

Risk management

3i has a comprehensive risk management framework which provides a structured and consistent process for identifying, assessing and responding to risks in relation to the Group's strategy and business objectives.

As part of this process, risks are considered across the following broad categories:

External	Risks arising from political, legal, regulatory, economic policy and competitor changes
Strategic	Risks arising from the analysis, design and implementation of the Group's business model, and key decisions on investment levels and capital allocations
Investment	Risks in respect of specific asset investment decisions, the subsequent performance of an investment or exposure concentrations across business line portfolios
Treasury and funding	Risks arising from (i) uncertainty in market prices and rates, (ii) an inability to raise adequate funds to meet investment needs or meet obligations as they fall due, or (iii) inappropriate capital structure
Operational	Risks arising from inadequate or failed processes, people and systems or from external factors affecting these

Risk management operates at all levels throughout the Group, across business lines, geographies and professional functions. It is monitored by a combination of the Board, the Audit and Compliance Committee, Management Committee and Risk Committee, supported by the Group Risk Assurance and Audit, and Group Compliance functions. The roles of the Board, Audit and Compliance Committee and Management Committee are described in the Directors' report. The Risk Committee meets four times a year to oversee movements in risk exposures across the Group and recommends appropriate responses. Its membership includes senior representatives from investment and professional services functions.

Given their fundamental significance to the Group, investment and treasury and funding risks are managed by specific processes which are described below.

Investment risk

3i's investment appraisal is undertaken in a rigorous manner. This includes approval by the relevant business line partnerships, and where appropriate, peer review by executives from other business lines, and our international network of industry and sector specialists. Investments over £5 million are presented to an Investment Committee chaired by one of our Group Partners and comprising some of our senior investment executives.

Having made our investment decision, a rigorous process is put in place for managing the relationship with the investee company for the period through to realisation. This can include board representation by a 3i investment executive and regular internal asset review processes.

3i invests across a range of economic sectors. The portfolio is subject to periodic reviews at both the business line and Group levels to ensure that there is no undue exposure to any one sector. The valuation of 3i's unquoted portfolio and opportunities for realisation depend to some extent on stock market conditions and the buoyancy of the wider mergers and acquisitions market.

Treasury and funding risk

3i's funding objective is that each category of investment asset is broadly matched with liabilities and shareholders' funds according to the risk and maturity characteristics of the assets, and that funding needs are met ahead of planned investment.

Credit risk 3i's financial assets are predominantly unsecured investments in unquoted companies, in which the Board considers the maximum credit risk to be the carrying value of the asset. The portfolio is well diversified and, for this reason, credit risk exposure is managed on an asset-specific basis by individual investment managers.

Liquidity risk During the financial year, 3i generated a cash surplus of £1,089 million (2005: £562 million) from its investing activities and cash resources at the end of the period amounted to £1,955 million (2005: £1,199 million). In addition, the Group had available to it undrawn committed facilities of £488 million at 31 March 2006 (2005: £764 million).

Price risk The valuation of unquoted investments depends upon a combination of market factors and the performance of the underlying asset. 3i does not hedge the market risk inherent in the portfolio but manages asset performance risk on an asset specific basis.

Foreign exchange risk 3i reports in sterling and pays dividends from its sterling profits. The Board seeks to reduce structural currency exposures by matching assets denominated in foreign currency with borrowings in the same currency. The Group makes some use of derivative financial instruments to effect foreign exchange management.

Interest rate risk 3i has a mixture of fixed and floating rate assets. The assets are funded with a mixture of shareholders' funds and borrowings according to the risk characteristics of the assets. The Board seeks to minimise interest rate exposure by matching the type and maturity of the borrowings to those of the corresponding assets. Some derivative financial instruments are used to achieve this objective.