Risk Management of ODA Loan Account

The operations of financial institutions involve various risks, including credit risk, market risk, liquidity risk, operational risk and other risks. As a government agency, JICA conducts financial operations to achieve policy objectives. Thus, JICA differs from private financial institutions in terms of the nature as well as the extent of risks involved in its operations and ways to deal with them. Nonetheless, it is essential to have appropriate risk management as a financial institution. In line with the international trend of focusing on risk management as the basis of operations of financial institutions, JICA is improving its internal risk management system.

More specifically, financial risk management of the ODA Loan Account was taken to be a managerial issue that needs to be addressed systematically by the entire organization. JICA has thus adopted a risk management policy under which it identifies, measures and monitors various risks to which its operations are exposed. The objective of this policy is to ensure sound and effective operations and to earn returns commensurate with risks.

JICA manages various risks that policy-based financing institutions are facing. The following are examples of JICA's major risk management activities.

Credit Risk

Credit risk refers to the potential loss from difficulties or failure to recover credit assets due to the declining financial position of a debtor. Given the very nature of financial support for external economic transactions and overseas economic cooperation, JICA frequently extends loans to foreign governments and government agencies. Therefore, sovereign risk makes up a considerable part of the credit risk that accompanies JICA's operations.

1) Credit Rating System

JICA has established a credit rating system as part of the organization's operating procedures and to be used to cover all the borrowers in principle. Credit ratings are the cornerstone of credit risk management, being used for conducting individual credit appraisals and quantifying credit risks. Credit ratings are revised when appropriate based on the organization's risk profile.

2) Self-Assessment of Asset Portfolio

JICA performs self-assessments of its loan portfolio to properly reflect the characteristics of its assets based on the Financial Inspection Manual prepared by Japan's Financial Services Agency. The purposes are to manage credit risk and to implement write-offs and loan loss provisions in a proper and timely manner. In this process, the first-stage assessment is conducted by the relevant financing departments, while the second-stage assessment is conducted by the corporate and country economic analysis departments with inspection by the Office of Audit. The results of self-assessments conducted on the asset portfolio are not only used internally for the continuous reviews of the loan asset portfolio but also reflected in the disclosure of asset quality to enhance the transparency of JICA's financial position.

3) Quantifying Credit Risk

In addition to individual credit risk management, JICA is working on quantifying credit risks with a view to evaluating the risk of the overall loan portfolio. To quantify credit risks, it is important to take into account the characteristics of JICA's loan portfolio, which holds a significant proportion of long-term loans and loans involving sovereign risk. Also to be taken into account is the mechanism of securing assets, such as the Paris Club, a unique framework for debt management by official creditor countries. The credit risk quantification model incorporating these factors is measuring credit risks and utilized for internal control.

Market Risk

Market risk refers to the potential losses incurred through changes in the value of assets held due to fluctuations in foreign currency exchange and/or interest rates. In the context of potential losses stemming from changes in market interest rates, JICA bears risks due to the long-term nature of its financing activities, which are conducted over terms that can reach up to 40 years. In this regard, JICA is enhancing its capacity to absorb interest rate risk by capital injection from the General Account Budget of the Japanese government. Furthermore, interest-rate swaps are carried out exclusively for the purpose of hedging interest rate risk. In order to control counterparty credit risk of interest rate swaps, the market value of transactions and credit worthiness of each counterparty are constantly assessed, and collateral is secured when necessary.

Liquidity Risk

Liquidity risk refers to risk of having difficulty securing sufficient funds due to a deterioration of JICA's credit or to an unexpectedly large increase in expenditures or an unexpectedly large decrease in revenues.

JICA takes full measures to avoid liquidity risk through management of its financing. This includes efforts to secure multiple procurement of funds such as Agency Bonds, and borrowing under Fiscal Investment and Loan Programs.

Operational Risk

Operational risk refers to the potential losses incurred from improper systems, personnel activities, work processes or other external events. For JICA, this refers to risks that stem from its work activities, systems and internal or external misconduct. JICA manages this operational risk as part of the efforts in compliance with the rules.