China Aircraft Leasing Group Holdings Limited

(Incorporated under the laws of the Cayman Islands with limited liability)

Stock code: 01848

Flying for Sustainable excellence

2021

RISK MANAGEMENT REPORT

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1 MAIN FEATURES OF RISK MANAGEMENT AND INTERNAL CONTROL

The Board has overall responsibility for evaluating and determining the nature and extent of the risks it is willing to take in achieving the company's strategic objectives and ensuring that the company establishes and maintains appropriate and effective risk management and internal control systems. Such risks include, amongst others, material risks relating to ESG. The Board oversees the company's risk management and internal control systems on an ongoing basis, and reviewing their effectiveness periodically. In this connection, the Board ensures there is adequacy of resources, staff qualifications and experience, training programs and budget for the accounting, internal audit and financial reporting functions, as well as those relating to the company's ESG performance and reporting.

The system of internal control is designed to achieve a high level and strong management of key types and overall risks in pursuit of the Company's business objectives.

The Board operates within clearly defined terms of reference, and has appropriate committees established, namely, Strategy Committee, Audit Committee, Nomination Committee and Remuneration Committee to oversee risk and internal control activities. These Committees also have clearly defined terms of reference.

The Board aims at achieving an appropriate balance between taking risks and generating returns for shareholders while executing its responsibility for ongoing monitoring of risk and internal controls.

Our Audit Committee is designated to oversee the risk management and internal control process, particularly, standards of financial reporting, risk management and internal controls.

On the operational level, we have a Risk Management team overseeing the operational and business risks of the aircraft leasing business. On the Group level, we have an Internal Audit function, which is directly reporting to the Audit Committee for independent monitoring and reporting of risks and controls.

The Company has the objectives of risk management and internal control as follows:

(i) Continue to optimize its business model, integrating it with its enhanced corporate governance structure to reduce the inherent risks in its business activities, such as liquidity risk and credit risk;

(ii) Continue to utilize its business network to effectively enhance its industry knowledge so as to reduce the probability of and the impact from defaulted and discontinued lease transactions; and

(iii) Continue to cultivate a strong risk management corporate culture throughout the organization.

The Company has implemented its risk management system and policies from the business model and strategic dimension.

Business model dimension

The Group's business is organized and operated on transaction basis so as to ensure each transaction is reviewed from different perspectives to ensure stringent selection of suitable aircraft assets and stringent review of credit assessment and approval.

Strategic dimension

Risk management initiatives are led by the Board (through its Audit Committee) and executed by CEO and his senior management team, through an independent Risk Management team.

The Company's risk management and internal control framework is designed to minimize the risks in the delivery of the Company's strategic objectives. The key principles of the framework are as follows:

– The Board and the Management shall promote a culture to identify, assess and report risks in an open, transparent and objective manner.

– The priority of the Company is to protect its long-term and sustainable interests.

Risk management is embedded within all businesses and operations of the Company. The Company expects all individual behavior to mirror and share the culture and core values of the Company. All employees have the responsibility of upholding the Company's risk and control culture and supporting effective risk management to deliver its strategy.

The Company operates a "three lines of defense" framework for managing and identifying risks.

The first line of defense against undesirable outcomes is undertaken by the business function and the respective line managers. Department heads of all business areas are responsible for implementing and maintaining appropriate controls.

Line management is supported and monitored by middle and back office functions like, Transaction Support, Finance and Accounting, Legal, Compliance, Company Secretarial, Human Resources, Information Technology and Risk Management, which constitute the second line of defense. This line of defense monitors and facilitates implementation of effective risk management practices by risk owners and reports risk related information throughout the organization.

Risk Management team reports to our Audit Committee on an ad-hoc basis. In addition, the Board reviews the effectiveness of the Group's risk management and internal control system with the assistance of Audit Committee, which covers all material controls including financial, operational and compliance controls, and the risk management system.

The third line of defense is carried out by our Internal Audit function. It provides independent review on the operation of controls.

2 ANNUAL REVIEW OF THE RISK MANAGEMENT AND INTERNAL CONTROL

The Risk Management team carried out the annual review of the effectiveness of the Group's risk management and internal control system. The results were reported to our Audit Committee and the Board. The Board acknowledged that the risk management and internal control system of the Group during the review period were effective and adequate.

2.1 The Board's annual review considers:

(i) the changes, since the last annual review, in the nature and extent of significant risks (including ESG risks), and the company's ability to respond to changes in its business and the external environment;

(ii) the scope and quality of management's ongoing monitoring of risks (including ESG risks) and of the internal control systems, and where applicable, the work of its internal audit function and other assurance providers;

(iii) the extent and frequency of communication of monitoring results to the board (or board committee(s)) which enables it to assess control of the company and the effectiveness of risk management;

(iv) Significant control failings or weaknesses that have been identified during the period. Also, the extent to which they have resulted in unforeseen outcomes or contingencies that have had, could have had, or may in the future have, a material impact on the company's financial performance or condition; and

(v) The effectiveness of the company's processes for financial reporting and Exchange Listing Rule compliance.

2.2 Ongoing Monitoring of Risk and Internal Control

2.2.1 Scope and quality

During the year, the Board reviewed the business of the Company through its regular meetings in order to ensure that business risks had been considered, assessed and managed as an integral part of the business. There was an ongoing process for identifying, evaluating and managing the Company's significant risks. The Company's risk assessment process included the monitoring of key strategic and financial risks. In addition, the Company reviewed the impact of any changes and developments on its risk profile, strategic risk and reputation.

The impact and likelihood of each significant risk was evaluated with reference to associated measures and key performance indicators. The adequacy of the risk mitigation plans was assessed and, if necessary, improvements were made.

2.2.2 Extent and frequency of communication

Our Audit Committee held regular meetings, at least quarterly for assessing control of the Company and the effectiveness of risk management.

Risk and risk events are captured by the business and reported to the second line of defense. Specific reports and periodic updates are submitted to the Board after the review by our Audit Committee, if necessary. Issues would be raised when there were control failings, weaknesses and inefficient processes identified or through continuous monitoring reviews by the second and third line of defense teams.

2.3 Significant Control Failings or Weaknesses

The Company has underlying procedures to handle significant control failings or weaknesses, which include material adverse event assessment, mitigation plan and follow up action. Significant control failing is required to be reported by senior management to our Audit Committee and the Board. No significant control failings or weaknesses were identified during the year.

2.4 Effectiveness of Financial Reporting and Listing Rule Compliance

With the support and input from the External Auditors, our Audit Committee carried out its review and assessment of the Company's financial reporting, covering key areas such as whether suitable accounting policies were adopted, whether management made appropriate estimates and judgments and whether disclosures in published financial statements were fair, balanced and understandable.

Our Audit Committee carries out its compliance review to assess whether the Company has been complying with the relevant regulatory requirements on a quarterly basis. The compliance review summarized the compliance status, corrective actions and the enhancement recommendations.

In regard to the above, our Audit Committee considered the Company's processes for financial reporting and Listing Rules' Compliance were effective.

2.5 Risk Mitigating Measures and Key Changes

Risk management and internal controls are the day-to-day responsibility of every employee. The Company is exposed to various risks including but not limited to financial market risk, counterparty risk, compliance risk and business risk.

In order to cope with these risks, the Company monitors and implements mitigating measures.

Due to the strong average credit quality of the Company's portfolio, counterparty risk has not been material in previous periods. However, the impact of the COVID-19 pandemic continues to be felt acutely by the worlds' airlines, including the Company's customers. The impact on the Company has been cushioned to a significant extent by the Company's large presence in China. As of December 31, 2021, by number of aircraft, 76% of the owned aircraft leased to Chinese Lessees (including Hong Kong, Macao and Taiwan), most of which were state-owned airlines with strong financial strength and abundant working capital. China has achieved remarkable results in the fight against the pandemic and the domestic aviation market has remained one of the best performers globally, with traffic has recovered to more than 75.6% of the level in 2019. And extensive Government financial support made available. The Risk Management team has been in constant dialogue with customers that did not receive substantial governmental or shareholders' support, or did not possess Investment Grade balance sheets with which to tap capital/debt markets and have invariably been obliged to seek accommodations with major suppliers including banks and lessors. The company has sought to consider each such request on its individual merits. Features of such support, where agreed are i) maximize cash flow in the near term; ii) protect the Company's assets and iii) compensate for financial concessions through lease amendments or interest payments. The status of receivables is reported to the Management on a regular basis and remedial actions are discussed frequently between relevant departments. In order to mitigate any risk to the integrity of the Company's assets, Risk Management, Legal and Technical teams coordinate to appoint local representatives to act on behalf of the Company.

During the year, the Company undertook the following measures in order to further mitigate finance/portfolio related risks:

(i) Took new delivery of 34 aircraft and disposed of 9 aircraft to make the risk diversification more better;

(ii) The company have increase significantly on unsecured working capital facilities and trade finance facilities in 2021 on top of issuing RMB MTN, SCP and USD bonds etc.

The diversity of funding channels helped the Company access various banks, financial institutions and investors with multiple financing products. During the year, the Company have also obtained international credit ratings from Moody's (Ba1) and Fitch (BB+) which may help in further diversifying our funding channels and/or reducing our funding costs.

(iii) The Company continues to monitor currency exchange risk through matching the currencies of lease receivables and borrowings to the greatest extent possible. In order to mitigate currency exchange risk, a hedging arrangement has been made and unhedged exposure on RMB has been decreased by around unhedged exposure on RMB has been decreased by around 80% for the financial year ended 31 December 2021 when compared to the general level as for the financial year ended 31 December 2020.

(iv) With the interest rate swap arrangement, the Company's floating interest rate borrowings were hedged as per its prudent interest rate hedging policy. The interest rate risk would be monitored on an ongoing basis.

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