Risk Management of Finance and Investment Account

The operations of the Finance and Investment Account of JICA involve various risks, including credit risk, market risk, liquidity risk, operational risk and other risks. The nature as well as the volume of risks in JICA's operations and the ways to deal with them differ from the risks and countermeasures at private financial institutions. Nonetheless, it is essential for JICA to have appropriate risk management just as at a financial institution. In line with the global trend of increasingly focusing on risk management among financial institutions and regulators, JICA is constantly improving risk management of its Finance and Investment Account.

More specifically, risk management of the Finance and Investment Account is positioned as a managerial issue that needs to be addressed systematically by the entire organization. JICA has thus adopted a risk management policy for its operations. Under the policy JICA identifies, measures and monitors various risks. The objective of this policy is to ensure sound and effective operations and to earn returns commensurate with risks. JICA has established Risk Management Committee for Finance and Investment Account that examines important issues related to integrated risk management.

JICA manages various risks associated with Finance and Investment operations as follows.

● Credit Risk

Credit risk refers to the potential loss from difficulties or failure to recover credit assets due to the deteriorating financial condition of a debtor. The main area of Finance and Investment operations is lending. Consequently, the control of credit risk is a major part of JICA's risk management. Sovereign risk makes up a considerable part of the credit risk that accompanies ODA loan operations. JICA, as an official financer, evaluates sovereign risk by making full use of information gathered through communication with the governments and relevant authorities in the recipient countries, multilateral institutions such as the International Monetary Fund (IMF) and the World Bank, other regional and bilateral donor organizations, and private financial institutions in developed countries. As for Private-Sector Investment Finance (PSIF), JICA assesses the risk associated with lending to private entities as well as country risk and currency risk.

1) Credit Rating System

JICA has established a credit rating system as part of the organization's operating procedures that is 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 divided into two categories: sovereign borrowers and non-sovereign borrowers. A different credit rating system is used for each category. Ratings are subsequently updated as appropriate.

2) Self-Assessment of Asset Portfolio

When managing credit risks, it is important for JICA to make proper self-assessments of its loan portfolio and implement write-offs and loan loss provisions in a proper and timely manner. Based on the Financial Inspection Manual prepared by Japan's Financial Services Agency, JICA has developed internal rules for assessment. To ensure an appropriate checking function, in this process, the first-stage assessment is conducted by the relevant departments in charge of lending and investment, and the second-stage assessment is conducted by the credit risk analysis department. An accurate understanding of asset quality is essential to maintain JICA's financial soundness as well as for disclosure.

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 do that, it is important to take into account the characteristics of JICA's loan portfolio, a significant proportion of which consists of long-term loans and sovereign loans to developing and emerging countries. Also, JICA takes into account multilateral mechanisms for securing assets such as the Paris Club, which is a unique framework for debt management by official creditor countries. By incorporating these factors in the credit risk quantification model, JICA measures credit risks and utilizes it for internal controls.

● Market Risk

Market risk refers to the potential losses incurred through changes in the value of assets and liabilities caused by fluctuations in foreign currency exchange rates and/or interest rates.

JICA bears risks arising from long-term fixed rate interest loans due to the characteristics of its lending activities. In this regard, JICA is enhancing its capacity to absorb interest rate risk by using capital injections 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.

JICA does not extend foreign currency-denominated loans but, with the introduction of the Japanese ODA loan with Currency Conversion Option in 2012 in response to the requests from borrowers, JICA bears currency risk that arises if yen-denominated loans are converted into foreign currency–denominated loans. To hedge currency risk, currency swap transactions are arranged properly.

Moreover, when foreign currency-denominated investments are extended in Private-Sector Investment Finance, the valuation of investments is exposed to exchange risks. JICA manages this risk through regular and continuous monitoring of exchange rate fluctuations in the currency of the country in which the counterparty is located.

● 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 uses many measures to avoid liquidity risk through management of its cash flow. This includes efforts to secure multiple sources of funds such as Agency Bonds and borrowing under Fiscal Investment and Loan Programs.

● Operational Risk

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