual obligations. The obligations include, for example, repayment of principal, interest and fees. A consequent loss may be partial or complete and may arise at any time as a result of a number of isolated or interlinked circumstances. The Group is exposed to credit risk on all its lending products.

The Credit Committee serves as the main decision-making body concerning credit strategies and exposures, and regularly reviews the Group's credit risk performance. The Credit Committee is responsible for making lending decisions on individual counterparties and lending programmes that are not under the authority of the Chief Risk Officer (CRO) or specific subsidiaries, but under the authority of the Board of Directors. The Credit Committee is chaired by the CRO.

The guidelines for the approval of lending programmes, as well as individual counterparty lending approvals, are set out in the credit risk policy. Lending authority that has been delegated, is actively monitored and reviewed regularly.

Credit risk metrics, portfolio and collection performance reports and macroeconomic trends are reviewed by the Credit Committee regularly, at least once every quarter. Summary reports of the Group's credit risk profile are reviewed by the Audit and Risk Committee every quarter and reported to the Board of Directors.

The Group maintains stringent underwriting processes, which are continually monitored and optimised to ensure that credit risk is adequately and responsibly managed. Prior to granting credit, the customer's creditworthiness, credit capacity and, where applicable, collateral are assessed. The customer's creditworthiness is evaluated by an automated credit risk rating system, which includes the use of scorecards and leverages available information about the customer. This ensures consistent and systematic decision-making across all lending products.

Where applicable, the credit capacity of consumers is also evaluated in accordance with the legal requirements of the Swiss Consumer Credit Act. Internal models determine the credit amount based on the customer's risk profile. Segments that are particularly exposed to credit risk are actively restricted beyond the requirements of the Swiss Consumer Credit Act through specific internal rules that aim to effectively implement and ensure responsible lending practices. Manual underwriting complements the automated system decision in cases where additional information may be required.

The quality of portfolios and specific customer segments is thoroughly and periodically assessed. Specifically in the area of vehicle leasing the Group is exposed to risks related to the valuation of underlying assets or objects. Contractual residual values might differ from actual values of lease objects and distribution partners might fail to honour their contractual obligations. In addition to the consistent setting of residual values at lease origination the Group regularly monitors its exposure to this type of risk and makes use of external data sources to verify results. The quality and performance of new business are monitored to ensure that the credit approval process continues to effectively mitigate credit risk, and underwriting procedures are being correctly followed. Scorecards are regularly monitored and back-tested to ensure their performance remains within expected levels and, if required, changes are made to the models. Segmented collection strategies are implemented to tailor activities to customer groups with different payment behaviours and to ensure optimal resource allocation and effective mitigation of credit risk. In exceptional individual

cases loan restructuring in a form of loan modification is granted (see also our approach to sustainability on page 29). The regular monitoring and control of performance metrics and processes ensure diligent and responsible execution and support the fair treatment of customers across a variety of servicing processes.

For its lending products, the Group uses consumer ratings (CR) to assess overall credit quality. There are five consumer ratings, each having an implied probability of default based on historical default experience, with default being defined as 90 days past due or write off. The Group's financing receivables from non-defaulted customers (before allowance for losses) at 31 December 2022 and 2021 were distributed among the CRs as follows:

At 31 December 2022[1]	Personal loans	Auto leases and loans	Credit cards	Total
CR1	43.4 %	53.3 %	72.8 %	52.8 %
CR2	31.7 %	32.7 %	19.4 %	30.2 %
CR3	18.0 %	11.6 %	7.2 %	13.3 %
CR4	5.1 %	1.9 %	0.5 %	2.9 %
CR5	1.7 %	0.5 %	0.0 %	0.9 %

[1] Does not include eny Credit GmbH, Swissbilling SA, Byjuno AG and Byjuno Finance AG

At 31 December 2021[2]	Personal loans	Auto leases and loans	Credit cards	Total
CR1	42.2 %	52.5 %	75.4 %	52.5 %
CR2	33.1 %	32.2 %	17.9 %	30.1 %
CR3	18.1 %	12.6 %	6.3 %	13.6 %
CR4	5.0 %	2.1 %	0.5 %	2.9 %
CR5	1.7 %	0.6 %	0.0 %	0.9 %

[2] Does not include eny Credit GmbH and Swissbilling SA

The Group is utilising behavioural scoring to enhance consumer rating methodology by considering customer behaviour through the life-cycle and its impact on probabilities of default. This enhanced methodology enables to further assess customer data in the areas such as calculation of allowances for credit losses, underwriting, limit management and collection strategies. Details about the calculation of allowances for credit losses are further described on page 135.

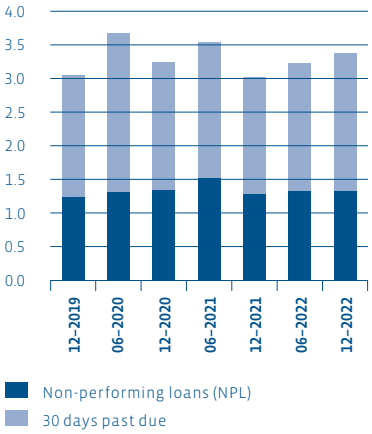
More details on the CRs and implied probability of default are provided in the Consolidated Financial Statements on page 146.

The Group's customer base primarily comprises individuals and small and medium-sized enterprises. Concentration risks are regularly assessed, managed and monitored. The large number of borrowers naturally results in a broad diversification of credit risk. However, certain concentration risk can be caused by cooperation with external partners.

Credit risk within specific portfolios is also monitored using asset quality metrics, such as delinquency metrics, which are further described on page 146. The historic trend is indicated in the graphs below.

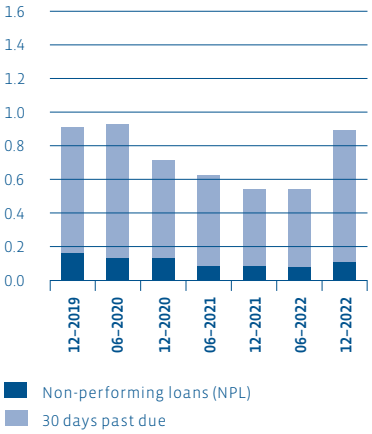
Personal loans

Delinquencies as %



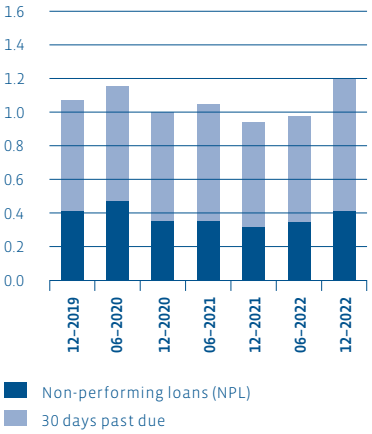
Auto leases and loans

Delinquencies as %



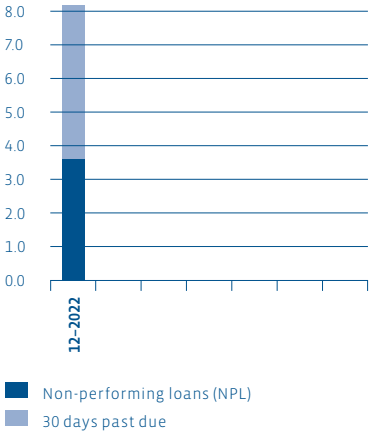
Credit cards

Delinquencies as %



BNPL

Delinquencies as %



ALM, market and liquidity risk

Asset and liability management (ALM) forms part of the Group's risk management framework and can be considered as the coordinated management of various inherent risk types, such as liquidity, funding and market risk, in order to achieve the Group's objectives whilst operating within prudent and predetermined risk limits and concentrations. The Asset & Liability Committee (ALCO) is the decision-making committee for asset and liability management activities and has overall responsibility for the administration of the respective regulation, as well as their monitoring and reporting. The ALCO is chaired by the CFO.

Liquidity and funding risk
Liquidity risk is defined as the risk of the Group not having sufficient funds to meet its contractual obligations when they fall due and support normal business activities, or only being able to secure such funds at excessive costs. The Group recognises that liquidity risks are often consequential rather than isolated in nature and arise from the materialisation of other risk types such as strategic, reputational, credit, regulatory or macroeconomic risks.

The Group's liquidity risk appetite is defined by the Board of Directors and forms the basis for the Group-internal liquidity risk management strategy, the liquidity-related policies and the risk steering and control process.

As it is headed by a listed entity, the Group aims to maintain a highly conservative liquidity profile; this approach is viewed as an essential safeguard in protecting the reputation of the Group as a stable institution. The Management Board ensures that adequate liquidity levels are maintained in order to meet operational and regulatory requirements under normal and stressed conditions. Excess liquidity can be invested with two main objectives in mind: principal preservation and liquidity management. Credit risk related to investment activities and liquidity management is assessed and monitored in line with the credit risk policy.

The Group maintains a robust and stable funding structure. In order to withstand an extended period of limited access to the wholesale funding markets, the Group proactively seeks to reduce reliance on short-term, potentially volatile, sources of funding. The Group actively averts building up concentration risk and strategically diversifies its investor base across different business sectors, by individual counterparty, by maturity buckets and across various categories of debt instruments.

For effective risk controlling, the overall condition of funding markets is regularly monitored and assessed against market-wide and Group-specific early warning indicators to ensure the Group's ability to access funding. This approach is designed to provide management with timely warning of events that might have a potentially unfavourable impact on its access to funding in the near future and, in turn, increase liquidity risk. Consequently, the Group has developed a comprehensive liquidity stress testing process to ensure it can adequately manage its liquidity during times of market stress of differing, yet plausible, magnitudes. This ensures the Group has sufficient controls and mitigation procedures in place to prevent or alleviate the consequences of stressed market conditions. The Group's contingency funding plan is based on the results of stress-testing scenarios and integrated into the Business Continuity Management (BCM) framework. The plan is tested annually, and results reported to the Management Board. Stress-testing results, along with other regulatory liquidity measures, such as the minimum reserve, liquidity coverage ratio (LCR) and net stable funding ratio (NSFR), are essential components of the Group's liquidity management approach and are reviewed regularly by the ALCO and the Board of Directors. The Group's LCR at 31 December 2022 was 339%, well above the regulatory requirement of 100%. The NSFR complements the LCR as part of the liquidity regulations under Basel III. The Group's NSFR at 31 December 2022 was 107%, above the required minimum level of 100%.

Further quantitative information is provided in the separate document "Basel III Pillar 3 disclosures 2022" published on the Cembra website (www.cembra.ch/financialreports).

Market risk
Market risk encompasses the risk of financial losses due to adverse movements in market prices. The Group's business model leads to limited exposure to market risk factors. The Group's main source of market risk is interest rate risk in the banking book (IRRBB). IRRBB is the current or prospective risk to the Group's capital and earnings arising from adverse movements in interest rates. Movements in interest rates might change the underlying value of assets, liabilities and off-balance-sheet items and hence their economic value. They might also affect net interest income and earnings by altering interest-rate-sensitive income and expenses. Excessive IRRBB can pose a significant threat to a group's current capital base and/or future earnings if not managed appropriately. The Group has implemented an effective interest rate risk management framework to limit the potential effects on the Group's current capital base or future earnings and to keep interest rate risk at an acceptable level.

Given the Group's predominantly fixed interest rate assets and liabilities, it is mainly exposed to repricing risk. This is the risk of adverse consequences of increasing or decreasing interest rates because of time differences in when these rate changes affect the Group's assets and liabilities. The Group considers different market scenarios such as a rapid increase in interest rates and actively manages its funding maturities including reliance on short-term sources of funding. The Group faces relatively low option and basis risk. Consequently, the Group focuses IRRBB monitoring on repricing risk.

The Group actively manages and monitors IRRBB performance. As per the regulatory requirement, the Group applies different interest rate shock scenarios and reports the impact on the economic value of equity (lifetime) and net interest income (next 12 months) on a monthly basis. At 31 December 2022, the Group did not use any hedging instruments to manage IRRBB.

Another type of market risk is foreign exchange (FX) risk, which is defined as the financial risk from adverse movements in the exchange rate on transactions denominated in a currency other than the base currency of the institution. The Group operates predominantly in the Swiss consumer lending market, and borrows and lends exclusively in Swiss francs. Therefore, the Group's exposure to FX risk is minimal and limited to external service provider invoices denominated in foreign currencies. FX exposure is monitored closely against internally set triggers, and the Group takes immediate corrective action if limits are exceeded. At 31 December 2022, the Group did not use any hedging instruments to manage its FX risk.

Further quantitative information is provided in the separate document "Basel III Pillar 3 disclosures 2022" published on the Cembra website (www.cembra.ch/financialreports).

Capital management

One of the Group's principal management goals is to maintain a strong capitalisation by taking a prudent approach to balance sheet growth and implementing a balanced dividend payment strategy.

Methodology for calculating minimum capital requirements
The Group uses the International Standardised Approach ("SA-BIS" approach) as described in the Basel Minimum Standards, which are the standards defined by the Basel Committee on Banking Supervision and used to calculate capital adequacy requirements. The "SA-BIS" approach is used for credit risk, market risk and operational risk. It therefore also fulfils the qualitative and quantitative requirements of the Ordinance on Capital Adequacy and Risk Diversification for Banks and Securities Dealers (CAO, SR 952.03).

Capital adequacy ratio
At 31 December 2022, the applicable regulatory requirement for a category 4 bank was set at 11.2% by FINMA. The Group aims to consistently maintain a capital base that is well above this mark, defining a mid-term minimum target for its Tier 1 capital ratio of 17% for the Group. Compliance with the target ratio is monitored at the ALCO meeting. At 31 December 2022, the Group's Tier 1 capital ratio was 17.8%, in line with the mid-term target.

Leverage ratio
The Basel leverage standard supplements the Basel III risk-adjusted capital standards and serves as a backstop. The leverage ratio compares the Group's equity against its total asset base (considering off-balance-sheet items) without any risk adjustment. At 31 December 2022, the Group's leverage ratio was 13.5%, well above the recommended 3.0%.

Further quantitative information is provided in the separate document "Basel III Pillar 3 disclosures 2022" published on the Cembra website (www.cembra.ch/financialreports).

Capital planning
Each year, the Group draws up a three-year capital plan and assesses the impact of several stress scenarios. As per FINMA requirements, the Group assesses its resilience to adverse macroeconomic conditions. In the 2022 stress test, the Group forecasts that it would be in a position to meet the minimum regulatory capital adequacy ratio prescribed by FINMA even under a prolonged severe stress scenario. The capital plan, as well as the output of the stress tests, are approved by the ALCO and submitted to the Board of Directors.

Operational risk

Operational risk is defined as the risk of direct or indirect loss resulting from inadequate or failed internal processes, people and systems, or from external events. It can be categorised into one of the seven Basel II event types. The Group recognises the importance of the effective management of operational risks and has implemented a robust framework and appropriate processes to manage them. The Risk & Controllership Committee (RCC) reviews and monitors all key internal controls, compliance and operational risk management activities and has overall responsibility for the administration of the respective regulations, as well as their monitoring and reporting. The RCC is chaired by the General Counsel and the CRO.

Key instruments to manage operational risk include:
- Operational risk assessments: regular identification and assessment of the likelihood and potential impact of inherent and residual operational risks
- Control catalogue: execution of a set of documented controls aligned with business processes and their risks
- Key risk indicators: regularly monitored risk metrics that serve as early warning indicators for material operational risks
- Loss data collection: historical dataset of loss events used to identify operational risks deriving from process inefficiencies or control gaps, and
- Analysis of external events: analysis of external operational risk events applicable to the Group's risk profile to identify emerging risks and evaluate controls.

The Group is exposed to a wide variety of operational risks, including technology and cyber-risk that stem from dependencies on information technology and service providers. The Group acknowledges the evolving cyber risk landscape and has therefore developed a comprehensive information security framework to effectively manage and control this type of risk. This framework addresses regulatory requirements, is based on international standards and is supported by a cyber-security strategy that ensures continuous improvements. Relevant cyber threats are regularly identified and assessed, and corresponding measures are considered. Specific response plans are maintained. The Group has implemented this framework with the overall goal to ensure the Group's sensitive data and critical information technology are protected. These defined technical and organisational measures include specifically training of relevant staff, protection and detection of data confidentiality, integrity and availability risks, and making use of vulnerability scans and penetration tests.

As part of its lending activities the Group is exposed to external fraud risk which is managed through comprehensive fraud detection, prevention and investigation processes and tools. Specifically in the area of BNPL, an automated digital identities verification process is utilised in order to identify and prevent digital fraud attempts.

The Group is aware that severe events beyond its control (such as natural disasters) may result in an inability to fulfil some or all of its business obligations, particularly where its physical and information technology would be damaged or made inaccessible. In compliance with the Recommendation for Business Continuity Management (BCM) issued by the Swiss Bankers Association, the Group has implemented a BCM programme, which involves identifying critical processes and their dependency on information technology and service providers. The Group's BCM framework encompasses planning, testing and other related activities. The framework aims to ensure that business-critical functions will either continue to operate in spite of a serious incident, or will be recovered to an operational state within a reasonably short period of time after such an incident occurs. In addition to its BCM framework and in the context of operational risk management the Group targets effective operational resilience in its critical functions in order to ensure robustness under consideration of severe but plausible scenarios.

Comprehensive crisis management plans are in place and define the processes to be followed in case of a business emergency while crisis is defined as a situation that requires critical decisions and cannot be handled with ordinary measures and decision-making powers. The aim is to safeguard the continuity of the Group's business-critical activities and to limit potential damage in the event of a significant business interruption. The status of the BCM programme and the status of the operational risk, cyber and information security framework are regularly reviewed by the RCC and a summary report is provided to the Audit and Risk Committee and the Board of Directors.

The Group has chosen to use service providers to support its business activities. With the implementation of policies governing this area and an ongoing monitoring process, the Group ensures compliance with relevant regulatory requirements. Before entering any material engagement with a service provider a due diligence exercise is conducted.

Climate-related risks

Climate-related risks include physical, transition, or legal and reputational risks. Physical risks arise from costs and losses due to the increasing severity and/or frequency of weather events. These can be acute and result from extreme weather events, or chronic events, arising from progressive shifts in weather patterns. Transition risks arise from disruptive technological breakthroughs or action taken on climate policies that will transform the economy, with the implication that assets in certain sectors may lose value.

Climate-related financial risks can be mapped into traditional risk categories such as credit risk, market risk, and operational risk. These risks do not represent a new risk category, but rather a risk driver. For management of climate-related risks, the Group builds on the established risk management process as described on page 20. Identification, assessment and management of climate-related risks are integrated into the Group's strategy – from strategic planning through to operations. The Group actively monitors regulatory developments related to climate change. The Sustainability Committee is the decision-making and monitoring committee for management of climate-related risks and opportunities. The Sustainability Committee is chaired by the CEO.

Immediate physical risks are generally considered to be rather low due to being a financial services provider that actively operates exclusively in Switzerland. The Group assesses physical security of its office locations on a regular basis.

Transition risks could gradually materialise in the form of credit risk where the leased assets may lose value over medium to long term. In connection with its auto lease business, the Group purchases vehicles and resells them in accordance with the lease contract. The risk that the re-sale value of any lease vehicle may be less than the remaining outstanding balance at the time such lease agreement is terminated, at contractual end or during contract term, is borne by the Group. This risk is mitigated by the Group's right under the dealer agreements obliging a dealer to repurchase a lease vehicle at the contractually defined price. Shifting of consumer preferences, including environmental considerations or potential bans for certain engines, such as combustion ones are among others potential reasons for a lower residual value of purchased lease assets, which may have a negative impact on new vehicle sales or used vehicle supply. The Group regularly monitors vehicle brand and model diversification and adopts bespoke mitigation measures. For further information on managing the residual value risk refer to the Credit risk section on page 21 and see also our approach to sustainability on page 30.

Other risks

Compliance risk is the risk of legal or regulatory sanctions, reputational damage and financial forfeiture or material loss deriving from violations of laws and regulations, internal regulations, prescribed best practice, or professional and ethical standards. The Group is exposed to this type of risk as a consequence of being a market participant in the financial services industry, with its legal and regulatory requirements and the changes made to them. To ensure operational independence, the Group has a separate legal & compliance function. This function effectively manages, controls, monitors and reports on legal and compliance risks and ensures that the Group's business activities adhere to all relevant legal requirements, regulatory standards and requirements for effective corporate governance. The Group acknowledges the increasing importance of behavioural compliance related to conduct risk in the banking sector and addresses this within the provisions of the Group's Code of Conduct.

Strategic risk is defined as possible losses that arise from uncertainties or untapped opportunities inherent in the Group's strategic goals. This context includes risks that the environment and climate change might pose to the Group's business model. The Group addresses these risks as any other risk through the established risk management process as described on page 20. The general risk management process is also applied for business risks that are caused by extraordinary events such as outbreak of pandemics, geopolitical conflicts, power supply shortages or economic downturns. In such events and periods multiple risk factors or categories might be impacted and need to be managed accordingly. The Group's BCM framework and its crisis management procedures support the effective continuation of business operations.

The Group's strategic programmes and transformation roadmap aim to accomplish a future state as outlined in the Group's vision and mission statements. Its execution highly depends on employees that through the Group's values determine the corporate culture. Consequently, various risks related to this transformation, such as human capital or employee health risks but also general execution risks relating to a changing technology and process landscape, are identified and managed.

Reputational risk is the risk of losses resulting from damages to the Group's reputation. The Management Board directly manages and supervises strategic risk, business risk and reputational risk. Recognising the fact that reputational risk can be difficult to quantify and arises as a consequence of another materialised risk, the Group manages reputational risk jointly with other risks by assessing the inherent reputational impact of those risks.