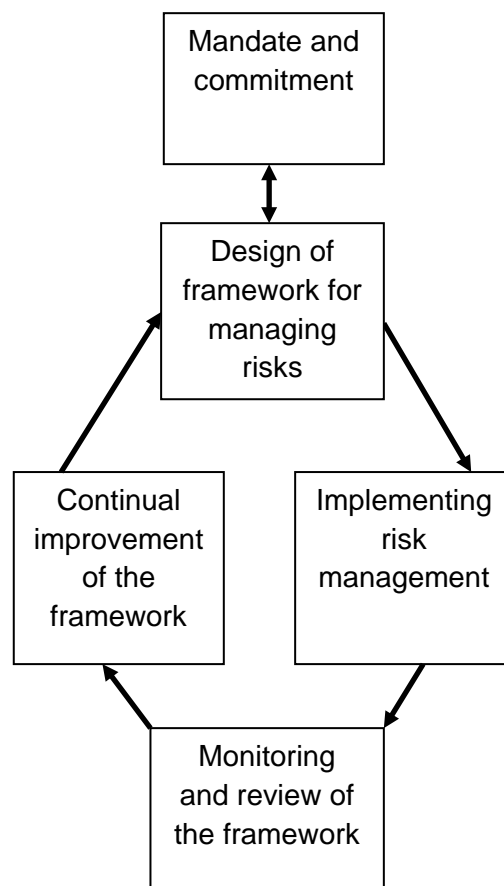


Risk Management Framework



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MYS Enterprise Risk Management Framework

Introduction

This document applies to MyState Limited (MYS) and all MyState Limited Group subsidiaries.

This Enterprise Risk Management Framework is based on Australian Standard *AS/NZS ISO 31000:2009 Risk Management – Principles and guidelines* (AS/NZS ISO 31000) and provides the foundations and organisational arrangements adopted by MYS in respect to Risk Management.

The framework is designed to ensure all employees take all reasonable steps in the identification, assessment, monitoring and management of risk within MYS to help facilitate MYS to achieve its strategic and business objectives.

Objectives

In accordance with AS/NZS ISO 31000, MYS takes an integrated approach to Risk Management and as such, this framework aims to:

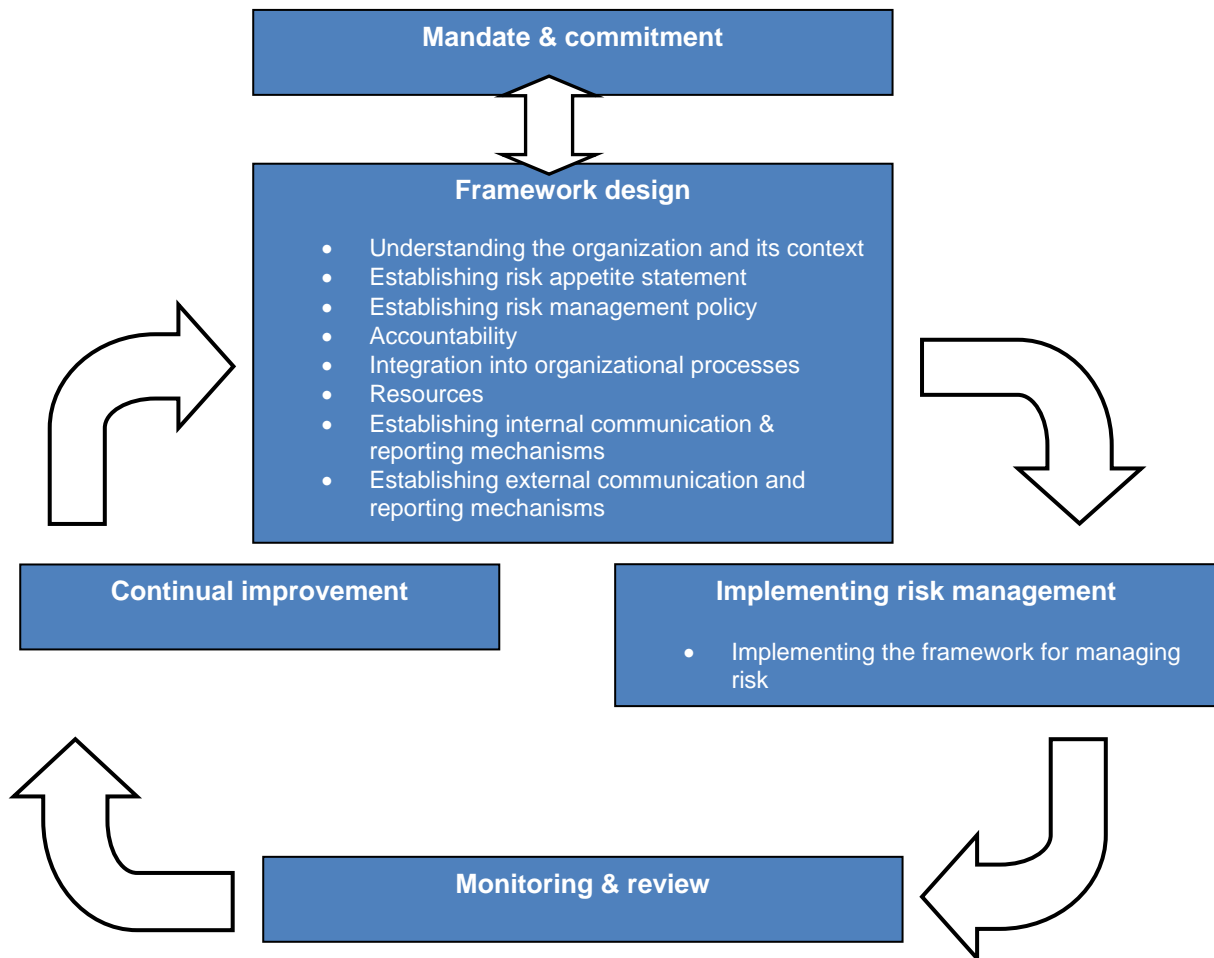
- Provide guidance for the context in which risk management within MYS should be considered;
- Ensure appropriate communication and consultation at each stage of the risk management process;
- Ensure risk identification is an integral part of the management of MYS;
- Ensure risk levels are analysed according to accepted standards;
- Establish criteria for the evaluation of risks;
- Provide guidance for the appropriate treatment of risks;
- Ensure appropriate records of MYS's risks are kept; and
- Ensure the risk management system is subject to appropriate monitoring and review.

In addition, MYS has included the following objective as an adjunct to the Australian Standard to ensure all MYS strategic initiatives and business activities:

- Approve and continually maintain the risk appetite statements to ensure MYS's strategic initiatives and business activities are within the boundaries of activity that the Board intends for MYS, as set within the risk appetite statements.

The framework forms an iterative process as depicted in Figure 1 and detailed further in this document:

Figure 1 – MYS risk management framework



Source: AS/NZS ISO 31000:2008 Risk management – Principles and guidelines

Framework parameters

The relationships between MYS's risk management principles, strategy, framework and process are detailed in the risk management policy.

Due to the integrated approach of enterprise risk management, this framework relies upon, but is not limited to, the following, which collectively form the foundation of enterprise risk management within MYS:

- The principles herein;
- The risk management policy;
- The risk management strategy;
- The strategic planning process;
- The risk appetite statement;
- The risk management process;
- All group risk registers;
- Board approved and mandated policy;
- Procedures, system standards and work instructions;
- Core business applications and associated internal controls;
- Regular reporting, from independent audit, compliance, risk and credit functions to management committees such as the Assets and Liabilities

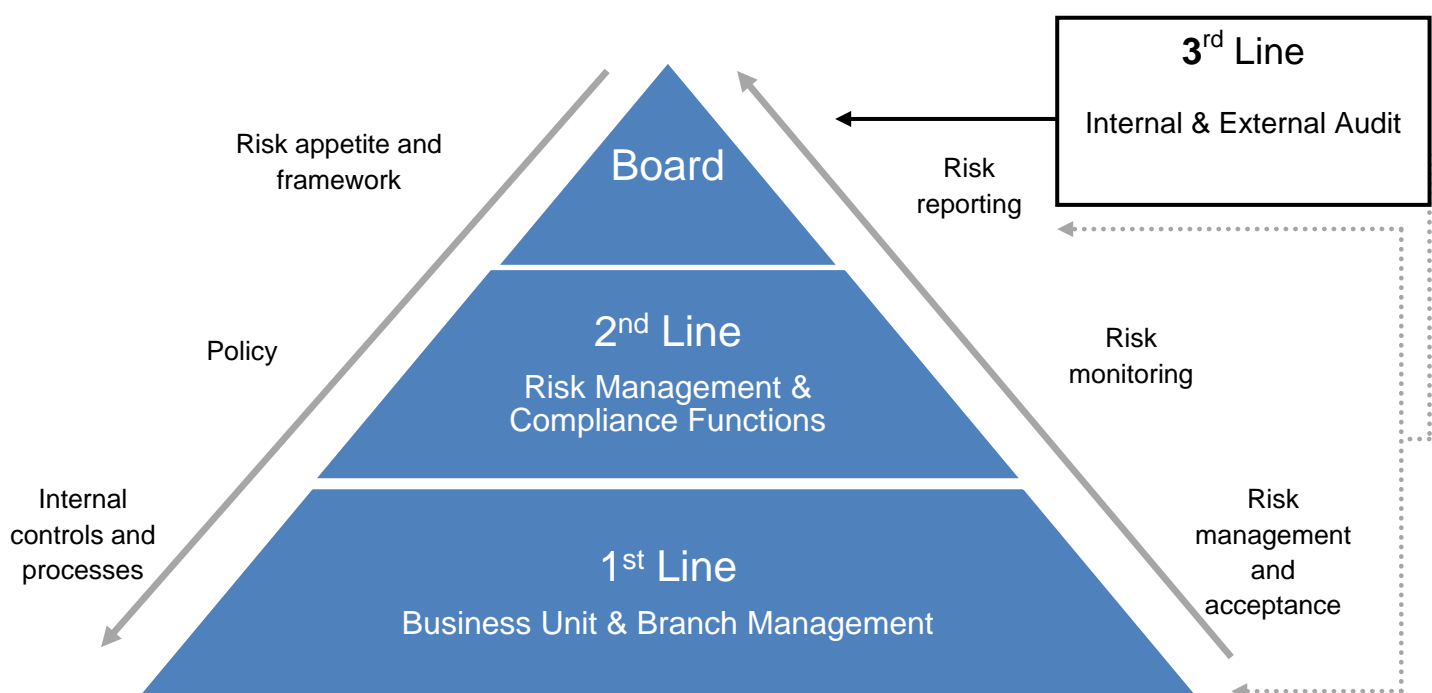
Committees (ALCO's), Group Credit Committee (GCC), Group Product, Pricing & Sales Committee (GPPSC), the Executive, Board committees and the Board;

- Budgeting processes;
- Executive, Board and Committee actions sheets and minutes; and
- Documented position descriptions with clear accountabilities for risk.

Risk principles

MYS's overall approach to risk management is based on 'the three lines of defence' model (Figure 2), which supports the relationship between the individual business units, the risk management and compliance functions, internal and external audit and the Board.

Figure 2 – MYS three lines of defence model



The 1st line of defence

Management within individual business units are responsible for working with their employees to identify, evaluate and manage the risks that originate in their respective business lines within the risk appetite statements and policies.

The 2nd line of defence

The risk management and compliance functions are responsible for providing independent risk management expertise, monitoring and oversight.

The 3rd line of defence

Internal and external audit independently reviews and tests business unit compliance with risk policies and procedures, and regularly assesses the overall adequacy and effectiveness of the risk management framework.

The framework is designed to ensure all risk management activity within MYS is linked to its business strategy and operations. The risk management policy,

strategy, framework and process is underpinned by responsibilities and functions driven from the Board level down to operational levels, covering all aspects of risk, including business, credit, legal & regulatory, liquidity, market, operational, reputation and strategic risks. In addition, specific details and responsibilities for managing each category of risk are contained in relevant policy, procedures, processes and work instructions.

Risk limits

Risk limits for liquidity, market, credit and interest rate risk are set and monitored by the relevant ALCO's, GCC and the GSC within the parameters approved by the Board. Risk limits are also articulated in policy, procedure, processes and work instructions.

All areas of the business are expected to continually monitor and assess their own performance with respect to risk management, to ensure they are operating within the risk limits, risk appetite and risk tolerances set by the Board.

Internal controls

To support the framework, MYS has a series of robust internal controls, built into core business applications and articulated in policy, procedure, processes and work instructions across all aspects of the business. It also has strong internal support functions in place including Company Secretariat; Risk (which together with the responsibility for the operation of this framework assumes responsibility for fraud risk management and credit risk oversight); Legal & Compliance; Finance; Treasury; Loan Operations; Collections; Technology; Marketing, Communications & Products and HR, Property & People. \. This ensures the efficiency and effectiveness of controls is evaluated in all new and amended systems, processes or products or where external and internal factors impact the operating environment (e.g. changes in organisation structure, new legislation, mergers & acquisitions, growth)

Risk management systems

MYS's risk management systems rely on accurate, reliable and timely information to support risk management decisions at all levels. These requirements cross a varied range of the business including the enterprise risk management & compliance system, market and credit risk analysis systems, budgeting, strategic planning, asset and liability management, performance measurement, regulatory reporting, as well as accounting and processing systems and those systems supporting normal business operations.

Data reconciliation is undertaken to ensure the integrity of the information used and ensure appropriate security controls are established, maintained and monitored around all systems. Back-up and recovery procedures are defined and documented and business continuity and crisis management plans are documented and communicated to promote awareness, resilience and minimise the impact of an incident.

Categories of risk

MYS categorises its material risks into the general categories detailed below. In addition to the risk management policy, strategy and framework, each category has specific risk management systems in place.

Business risk

The risk of financial loss due to unexpected movements in volume, profit margin and operating expenses (excluding risks elsewhere defined) arising from unexpected changes in the business environment.

MYS's approach to managing business risk is detailed further in the Risk Management Strategy.

Credit risk

The risk of financial loss resulting from the failure of a MYS customer or counterparty to honour or fully perform the terms of a loan or contract.

MYS's approach to managing credit risk is detailed further in the Risk Management Strategy.

Legal & regulatory risk

The risk that MYS's business is affected by changes in laws and regulations, or by existing laws and regulations, that it had not properly taken into account.

Includes the possible financial or reputation loss resulting from an action by a court, regulator or legislative body.

MYS's approach to managing legal & regulatory risk is detailed further in the Risk Management Strategy.

Liquidity risk

The risk that MYS has insufficient capacity to fund increases in assets, or is unable to meet its payment obligations as they fall due, including repaying depositors or maturing wholesale debt.

MYS's approach to managing legal & regulatory risk is detailed further in the Risk Management Strategy.

Market risk

The risk of an adverse impact on earnings resulting from changes in market factors, such as interest rates, foreign exchange rates, commodity prices and equity prices. This includes interest rate risk – the risk to interest income from a mismatch between the duration of assets and liabilities that arises in the normal course of business activities.

MYS's approach to managing market risk is detailed further in the Risk Management Strategy.

Operational risk

The risk of loss resulting from inadequate or failed internal process, people and systems, or from external events. This is a very broad risk category and includes specific risks such as non-compliance with policy and procedure, employment practices and workplace safety, breaches of relevant legislation, damage to physical assets, business disruption, system failures etc.

MYS's approach to managing operational risk is detailed further in the Risk Management Strategy.

Reputation risk

The risks of loss caused by damage to brand image or adverse perception of MYS held by the public, shareholders, investors, regulators, or rating agencies that may directly or indirectly impact earnings, capital adequacy or value.

MYS's approach to managing reputation risk is detailed further in the Risk Management Strategy.

Strategic risk

The risk of loss arising from a failure in MYS's strategies.

MYS's approach to managing strategic risk is detailed further in the Risk Management Strategy.

Mandate & commitment

The Board of Directors has endorsed the MYS risk management policy and supporting policies and processes. Authority flows from the Board of Directors to the Group Risk Committee and from there to the Executive.

In order to support the risk management policy, MYS will:

- Ensure its culture is aligned with the principles contained within the risk management policy;
- Maintain a written strategic plan setting out its approach for the implementation of its strategic objectives;
- Ensure Executive and Senior Management ELTIP and STI arrangements are completely aligned with the MYS strategic plan and the MYS risk appetite statements;
- Establish a set of risk appetite statements for MYS;
- Determine risk management performance indicators that align with MYS's key performance indicators (KPI's);
- Ensure its risk management objectives are aligned with MYS's key objectives and strategies;
- Ensure legal and regulatory compliance;
- Assign appropriate risk management accountabilities and responsibilities throughout MYS;
- Ensure necessary resources are allocated to risk management;
- Communicate the benefits of risk management to all employees and stakeholders; and
- Ensure that this framework remains appropriate to MYS.

Strategic Plan

The strategic plan must be a rolling plan of at least three years' duration that is reviewed at least annually, with the results of the review reported to the Board. The strategic plan must cover the entirety of the institution and be approved by the Board.

Risk culture

MYS recognises that an awareness and appreciation of risk amongst employees and management is more likely to lead to the pursuit of sustainable policies and business practices which are within MYS's risk appetite and which do not put the operations of the Group under unnecessary strain. In this regard, MYS believes risk culture can become a key business driver.

In order to develop a risk culture, MYS will create a workplace where employees have the confidence to ask questions and to challenge assumptions about the way the business is conducted.

MYS's corporate ambition, purpose and values are key considerations in determining risk appetite and also in ensuring the desired risk culture is achieved and maintained.

All levels of management within MYS will take an active role in leading the Group through the cultural change to improve the focus on risk management.

Risk appetite statement

MYS has developed a set of risk appetite statements that collectively form the MYS risk appetite statement, which is aligned with its corporate values, strategic plan and existing business objectives.

Risk management performance indicators

MYS will develop risk management performance indicators that are aligned with its risk management framework.

Alignment of risk management objectives

MYS ensures alignment between organisational and risk management objectives and strategies by ensuring its risk management processes are incorporated into all strategic planning activities.

The Chief Risk Officer (CRO) attends Executive; Group Risk Committee and Group Audit Committee meetings to ensure the risk management framework is considered during all key business decisions.

Legal & regulatory compliance

MYS ensures Legal & Regulatory compliance by a number of mechanisms including, but not limited to:

- Advice and direction from the MYS Legal & Compliance function;
- Compliance management and risk management incident (RMI) reporting via the online system;
- Quarterly reporting to the Australian Prudential Regulation Authority (APRA) in respect to MYS's standardised approach to credit and operational risk;
- Lodgement of an annual declaration to APRA in accordance with *Prudential Standard APS 310 Audit and Related Matters* from the Managing Director and endorsed by the Board of Directors attesting that, for the financial year past:
(a) The Board and management have identified the key risks facing the ADI;

(b) The Board and management have established systems to monitor and manage those risks including, where appropriate, by setting and requiring adherence to a series of prudent limits, and by adequate and timely reporting processes;

(c) These risk management systems are operating effectively and are adequate having regard to the risks they are designed to control; and

(d) The risk management systems descriptions provided to APRA are accurate and current.

Lodgement of this declaration must be submitted to APRA within three months of its annual balance date.

- Lodgement of an annual declaration to APRA in accordance with *Prudential Standard CPS 220 Risk Management from the Board and signed by the chairperson of the Board and the chairperson of the Group Risk Committee stating that, to the best of its knowledge and having made appropriate enquiries:*
 - (a) The APRA-regulated institutions have in place systems for ensuring compliance with all prudential requirements;
 - (b) The systems and resources that are in place for identifying, measuring, evaluating, monitoring, reporting, and controlling or mitigating material risks, and the risk management framework, are appropriate to the institution, having regard to the size, business mix and complexity of the institution and group;
 - (c) The risk management and internal control systems in place are operating effectively and are adequate having regard to the risks they are designed to control;
 - (d) MYS has a Risk Management Strategy (RMS) that complies with *Prudential Standard CPS 220 Risk Management* and MYS has complied with each measure and control described in the RMS; and,
 - (e) MYS is satisfied with the efficacy of the processes and systems surrounding the production of financial information at the institution and group;
- Lodgement of this declaration must be submitted to APRA on, or before, the day the ADIs end of financial year accounts are submitted.
- Formal due diligence and verification processes, including attestations from management and External Auditors regarding the Group's financial statements.

Responsibilities

Risk management within MYS is part of everyday decision making at all levels. As such, all employees must accept and be accountable for all risk management activities relevant to their respective business units and role.

The Risk Management Strategy lists responsibilities additional to those detailed above and in the risk management policy.

Framework design

Understanding the organisation and it's context

Prior to the design and implementation of this risk management framework, the external and internal context of MYS and all MYS Group subsidiaries was evaluated.

MYS is the Non Operating Holding Company (NOHC) of MSF and The Rock, Authorised Deposit Taking Institutions (ADIs) and TPTL a Trustee and Wealth Management Company. MYS and the ADIs are regulated by the Australian Prudential Regulation Authority (APRA) and MYS was enabled under Tasmanian legislation to own an authorised trustee company, i.e. TPTL.

APRA requires MYS, as the NOHC of an ADI to comply with the prudential obligations that apply directly to the ADI.

The ADIs and TPTL hold Australian Financial Services Licences (AFSL's) and Australian Credit Licences (ACL's) issued by ASIC.

The process of designing the framework and understanding the organisation and its context also includes the setting by the Board of the MYS risk appetite statements.

As this framework is reviewed or as MyState Limited Group Companies and subsidiaries are added or removed from the Group, the external and internal context should be re-evaluated, to ensure the current operating environment is understood. The Strategic Plan and risk appetite statements will be re-evaluated at the same time.

Evaluating MYS's external context may include, but is not limited to:

- a. The social and cultural, political, legal, regulatory, financial, technological, economic, natural and competitive environment, whether international, national, regional or local;
- b. Key drivers and trends having impact on the objectives of MYS; and
- c. Relationships with, and perceptions and values of, external stakeholders.

Evaluating MYS's internal context may include, but is not limited to:

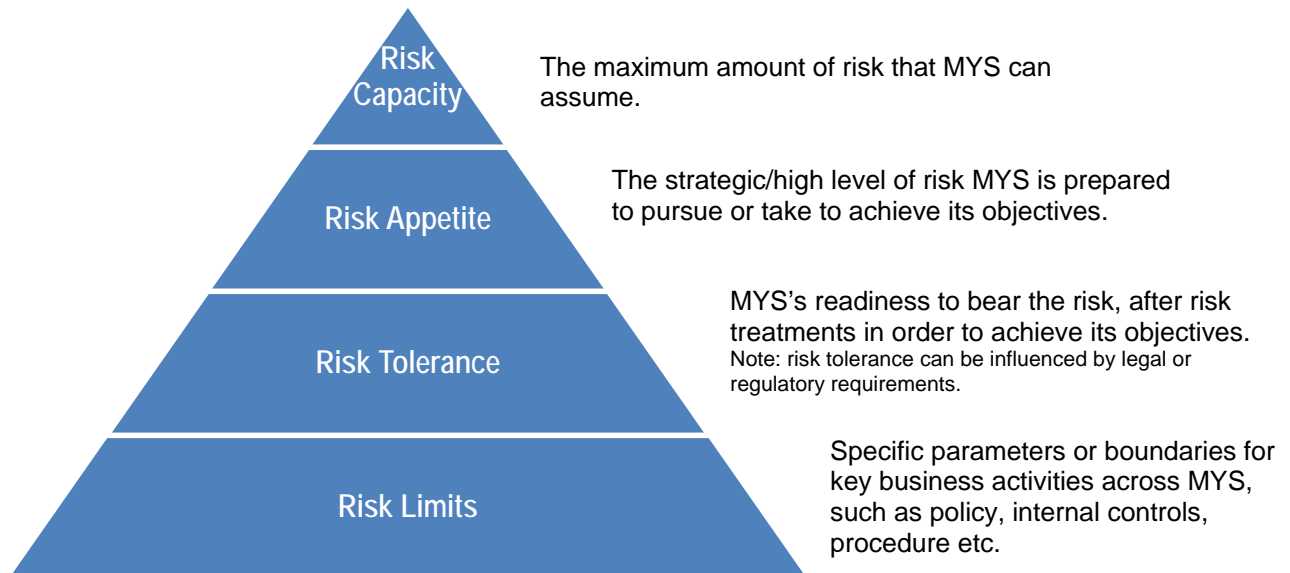
- a. Governance, organisational structure, roles and accountabilities;
- b. Policies, objectives, and the strategies that are in place to achieve them, with particular emphasis on MYS's Strategic Plan;
- c. MYS Group capabilities, understood in terms of resources and knowledge (e.g. capital, time, people, processes, systems and technologies);
- d. Information systems, information flows and decision making processes (both formal and informal);
- e. Relationships with, and perceptions and values of, internal stakeholders;
- f. MYS's culture;
- g. Standards, guidelines and models adopted by MYS; and
- h. The form and extent of contractual relationships.

Establishing the risk appetite statements

The term risk appetite refers to the strategic/high level of risk MYS is prepared to pursue or take to achieve its strategic objectives and defines the boundaries of activities that the Board intends for MYS and all MYS subsidiaries. The Board articulates MYS's risk appetite through a set of risk appetite statements to ensure all activities are aligned with and support MYS's strategic objectives.

When determining risk appetite and capacity, risk tolerance and limits (Figure 3) are also considered and determined, having regard to the overall risk posed to the business. Where risks fall outside MYS's risk appetite and/or residual risk falls outside MYS's risk tolerance, MYS will either modify the risk or identify risk mitigants, to reduce the risk to a point within MYS's appetite or tolerance, or cease the activity that gave rise to the risk.

Figure 3 – Hierarchy of risk appetite within MYS



The Executive, Group Risk Committee and Board will review the risk appetite statements at least annually, and whenever the Strategic Plan is reviewed or amended.

The risk appetite statements are commercially sensitive and must not be made publically available. It will be communicated to all appropriate and relevant MYS employees to ensure activities within MYS support strategic objectives and are conducted within the required boundaries determined by the Board.

The benefits of defining risk appetite include:

- The ability to make better informed business decisions;
- Regular and effective monitoring of Key Risk Indicators (KRI's);
- Effective monitoring of individual or aggregated risks that exceed threshold or trigger points;
- Creation of cultural norms around risk and risk management;
- A clearly demonstrable and rigorous process that supports the balance between 'courage' and 'caution';
- A more integrated, enterprise wide risk management model;
- Clarity around which aspects of risk controls should be developed, transferred or reduced; and
- A dynamic link between strategy, objective setting and risk management.

Establishing the risk management policy

In establishing the risk management policy, the Board accepts that a certain amount of risk is necessary to take advantage of opportunities and does not seek to eliminate risk. The Board also recognises that MYS is not in the business of speculation and therefore advocates the prudent management of the upside (opportunities) and downside (threats) of risk, to ensure desirable outcomes.

In pursuit of this objective, all new business propositions or proposed changes to current business practices must undergo a comprehensive risk analysis as part of the decision-making process. MYS will also conduct a comprehensive risk analysis of its existing activities at least annually. The risk analysis includes review against the risk appetite statements.

Furthermore, the management and treatment of risk must be considered with regard to the costs and benefits of doing so. If the cost of treating the risk outweighs the cost of the consequence, the risk should not be treated.

Accountability

MYS must ensure there is accountability, authority and appropriate competence for managing risk, including implementing and maintaining the risk management process and ensuring the adequacy, effectiveness and efficiency of any controls.

At MYS, this is facilitated by:

- Identifying risk owners who have the accountability and authority to manage risks via the risk management policy, this framework and the risk management process;
- Identifying who is accountable for the development, implementation and maintenance of the framework for managing risk;
- Appointing and training dedicated BURs in each functional business unit line;
- Identifying other responsibilities of people at all levels within MYS for the risk management framework process;
- Establishing performance measurement and external and internal reporting and escalation processes;
- Position descriptions, key performance indicators (KPI's) and performance appraisals; and
- Ensuring appropriate levels of recognition exist via the risk management policy, this framework and the risk management process.

Integration into organisational processes

At MYS, risk management must be embedded in all Group practices and processes in ways that are relevant, effective and efficient. The risk management process should be part of, and not separate from, all organisational processes.

In particular, risk management must be embedded into policy development, business and strategic planning and review, and all change management processes. As such, all new policies, procedures, work instructions, business and strategic planning processes and subsequent reviews and/or changes to such matters, will be risk

assessed by the responsible and appropriate levels of management and then independently reviewed and risk assessed by the risk management function.

Policy, procedures and work instructions

Policies, procedures and work instructions are an integral part of an effective risk management framework. If employees breach MYS policies, procedures or work instructions, they increase the risk exposure of MYS. As such all breaches must have consequences that are appropriate, timely, effective, and transparent. Breaches that are sufficiently material, intentional or reckless, and, upon proper assessment, deserving of individual performance based counselling should result in disciplinary action against the employee(s) involved.

All policies are subject to annual review by the designated policy owner. Changes to policy must be reviewed and agreed by all key internal stakeholders and endorsed by the Executive prior to submission to the Board for approval.

Policy changes must be published on all relevant internal systems and communicated to all employees via appropriate channels, such as the intranet, Lotus Notes and email.

Changes to policy must be cross-referenced to procedures, work instructions, system standards, internal forms and any other relevant internal processes. Any changes to other work processes must be communicated at the same time as the associated policy changes.

Resources

MYS will ensure adequate and appropriate resources are allocated to risk management, given particular consideration to the following:

- People, skills, experience and competence;
- Resources needed for each step of the risk management process;
- MYS's processes, methods and tools used for managing risk;
- Documented policies, processes, procedures and work instructions;
- Information and knowledge management systems; and
- Training programmes.

Establishing internal and external communication and reporting mechanisms

Perceptions of risk can vary dramatically due to difference in assumptions, concepts, needs and concerns of different stakeholders. It is important that all stages of the risk management process involve dialogue and consultation between the various internal and external stakeholders. The CRO is responsible for encouraging, promoting and coordinating communication and consultation with regard to risk management processes and practices.

Communication and training are therefore vital to ensure that every employee is aware of the risk management policy, strategy, framework, risk appetite statements (where relevant) and associated policies, procedures, work instructions and system standards and understand how risk management processes fit within normal business operations and activities.

All changes and updates to the risk management policy, this framework, risk appetite statements and associated policies, procedures, work instructions and system standards must be communicated via the appropriate internal staff communication channels.

In addition to the above requirements, MYS will establish internal communication and reporting mechanisms in order to support and encourage accountability and ownership of risk. These mechanisms will ensure that:

- Key components of the risk management framework, and any subsequent modifications, are communicated appropriately;
- There is adequate internal reporting on the framework, its effectiveness and the outcomes;
- Relevant information derived from the application of risk management is available at appropriate levels and times; and
- There are processes for consultation with internal stakeholders.

These processes will include methods to consolidate risk information from a variety of sources, and must consider the sensitivity of the information.

MYS will utilise existing internal communication protocols to support and encourage these requirements.

MYS has implemented a web based risk management system, based on AS/NZS ISO 31000, to further support and encourage accountability and ownership of risk.

MYS has established external communication and reporting mechanisms. These mechanisms ensure that:

- Appropriate external stakeholders are engaged as required to ensure the effective exchange of information;
- External reporting complies with legal, regulatory and governance requirements;
- Feedback and reporting is provided on communication and consultation;
- Communication is used to build confidence in MYS; and
- Stakeholders are communicated with in the event of a crisis or contingency.

These mechanisms include, but are not limited to, MYS and all MYS Group companies policies and procedures; business continuity and crisis management plans and procedures; regular Board and Board Committee reporting; Executive and management committee reporting; external and internal audit processes and reporting; project management methodologies and mechanisms previously detailed herein under legal & regulatory compliance.

The CRO and other employees where relevant, will maintain active relationships, memberships and associations with industry bodies and suppliers such as COBA, Cuscal, the Professional Risk Managers International Association (PRMIA), the Governance Institute, the Australian Institute of Company Directors (AICD) and other established industry bodies as considered appropriate.

Active relationships are also maintained with relevant alert and web services offered by regulators and industry bodies such as ASIC, APRA, AUSTRAC, COBA weekly updates and online portal, the COBA Online Fraud Community and the Australian Customer Owned Banking Fraud Committee.

Implementing risk management

Implementing the framework for managing risk

In implementing this framework MYS will:

- Apply the risk management policy and risk management process to organisational processes;
- Comply with legal and regulatory requirements;
- Ensure that decision making, including the development and setting of objectives, is aligned with the outcomes of risk management processes;
- Hold information and training sessions; and
- Communicate and consult with stakeholders to ensure that this framework remains appropriate.

Implementing the risk management process

Risk management within MYS will be implemented by ensuring that the risk management process is applied at all levels and functions of MYS as part of its normal practices and processes.

The risk management process (detailed in a separate document) is reviewed by the Group Risk Committee and recommended to the Board for approval.

Monitoring & review

Monitoring and review form part of the risk management process and involve regular checking and surveillance by the CRO.

The risk management process aims to:

- Ensure controls are effective and efficient in both design and operation;
- Obtain further information to improve risk assessment;
- Analyse and learn lessons from events (including near misses), changes, trends, successes and failures;
- Detect changes in the external and internal context, including changes to risk criteria and the risk itself, which may in turn require revision of risk treatment and priorities; and
- Identify emerging risks.

The results of monitoring and review within MYS are recorded and reported as detailed in the risk management process and are used as part of the review of the framework itself.

Continual improvement

Risk management is a continuous improvement process to facilitate effective management of risk. This is critical to the achievement of strategic objectives embedded in and underpinning MYS's Strategic Plan. The importance of continuous improvement to the risk management framework must be reinforced by all levels of

management to ensure the quality and effectiveness of risk management and internal control within MYS

Based on the results of monitoring and reviews, decisions should be made on how the risk management policy, strategy, framework, risk appetite statement and process can be improved. The CRO will report at a minimum, annually on the findings. These decisions should in turn lead to improvements in MYS's management of risk and its risk management culture.