

Crown Agents

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Bank

# Pillar 3 Disclosures

31 December 2017



## Table of Contents

<b>1.</b>	<b>Introduction.....</b>	<b>2</b>
1.1	Background.....	2
1.2	Frequency, Location, and Verification.....	2
1.3	Scope of Disclosures.....	3
1.4	Summary of Key Capital Ratios.....	3
<b>2.</b>	<b>Governance Arrangements.....</b>	<b>4</b>
2.1	Risk Management.....	4
2.2	Monitoring & Control.....	5
2.3	Risk Categories.....	5
2.4	Control Framework.....	5
2.4.1	<i>Committees.....</i>	<i>5</i>
2.4.2	<i>Group Board.....</i>	<i>6</i>
2.4.3	<i>Group Audit &amp; Risk Committee (“ARC”).....</i>	<i>6</i>
2.4.4	<i>Group Remuneration and Nominations Committee.....</i>	<i>6</i>
2.4.5	<i>Bank Board (“The Board”).....</i>	<i>7</i>
2.4.6	<i>Credit Committee (“CC”).....</i>	<i>7</i>
2.4.7	<i>Executive Committee (“EXCO”).....</i>	<i>7</i>
2.4.8	<i>Compliance &amp; Operational Risk Committee (“CORC”).....</i>	<i>8</i>
2.4.9	<i>Assets and Liabilities Committee (“ALCO”).....</i>	<i>8</i>
2.5	Board of Directors.....	8
<b>3.</b>	<b>Risk Appetite.....</b>	<b>10</b>
<b>4.</b>	<b>Capital Adequacy.....</b>	<b>11</b>
4.1	Capital Requirement.....	11
4.2	Countercyclical Buffer.....	11
4.3	Capital Resources.....	11
4.4	Leverage Ratio.....	13
<b>5.</b>	<b>Capital Management.....</b>	<b>15</b>
5.1	Capital Requirements.....	15
5.2	Minimum Capital Requirement Pillar 1.....	16
<b>6.</b>	<b>Credit Risk.....</b>	<b>17</b>
6.1	Controls & Mitigation.....	17
6.2	Minimum Capital Requirement: Credit Risk.....	18
6.3	Credit Risk Exposures by Sector.....	19
6.4	Geographic Distribution OF Credit Risk Exposures.....	20

6.5	Residual Maturity of Credit Risk Exposures .....	21
6.6	Management of Credit Risk .....	21
6.7	Credit Risk – Rating of Exposures .....	22
6.8	Credit Risk Concentration .....	23
6.9	Counterparty Credit Risk.....	23
6.10	Reconciliation to Statutory Accounts .....	24
<b>7.</b>	<b>Market Risk - Interest Rate Risk .....</b>	<b>25</b>
7.1	Management of Interest Rate Risk .....	25
7.2	Asset-liability Gap Risk.....	26
<b>8.</b>	<b>Market Risk - Currency Risk .....</b>	<b>27</b>
8.1	Management/Mitigation .....	27
8.2	Measurement/Control.....	27
<b>9.</b>	<b>Market Risk – Other Risks .....</b>	<b>28</b>
9.1	Controls & Mitigation .....	28
9.2	Other Market Risks .....	28
<b>10.</b>	<b>Liquidity Risk.....</b>	<b>29</b>
10.1	Controls & Mitigation .....	29
10.2	Liquidity Ratios.....	30
10.2.1	<i>Liquidity Coverage Ratio (“LCR”)</i> .....	30
10.2.2	<i>Net Stable Funding Ratio (“NSFR”)</i> .....	31
10.3	Key Liquidity Risk Drivers .....	31
10.3.1	<i>Deposit funding risk</i> .....	31
10.3.2	<i>Wholesale funding</i> .....	31
10.3.3	<i>Payments systems</i> .....	31
10.3.4	<i>Liquidity contingency plan</i> .....	31
10.4	Encumbered Assets.....	31
<b>11.</b>	<b>Operational Risk .....</b>	<b>32</b>
11.1	Controls and Mitigation .....	32
11.2	Management of Operational Risk.....	33
<b>12.</b>	<b>Compliance (including Regulatory) Risk .....</b>	<b>34</b>
12.1	Controls & Mitigation .....	34
<b>13.</b>	<b>Strategic Risk .....</b>	<b>35</b>
13.1	External Factors .....	35
13.2	Internal Factors.....	35
13.3	Controls & Mitigation .....	36
<b>14.</b>	<b>Conduct Risk.....</b>	<b>37</b>

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15.	Financial Crime Risk .....	38
16.	Insurance Risk.....	39
17.	Pension Obligation Risk .....	40
18.	Remuneration.....	41
18.1	Approach to Remuneration .....	41
18.2	Decision-making Process for Determining Remuneration Policy .....	42
18.3	Remuneration Policy for Code Staff .....	42
18.3.1	<i>Basic salary</i> .....	42
18.3.2	<i>Variable pay</i> .....	42
18.3.3	<i>Benefits</i> .....	42
18.3.4	<i>Link between pay and performance</i> .....	42
18.3.5	<i>Design and structure of remuneration</i> .....	43
18.4	Salary and Fees .....	44
18.5	Variable Awards.....	44
18.6	Remuneration Paid to Code Staff .....	45

## GLOSSARY

The following terms are used throughout these Disclosures:

ALCO	Asset and Liability Committee
CC	Credit Committee
CEO	Chief Executive Officer
CET 1	Common Equity Tier 1 Capital
CORC	Compliance & Operational Risk Committee
CRD	Capital Requirements Directives
CRR	Capital Requirement Regulations
EBA	European Banking Authority
ED	Executive Director
EXCO	Executive Committee
FCA	Financial Conduct Authority
FSCS	Financial Services Compensation Scheme
HQLA	High Quality Liquid Asset
ICAAP	Individual Capital Adequacy Assessment Process
ILAAP	Individual Liquidity Adequacy Assessment Process
ILG	Individual Liquidity Guidance
INED	Independent Non-Executive Director
IT	Information Technology
JMSLG	Joint Money Laundering Steering Group
LCP	Liquidity Contingency Plan
LCR	Liquidity Coverage Ratio
MLRO	Money Laundering Reporting Officer
NED	Non-Executive Director
NGO	Non-Governmental Organisation
NSFR	Net Stable Funding Ratio
PRA	Prudential Regulation Authority
RATS	Risk Appetite and Tolerances Statement
SME	Small & Medium Size Enterprise
SREP	Supervisory Review and Evaluation Process
TCR	Total Capital Requirement

## I. Introduction

### I.1 Background

The Capital Requirements Directive (“CRD”) introduced a new framework under which banks and financial institutions are required to calculate their capital. This was based on global standards introduced by the Basel Committee on Banking Supervision through the Basel II framework. The framework consists of 3 Pillars:

<b>Pillar 1</b>	<b>Minimum capital requirements:</b> defines the rules for the calculation of credit, market and operational risk to ensure that banks hold adequate regulatory capital against the risks they assume within their current business.
<b>Pillar 2</b>	<b>Supervisory review process:</b> sets out the key principles for the supervisory review of a bank’s risk management framework and its capital adequacy. It sets out specific oversight responsibilities for both the Board and senior management, thereby reinforcing the principles of internal control and other corporate governance practices.
<b>Pillar 3</b>	<b>Market discipline:</b> sets out the items covered by this report; it requires expanded disclosures to permit investors and other market participants to obtain an understanding of the risk profiles of the bank.

The Financial Conduct Authority (“FCA”) and Prudential Regulation Authority (“PRA”) have responsibility for implementing the CRD within the United Kingdom.

The disclosure requirements set out the minimum capital requirements (Pillar 1) and the supervisory review process (Pillar 2), and are designed to promote market discipline by allowing market participants to assess the impact of key information on risk exposures and the risk assessment processes of the firm (Pillar 3).

The following represents the Bank’s Pillar 3 disclosures in accordance with this requirement.

### I.2 Frequency, Location, and Verification

The Bank publishes its Pillar 3 Disclosures on an annual basis. Disclosures comply with the disclosure requirements laid out in the Capital Requirements Regulations 2015 (Part Eight) (“CRR”) and are based on the financial year end following publication of audited accounts. These disclosures are therefore based on the results of the year ended 31<sup>st</sup> December 2017 (with comparatives) unless otherwise stated. The Disclosures include the impact of the 2017 financial performance and have been updated to reflect the most recent operational risk capital requirements.

The Pillar 3 disclosures should be read in conjunction with the Bank's Annual Report and Financial Statements.

The disclosures have not been, and are not required to be, subject to independent external audit and do not constitute any part of the Bank's Financial Statements.

### 1.3 Scope of Disclosures

The Bank is an unquoted company registered in England, authorised by the PRA and regulated by the PRA and the FCA. It is a single branch bank, whose principal function is to provide multicurrency account management, payment, foreign exchange and trade finance services to central banks, governments, supranationals, development agencies, large non-governmental organisations ("NGOs") and selective corporate organisations worldwide.

The Bank is a wholly owned subsidiary of CABIM Limited, which is owned by funds managed by Helios Investment Partners LLP. The Bank's management and ownership structures are set out in the Appendices to these disclosures.

The disclosures below are the required Pillar 3 disclosures and apply solely to the Bank. The Bank continues to develop the quality and transparency of disclosures to ensure that they are as clear and informative as possible.

### 1.4 Summary of Key Capital Ratios

Capital ratios are a measurement of a company's financial strength and reflect the level of protection it holds against any unexpected losses. The key capital ratios under CRD IV for the Bank are presented below.

<b>Capital Ratios</b>		2017	2016
Common Equity Tier 1 Capital (CET1)		20.8%	21.0%
Tier 1 Capital Ratio		20.8%	21.0%
Total Capital Ratio		20.8%	21.0%
Credit Risk Weighted Assets (£m)		234,511	166,748
<b>Leverage ratio</b>		<b>6.0%</b>	<b>4.3%</b>

Further details on the Bank's capital ratios, risk weighted assets and leverage ratio are presented in Section 4 of these disclosures.

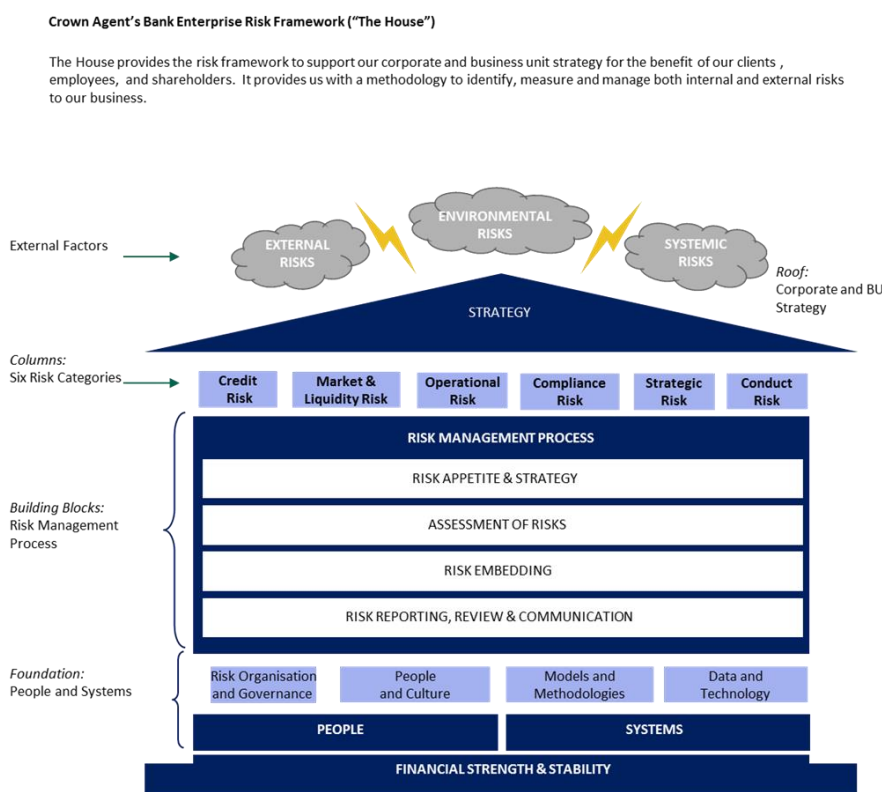
## 2. Governance Arrangements

### 2.1 Risk Management

Through its normal operations the Bank is exposed to a number of risks, the most significant of which are credit, market and liquidity, operational (including reputational risk), compliance (including regulatory risk), strategic and conduct risks.

The Board of the Bank is responsible for determining the long-term strategy of the business, the markets in which it operates, and the level of risk acceptable to the Bank. The level of risk acceptable to the Bank is controlled through the Bank’s Risk Appetite and Tolerances Statement (“RATS”). Risk Management has an oversight role in the maintenance of policies and procedures, evaluating and monitoring risk levels and reports through the individual committees to the Board on risk issues generally.

The Bank’s Corporate Governance Manual outlines how the Bank’s Board and the Executive Management team fulfil their respective risk management responsibilities through the deployment of a risk management framework. This framework covers the full spectrum of risk to which the Bank is exposed and sets out how those risks are described and the measures which apply to mitigate those risks. It is the use of this framework (or “House”) which will enable the Bank to maximise value to its shareholder and its customers by aligning risk management with the business strategy; assessing the impact of emerging legislation and regulation; and developing the Bank’s risk appetite accordingly.



**Key Principles**

- Forward-looking
- Enterprise-wide, consistent application across all risk categories
- Dynamic, allowing pro-active management of the risk profile and risk appetite
- Flexible and scalable to allow for changes in business and regulatory requirements
- Usable at all levels within the organisation e.g., departments, corporate, and divisional
- Embedded in business processes such as planning, and performance management



## 2.2 Monitoring & Control

The Bank's approach to capital management is driven by its desire to maintain a strong capital base to support the development of its business and to meet regulatory capital requirements at all times.

Each year the Bank updates its three-year strategic plan which covers both the development of the business and its impact on the capital of the Bank. The plans are underpinned by the Bank's risk appetite and ensure that the available levels of capital are appropriate to the business plans and strategy. The plans also ensure that business growth assumptions are integrated into the overall capital assessment.

The Bank undertakes a detailed Internal Capital Adequacy Assessment Process (ICAAP) to support its capital requirements. Each material risk is assessed through a series of stress testing scenarios, relevant mitigants considered and appropriate levels of capital determined. The ICAAP, which is carried out annually, is a key part of the Bank's management disciplines through its review by the Assets and Liabilities Committee (ALCO), the Audit and Risk Committee and approval by the Board. It is available for review by the PRA, when a minimum level of capital is agreed.

The Bank monitors its capital requirements on a daily basis using a traffic light system to ensure internal and external capital requirements are met. Its Regulatory Capital Policy sets out the actions to be taken when capital reaches pre-set levels. At 31<sup>st</sup> December 2017, and at all times, the Bank complied with its capital requirements.

## 2.3 Risk Categories

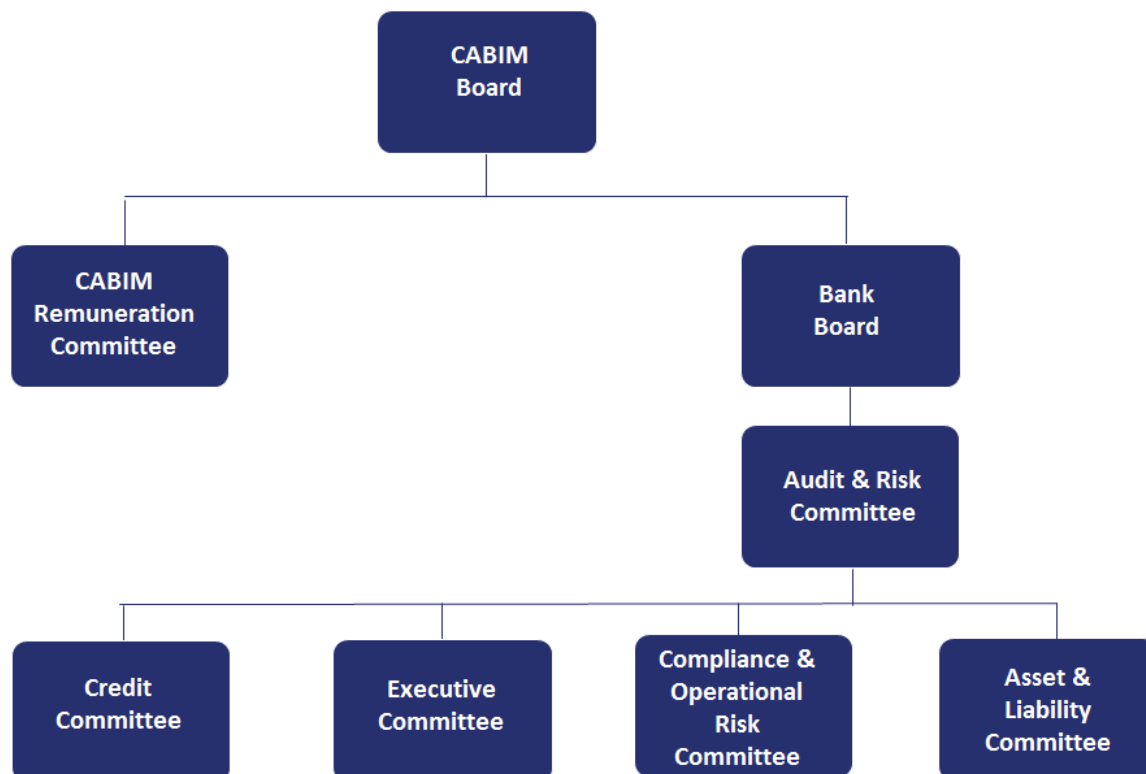
The Bank recognises six broad categories of risk inherent within its operations:

- Credit risk – the risk of financial loss arising from a borrower or counterparty failing to meet their financial obligations to the Bank in accordance with agreed terms.
- Market & Liquidity risk – Market risk is the risk that the value of, or net income arising from, the Bank's assets and liabilities changes as a result of changes to market forces, in particular interest rates, exchange rates or asset prices. Liquidity risk is the risk that the Bank is not able to meet its financial obligations as they fall due or can do so only at excessive cost.
- Operational risk – is the risk of a financial or non-financial impact resulting from inadequate or failed internal processes, people and systems or from external events including financial crime.
- Regulatory / Compliance risk – is the risk to the Bank's reputation of failure to comply with regulatory requirements.
- Strategic risk – the risk which can affect the Bank's ability to achieve its corporate and strategic objectives.
- Conduct risk – the risk of detriment caused to the Bank's customers due to the inappropriate execution of its business activities and processes

## 2.4 Control Framework

### 2.4.1 Committees

The Bank's supervision is driven through the establishment of a number of committees which are responsible for technical governance of the business ensuring adherence to internal policies and with powers to make decisions related to the day to day running of the business.



**2.4.2 Group Board**

The CABIM group Board is the primary governing body and has ultimate responsibility for setting the group strategy.

**2.4.3 Group Audit & Risk Committee (“ARC”)**

CABIM has an Audit and Risk Committee which monitors and manages risk issues throughout the group, including the Bank. It monitors compliance with the Bank’s policies and procedures through the review of audit and other reports, and with recommendations of its Regulators, the Prudential Regulatory Authority and Financial Conduct Authority. It ensures that any reports of the external auditors are considered in full and implemented where appropriate.

The Committee consists of three independent non-executive directors of the Bank. It receives frequent reports and meets at least six times annually. It also monitors the work and considers the reports of the group’s Internal Audit, Risk Management, and Compliance functions, monitoring the implementation of their recommendations where appropriate, giving due consideration to the effectiveness of internal controls and compliance checks. Updates to the Bank’s Risk Register following management review are also made available to ARC.

Any issues of concern are reported to subsequent board meetings for discussion.

**2.4.4 Group Remuneration and Nominations Committee**

The Group Remuneration and Nominations Committee provides a framework for ensuring that the Bank complies with its regulatory requirements in respect of remuneration. It meets as required but at least twice annually. Its main functions are to:

- Determine and agree with the Board the framework or broad policy for the remuneration of the company's Chairman, Chief Executive, the executive directors, the company secretary and such other members of the executive management as it is designated to consider. The remuneration of Non-executive directors is a matter for the Chairman and the Chief Executive. No director or manager may be involved in any decisions as to their own remuneration;
- Review the ongoing appropriateness and relevance of the remuneration policy;
- Determine, within the terms of the agreed policy, the total individual remuneration package of personnel designated as Code Staff within the Financial Services subsidiaries;
- Approve the design of, and determine targets for, any performance related pay schemes operated by the Bank and approve the total annual payments made under such schemes;
- Consider succession planning;
- Oversee any major changes in employee benefits structures throughout the Bank or group.

In addition, the committee will meet on an ad hoc basis to consider nominations to the CABIM group boards, and its various committees.

#### **2.4.5 Bank Board ("The Board")**

The Bank Board is the primary governing body for the Bank and has ultimate responsibility for setting the bank strategy, corporate objectives and risk appetite. That strategy takes account of the interest of all stakeholders in the Bank.

The Risk Appetite and Tolerances Statement ("RATS"), which is approved by the Board, sets out the levels of risk which the Bank is willing to take within the confines of the group strategy. The Board is also responsible for the establishment of a control environment to manage the risks encapsulated within the RATS, which is set out in the Enterprise Risk Management Framework (ERMF)

The Board also maintains close oversight of the current and future activities through a combination of board reports (at least four times each year) and monthly financial results, including budgets, forecasts and other operational reports.

#### **2.4.6 Credit Committee ("CC")**

The role of the CC is to review the Bank's credit portfolio to ensure it remains within the Bank's credit risk appetite; to review and maintain the Bank's credit policy; and to assess the clients and counterparties with which the Bank will undertake business. It meets weekly to review client, counterparty and country exposures, as well as considering issues of a strategic (credit related) nature.

The CC reports to ARC every two months, on matters within its terms of reference, and will make recommendations to the ARC on items within its remit where actions are required.

#### **2.4.7 Executive Committee ("EXCO")**

EXCO meets on a weekly basis and takes day to day responsibility for running the business. EXCO implements the strategy and financial plan, which is approved by the Board annually, and ensures the performance of the business is conducted in accordance with the Board's established risk appetite. It reports to the Board at least six times each year via reports prepared by the Chief Executive Officer (CEO) and other financial reports.

#### 2.4.8 Compliance & Operational Risk Committee (“CORC”)

CORC meets at least six times a year, and has been established to

- Develop an operational risk framework through which operational risk is monitored, measured and managed;
- Monitor compliance with internal policies and procedures and with external regulatory and legal requirements;
- Monitor forthcoming compliance regulation and manage the Bank’s response;
- Manage the Bank’s Anti-Financial Crime response;
- Consider the recommendations of any regulatory related notices or instructions and present responses to the Board
- Review key operational risk documentation; and
- Monitor operational risk events.

CORC reports regularly to the Board through the Audit and Risk Committee, which will, on at least an annual basis, receive a report from the Money Laundering Reporting Officer (“MLRO”).

#### 2.4.9 Assets and Liabilities Committee (“ALCO”)

ALCO monitors the liquidity and capital adequacy of the Bank on a monthly basis and ensures that the Bank adheres to the market risk, interest rate risk, capital utilisation and liquidity policies and objectives set down by the Board. It also has responsibility for ensuring that the policies that are implemented are adequate to remain within prudential and regulatory limits.

Management information on the matters noted above are generated and distributed by the Finance Division daily. In addition, ALCO:

- Reviews the Individual Capital Adequacy Assessment Process (“ICAAP”) and recommends it to the ARC and subsequently to the Board
- Reviews the Individual Liquidity Adequacy Assessment Process (“ILAAP”) and recommends it to the ARC and subsequently to the Board
- Allocates capital and liquidity to support business activities by department and/or product in terms of risk/reward

In addition to the recommendations outlined above, the ALCO will report to the Audit & Risk Committee every two months on matters impacting the balance sheet.

### 2.5 Board of Directors

The Directors who served on the Bank’s Board during the year ended 31 December 2017 are as set out below. There have been no changes to the composition of the Board since the end of 2017 up to the date of publication of these Disclosures.

Name	Position	Date of Board Appointment / Cessation
Jeremy Parrish	INED, Chairman	Appointed 4 April 2017
Paul Batchelor	INED, Chairman	Resigned 30 April 2017
Nick Beecroft	Senior INED, Chair Remuneration Committee	
Raj Bhatia	INED	
Arnold Ekpe	NED	
Richard Hallett	ED, Chief Financial Officer	Appointed 31 January 2017
Richard Jones	ED, Group Chief Executive Officer	Resigned 6 February 2017
Albert Maasland	ED, Group Chief Executive Officer	
Carole Machell	INED, Chair Audit & Risk Committee	Appointed 04 April 2017
Douglas MacLennan	ED, Chief Risk Officer	
Derek McMenamin	INED	
Simon Poole	NED	
Mary Reilly	INED	Resigned 30 April 2017

The Board of the Bank is responsible for providing governance and oversight over strategy, risk management and operations of the bank. The key responsibilities include:

- Approval of the Bank's strategic and financial plans and regular review of progress to ensure the sustainability and health of the business;
- Ensuring that processes are maintained to ensure the integrity of the financial reporting and disclosures by the company and compliance with legal and ethical responsibilities;
- Periodical review and approval of the risk strategy, policies, risk appetite and risk management framework, including approval of the Bank's ICAAP, ILAAP and Recovery Plan / Resolution Pack ("RRP") on at least an annual basis;
- Ensuring that there is an appropriate system of internal audit and periodically reviewing its effectiveness;
- Delegating authority for day-to-day running of business to the Chief Executive Officer ("CEO").

As reflected in the Bank's Policies and its Authorities Manual, the Board delegates the day-to-day capital adequacy and liquidity risk management responsibilities to the CEO and the EXCO. The Management team meets weekly (as EXCO) to discuss current issues with a full agenda covering all aspects of the business including new business and emerging risks. It reports to the Board six times each year.

In the event of a capital or liquidity crisis, a Special meeting of the Bank's ALCO, headed by the CEO, will take responsibility, ensuring that the overall strategy is approved by the Board.

### 3. Risk Appetite

Risk appetite is the maximum level of residual risk that the Bank is prepared to accept to deliver its business objectives. The Bank has developed a robust framework that is used to articulate risk appetite throughout the Bank and to external stakeholders.

The Board is responsible for the establishment of the Bank's Risk Appetite and Tolerances Statement. It establishes the Bank's parameters for risk appetite by:

- Providing strategic leadership and guidance;
- Reviewing and approving annual budgets and forecasts, under both normal and stressed conditions, for the Bank; and
- Regularly reviewing, anticipating and monitoring the Bank's risk performance through Board reports six times each year.

Via ARC, the Board delegates the management and control of risk appetite to the CC (for credit risk appetite); to the CORC for compliance (including anti-financial crime and conduct) and operational related issues; to ALCO for balance sheet related issues; and to EXCO for all other risk appetites. It ensures that risk appetite is in line with Bank strategy and the Bank's desired balance between risk and reward. Each committee is responsible for recommending to the Board the respective levels of risk appetite and risk tolerances for the Bank.

The Bank's risk appetite statements are defined by five broad metrics:

- Headline earnings
- Liquidity
- Regulatory capital
- Economic capital and
- The confidence level applied to our capital adequacy to cover any unexpected losses

These metrics are then converted into tolerance levels and limits through an analysis of the risks that impact on them. The Bank's risk assessment process is linked to its Risk Appetite and Tolerances Statement; this means that it links qualitative assessments to the overall appetite for risk used in the Risk Appetite and Tolerances Statement. In turn this enables a comparison to be made between risk appetite, and residual risk.

The Bank's business model is not asset-led and its exposure to money markets is restricted to highly rated counterparties. The Bank seeks to focus on benefiting from the markets in which it operates as well as ensuring it remains commercially viable in order to continue to service its clients. As a result, the Bank's over-riding approach to risk is closely controlled. It provides a market rate of return to its depositors while at the same time safeguarding assets through careful appraisal of placements made.

The Bank offers quality, ethical, banking products and services that provide clients with the assurance that their funds will be placed with banks which act responsibly. As a consequence, the Bank is selective about both the products and services it offers as well as its investment decisions. However, within these parameters, the Bank seeks a profitable return by optimising its return within its risk tolerances, the expansion of its client base, and through alert management of cost/income ratios.

The Bank does not run a trading book. It offers limited lending facilities and focuses money market exposures primarily to F1+ and F1 rated institutions, and to securities issued by these institutions, along with top rated sovereigns, and multinational development banks. Trade finance facilities are provided, however much of those are cash collateralised or otherwise guaranteed.

## 4. Capital Adequacy

### 4.1 Capital Requirement

CRD IV has increased the quantity and quality of capital that firms are required to hold, through the introduction of additional and increased deductions from CET1 resources and a phased implementation of new buffers, designed to prevent firms from breaching their minimum regulatory requirement in a stressed environment.

The Total Capital Requirement (“TCR”) is set by the PRA on a periodic basis, following completion of the ICAAP and Supervisory Review and Evaluation Process (“SREP”). The Bank has complied with the capital requirements set by the PRA at all times.

The minimum regulatory capital requirement is 8% of risk weighted assets. Additionally, banks are required to hold additional capital to cover future possible credit exposures and other risks in the business.

The TCR determined by the PRA for the Bank is set out below:

Total Capital Requirement	As At 31-Dec 2017	As At 17-May 2018
As a % of RWAs:		
Minimum Capital Requirement	8.000	8.000
Pillar 2A requirement	3.600	3.740
Total Capital Requirement	11.600	11.740
Capital Conservation Buffer	1.250	1.875
Total	12.850	13.615

### 4.2 Countercyclical Buffer

The Bank had no eligible exposures to countries for which the inclusion of a Countercyclical Buffer was applicable. As a result, no underlying disclosures have been provided.<sup>1</sup>

### 4.3 Capital Resources

The table below shows the composition of the Bank’s regulatory capital position as at 31 December 2017.

The Bank’s regulatory capital consists entirely of Common Equity Tier 1 capital, which is comprised of one class of issued ordinary share capital (issued at par) and accumulated reserves, subject to deductions for intangible assets and deferred tax assets (net of deferred tax liabilities). As a result:

- a. the Capital Instruments<sup>2</sup> template has not been included as all data points are either not applicable or nil.

<sup>1</sup> The detailed template is set out in European Delegated Regulation 2015/1555 which only requires the disclosure of information “relevant” to the calculation of the Countercyclical Buffer.

<sup>2</sup> European Commission Implementing Regulation 1423/2013 Annex II (Capital Instruments).

- b. The data re the Own Funds template<sup>3</sup> is included below. All the other data points are either not applicable or nil.

<b>Capital Resources</b>		Template	2017	2016
		Row	£000	£000
Common Equity Tier 1 Capital:				
Share Capital		1	41,200	25,300
Retained earnings		2	16,464	16,307
		6	57,664	41,607
Less deductions:				
	Intangible Assets	8	(4,092)	(2,836)
	Net Deferred Tax Asset	10	(721)	(711)
		28	(4,813)	(3,547)
<b>Total Common Equity Tier 1 Capital</b>		<b>29</b>	<b>52,851</b>	<b>38,060</b>
<b>Total Capital Resources</b>		<b>59</b>	<b>52,851</b>	<b>38,060</b>
<b>Risk Weighted Assets - Pillar 1</b>				
		Template		
		Row		
Credit Risk			249,509	177,292
Less: mitigation - collateral/guarantees			(15,933)	(11,606)
Total			<b>233,576</b>	<b>165,686</b>
Counterparty Risk			935	1,062
Total Credit Risk Weighted Assets			<b>234,511</b>	<b>166,748</b>
Market Risk			1,063	554
Operational Risk			18,625	13,847
Total Risk Weighted Assets		60	<b>254,199</b>	<b>181,149</b>
<b>Capital Ratios</b>				
		Template		
		Row		
Common Equity Tier 1 Capital Ratio		61	20.8%	21.0%
Total Tier 1 Capital Ratio		62	20.8%	21.0%
Total Capital Ratio		63	20.8%	21.0%
Capital Conservation Buffer/ Total Institution Specific Buffers		64/65	1.25%	1.25%

<sup>3</sup> European Commission Implementing Regulation 1423/2013 Annex IV (Own Funds). The Transitional Own Funds Disclosure Template (Annex VI) is not applicable as the Bank has not availed itself of any transitional provisions.



Capital ratios are calculated as regulatory capital divided by risk weighted assets. The Pillar 1 calculations are based on the Standardised Approach for Credit Risk and on the Basic Indicator Approach for Operational Risk.

Based on the TCR, the Bank has a capital surplus as shown below:

Total Capital	2017	2016
	£000	£000
Total Risk Weighted Assets	254,199	181,149
Total Capital Requirement (including Capital Conservation Buffer)	32,665	27,689
Total Capital Resources	52,851	38,060
Capital Surplus in Excess of Requirement	20,186	10,371

#### 4.4 Leverage Ratio

CRD IV requires firms to calculate a non risk-based leverage ratio to supplement risk-based capital requirements. The leverage ratio measures the relationship between the capital resources of the organisation and its total assets. The purpose of monitoring and managing this metric is to enable regulators to constrain the build-up of excessive leverage. It is calculated as:

$$\frac{\text{Tier 1 capital}}{\text{Total on and off-balance sheet assets adjusted for deductions}}$$

The minimum requirement for the leverage ratio has historically been 3% but was increased to 3.25%, effectively from 1 January 2018<sup>4</sup>. While the leverage ratio is not a regulatory requirement for the Bank<sup>5</sup>, the Bank chooses to monitor the metric as part of its risk management framework.

The Bank's leverage ratio is calculated daily, reviewed and monitored by ALCO monthly and included in the capital forecast and business-as-usual stress testing. The Bank's leverage ratio is included within its RATS, which documents the monitoring and escalation framework and the Bank's leverage ratio limits.

The calculation of the Leverage Ratio is as set out in the tables below which are based on the regulatory disclosure templates<sup>6</sup>. All template rows other than those noted in the tables are either not applicable or nil.

<sup>4</sup> Policy Statement | PS21/17 UK leverage ratio: treatment of claims on central banks (October 2017)

<sup>5</sup> The leverage ratio regime only applies to banks/ building societies with retail deposits exceeding £50 billion.

<sup>6</sup> The detailed disclosure templates re the Leverage Ratio are set out in the Commission Implementing Regulation (EU) 2016/200.

Leverage Ratio		Template	2017	2016
		Row	£000	£000
<b>Table LR Sum - Summary Reconciliation Of Accounting assets and Leverage Ratio exposures</b>				
Total Statutory Assets per the Balance Sheet		1	993,045	867,412
Derivatives/other		4	(1,257)	(11,734)
Off balance sheet Items		6	10,950	39,496
Less: central bank exposures (2017 only)*		7	(143,042)	-
Amounts deducted in determining Tier 1 capital		7	(5,005)	(3,612)
Leverage ratio total exposure measure		8	854,691	891,562
<b>Leverage Ratio</b>				
		Row	£000	£000
<b>Table LR Com -- Leverage Ratio Common</b>				
On Balance Sheet exposures (excluding derivatives)				
On balance sheet items		1	848,746	855,678
Amounts deducted in determining Tier 1 capital		2	(5,005)	(3,612)
Total on balance sheet exposures		3	843,742	852,066
Derivative Exposures				
Replacement cost associated with all derivative transactions		4	4,659	16,401
Total derivative exposures		11	4,659	16,401
Other Off Balance Sheet Exposures				
Other off balance sheet exposures		17	31,553	45,348
Adjustment for credit conversion factor		18	(25,263)	(22,253)
Total off balance sheet exposures		19	6,290	23,095
Capital And Total Exposure Measure				
Total Tier 1 Capital & Total Capital		20	52,851	38,060
Leverage Ratio Total Exposure Amount		21	854,691	891,562
Leverage Ratio				
<b>Total Leverage Ratio</b>		<b>22</b>	<b>6.2%</b>	<b>4.3%</b>
<b>Leverage Ratio</b>				
		Row	£000	£000
<b>Table LRSpl - Split Of Balance Sheet Exposures</b>				
Total on balance sheet exposures, of which		EU1	848,746	855,678
Trading book		EU2	0	0
Banking book exposures, of which		EU3	848,746	855,678
Exposures treated as sovereigns		EU5	280,083	458,053
MDB,international organisations and PSE not treated as sovereigns		EU6	10,084	0
Insitutions		EU7	485,027	309,749
Corporate		EU10	64,291	83,053
Other		EU12	9,261	4,823

\* exposures to central banks subject to a maximum of deposits in the same currency.

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## 5. Capital Management

### 5.1 Capital Requirements

As part of the ICAAP applicable to CRD IV firms, the Board is required to consider all material risks which the Bank faces and to determine whether additional capital is required in order to provide additional protection to depositors and borrowers and to ensure the Bank is sufficiently well capitalised to withstand a severe economic downturn.

The Board manages its internal capital levels for both current and future activities and documents its risk appetite and capital requirements during stress scenarios as part of the ICAAP.

The ICAAP represents the aggregated view on risk for the Bank and is used by the Board and management to understand the levels of capital required to be held over the near and medium term – a three year time horizon is considered - and to assess the resilience of the Bank against failure. The Bank concluded its last ICAAP in September 2017.

The Bank is required to maintain a certain level of capital to meet several requirements:

- To meet minimum regulatory capital requirements;
- To ensure the Bank can meet its objectives, including growth objectives;
- To ensure the Bank can withstand future uncertainty, such as a severe economic downturn; and
- To provide assurance to depositors, borrowers, shareholders and other third parties.

The Bank presents regular reports on the levels of capital, as well as the results of stress scenarios, to ALCO, the Audit & Risk Committee and the Board.

The key assumptions and risk drivers used to create the ICAAP are regularly monitored and reported and any material deviation from the forecast and risk profile of the Bank would mean the ICAAP would need to be reviewed.

The Bank aims to maintain sufficient capital to cover regulatory requirements, including any capital planning buffers, and to maintain an appropriate operational capital buffer.

Risk arises from the Bank's activities and will be affected by any unexpected increase in regulatory requirements or poor financial performance, losses being higher than expected and any downturn in market conditions.

The Bank undertakes certain activities to manage and mitigate capital risk. The primary mechanism to ensure that sufficient capital is held is through regulating the volume of asset origination. In addition, capital risk management activities include capital forecasting over a period of 3 years designed to provide a forward view on capital allocation and excess regulatory capital. Furthermore, stress testing and sensitivity analysis is performed to provide information on the Bank's capital position. Capital requirements under stressed conditions are considered as part of the ICAAP.

## 5.2 Minimum Capital Requirement Pillar 1

The Bank's overall capital resources requirement under Pillar 1 is calculated by adding the capital resources requirements for credit risk, market risk and operational risk. The following table shows the Bank's capital resources requirement and capital resources surplus under Pillar 1:

Total Minimum Pillar 1 Capital Requirement	2017	2016
	£000	£000
Capital Resources	<u>52,851</u>	<u>38,060</u>
Capital Resource Requirement		
Credit Risk	18,686	13,255
Counterparty Risk	75	85
Market Risk	85	44
Operational Risk	1,490	1,108
Capital Resource Requirement under Pillar 1	20,336	14,492
Capital Resources Surplus over Pillar 1 Requirement	<u>32,515</u>	<u>23,568</u>

The overall Pillar 1 capital resources requirement for the Bank is £6m higher than in 2016. The Bank's largest exposures continue to be credit risk exposures mostly relating to placements with rated financial institutions. Minimum Pillar 1 capital requirements for credit risk are considered in further detail in Section 6 of this document.

## 6. Credit Risk

Credit risk is the risk of financial loss arising from a borrower or counterparty failing to meet their financial obligations to the Bank in accordance with agreed terms. This risk arises principally from the Bank's placement of deposits within the money markets, discounted letters of credit, and certain off-balance sheet activities. These include trade finance and forward foreign exchange transactions. The Bank does not actively trade in financial instruments, other than for liquidity management purposes.

### ***Risk Appetite and Tolerances Statement – Approach:***

- *Credit policy, covering limits, restrictions, minimum credit ratings and concentration criteria, is set out in policy papers approved and affirmed by the Bank's board of directors.*
- *Credit risk is managed by the Credit Committee which approves all counterparty limits and is responsible for concentration risk both in terms of individual counterparties and country exposures.*
- *The committee's activities are reported and discussed at the Audit & Risk Committee; Exposures are monitored daily against the limits set.*

***Risk Appetite and Tolerances Statement – Appetite:*** *Moderate - liability led model with credit risk appetite limited to vanilla treasury products and low levels of trade finance.*

The Bank evaluates its level of risk through consideration of the level of exposure that it has to a range of different exposures. Exposure is defined as the maximum loss that a financial institution might suffer if a borrower, counterparty or group fails to meet their obligations or if assets and off-balance sheet positions (after offsets) have to be realised. Mark to market exposures are carefully monitored in respect of forward foreign exchange transactions.

The Bank's credit risk is closely controlled. Commercial client relationships are not founded on a willingness to offer credit exposure and credit is not used as a marketing tool. However, the Bank recognises that exposure to counterparty institutions is unavoidable if an acceptable level of profitability is to be maintained. The Bank's products are linked to the provision of international banking and payment services on a pre-funded basis. Risk is further mitigated by cash cover or multilateral agency guarantees held for significant part of its trade finance business. Uncovered trade finance deals are restricted and spread across a variety and location of entities and countries, and subject to additional review prior to acceptance, as well as higher levels of monitoring and control once in place.

The Bank's strategy includes plans for a moderate and targeted expansion of its trade finance activities and the provision of a limited amount of targeted unfunded credit lines. The Bank does not have a commercial loan book.

Credit risk is assessed in line with the Standardised Approach laid down in the CRD.

### 6.1 Controls & Mitigation

The Bank reviews its money market counterparty selection criteria, limiting its exposure to investment grade rated institutions. Limits are set by the Bank's Credit Committee which meets on a weekly basis. Exposures are monitored on a daily basis. Allowances are made for currency fluctuations to ensure limits are not breached. The Bank's credit policy is formalised in a policy paper which is reviewed annually by its Board.

Credit risk is principally controlled by establishing and enforcing authorisation limits, including set-off limits, by checking the creditworthiness of counterparties and defining exposure levels to those counterparties. Daily monitoring of positions ensures that prudential limits are not exceeded. The Bank continues to adopt a conservative credit policy and has suffered only a single (minor) credit exposure loss in the last 20+ years.

The capital requirement relating to credit risk underlying certain exposures is mitigated by:

- a. Collateral – cash placed with the Bank by the client; or
- b. Guarantees – typically from institutions with very high credit ratings (eg World Bank).

Regular stress testing considers the likelihood of the failure of a market counterparty, credit concentrations and country risk.

## 6.2 Minimum Capital Requirement: Credit Risk

The Bank uses the Standardised Approach in determining the appropriate level of capital to be held for regulatory purposes. Under this approach the Bank must set aside capital equal to 8% of its total risk weighted assets to cover its Pillar 1 capital requirements.

The following table shows the credit risk exposures, the risk weighted assets and the composition of the minimum capital requirements for credit risk at 31 December 2017 and 31 December 2016:

Credit Risk Requirement	Credit Risk Exposure	Risk Weighted Assets	Minimum Capital Requirement
	£000	£000	£000
<b>31 December 2017</b>			
Central Governments and Central Banks	439,783	1,313	105
Multilateral Development Banks	-	-	-
Public Sector Enterprises	10,084	-	-
Institutions	489,687	193,783	15,503
Corporate	79,186	34,224	2,738
Other	4,256	4,256	340
<b>Total</b>	<b>1,022,995</b>	<b>233,576</b>	<b>18,686</b>
<b>31 December 2016</b>			
Central Governments and Central Banks	482,199	2,508	201
Multilateral Development Banks	3,321	-	-
Public Sector Enterprises	-	-	-
Institutions	326,911	114,332	9,147
Corporate	100,173	47,636	3,811
Other	1,210	1,210	97
<b>Total</b>	<b>913,814</b>	<b>165,686</b>	<b>13,255</b>

The overall capital requirement for credit risk has increased by 41 % between 2016 and 2017. This is largely because of increased exposures to Banks and Other Financial Institutions.

The exposures categorised within ‘Other’ predominantly relate to other balance sheet assets that have no associated credit risk. These comprise various non-financial assets, including fixed assets, prepayments and sundry debtors.

The Bank has no retail or equity exposure and does not securitise its exposures.

### 6.3 Credit Risk Exposures by Sector

The following table shows the total amount of exposures, net of any provisions, including pipeline commitments and after offsets, analysed by sector:

<b>Credit Risk Exposure by Sector</b>	<b>Financial</b>	<b>Government &amp; Public Administration</b>	<b>Other Commercial</b>	<b>Total</b>
	£000	£000	£000	£000
<b>31 December 2017</b>				
Central Governments and Central Banks	-	439,783	-	439,783
Multilateral Development Banks	-	-	-	-
Public Sector Enterprises	-	10,084	-	10,084
Institutions	489,687	-	-	489,687
Corporate	79,186	-	-	79,186
Other	-	-	4,256	4,256
<b>Total</b>	<b>568,872</b>	<b>449,867</b>	<b>4,256</b>	<b>1,022,995</b>
<b>31 December 2016</b>				
Central Governments and Central Banks	-	482,199	-	482,199
Multilateral Development Banks	3,321	-	-	3,321
Public Sector Enterprises	-	-	-	-
Institutions	326,911	-	-	326,911
Corporate	97,534	-	2,639	100,173
Other	-	-	1,210	1,210
<b>Total</b>	<b>427,766</b>	<b>482,199</b>	<b>3,849</b>	<b>913,814</b>

“Corporates” is a regulatory term and, includes exposures to banks in jurisdictions which do not have in place a financial regulatory system equivalent to that in the UK.

## 6.4 Geographic Distribution OF Credit Risk Exposures

The geographical spread of the Bank's credit risk exposures is set out in the table below.

<b>Credit Risk Exposure by Geographic Location of Counterparty</b>			
	<b>UK £000</b>	<b>Other £000</b>	<b>Total £000</b>
<b>31 December 2017</b>			
Central Governments and Central Banks	439,783		439,783
Multilateral Development Banks	-	-	-
Public Sector Enterprises	-	10,084	10,084
Institutions	109,307	380,380	489,687
Corporate	14,895	64,291	79,186
Other	4,256	-	4,256
<b>Total</b>	<b>568,241</b>	<b>454,754</b>	<b>1,022,995</b>
<b>31 December 2016</b>			
Central Governments and Central Banks	460,479	21,720	482,199
Multilateral Development Banks	-	3,321	3,321
Public Sector Enterprises	-	-	-
Institutions	70,481	256,430	326,911
Corporate	2,539	97,634	100,173
Other	1,210	-	1,210
<b>Total</b>	<b>534,709</b>	<b>379,105</b>	<b>913,814</b>

Credit risk exposures outside of the UK typically arise on money market placements with, and Certificates of Deposit and fixed rate bonds issued by, Tier 1 banks that are held as part of the Bank's liquidity buffer, or as earning assets.



## 6.5 Residual Maturity of Credit Risk Exposures

The table below summarises the Bank's exposures, including off balance sheet items, analysed by remaining contractual maturity. The maturity of exposures is shown on a contractual basis.

<b>Credit Risk Exposure by Residual Maturity</b>				
	<b>Within 1 Year</b>	<b>1 to 5 Years</b>	<b>Undated</b>	<b>Total</b>
	£000	£000	£000	£000
<b>31 December 2017</b>				
Central Governments and Central Banks	16,658	-	423,125	439,783
Multilateral Development Banks	-	-	-	-
Public Sector Enterprises	-	10,084	-	10,084
Institutions	458,700	26,327	-	485,027
Corporate	80,120	3,725	-	83,845
Other	-	-	4,256	4,256
<b>Total</b>	<b>555,478</b>	<b>40,136</b>	<b>427,381</b>	<b>1,022,995</b>
<b>31 December 2016</b>				
Central Governments and Central Banks	21,720	2,426	458,053	482,199
Multilateral Development Banks	3,321	-	-	3,321
Public Sector Enterprises	-	-	-	-
Institutions	280,577	10,598	35,736	326,911
Corporate	91,256	8,142	775	100,173
Other	-	-	1,210	1,210
<b>Total</b>	<b>396,874</b>	<b>21,166</b>	<b>495,774</b>	<b>913,814</b>

## 6.6 Management of Credit Risk

Credit risks associated with credit exposure are managed through the use of detailed credit policies which outline the approach to credit exposure, underwriting criteria, credit mandates, concentration limits and product terms. The Bank maintains a dynamic approach to credit management. Its credit policies and performance against risk appetites are regularly reviewed. The Bank will take necessary steps if specific issues are identified or if credit performance deteriorates, or is expected to deteriorate, due to economic or sector-specific weaknesses.

The Bank also seeks to mitigate credit risk by focusing on business sectors where it has specific expertise and through limiting concentrated exposures on larger loans or certain sectors which can represent higher risk. The Bank also seeks to obtain security cover from borrowers.

External rating agency ratings for borrowers are not always available in the specialist segments in which the Bank operates. Credit risk is, however, assessed through a combination of due diligence, reviewing credit reference agency reports, reviewing financial information, and the use of experienced underwriters.

The Bank has a single Credit policy and dedicated credit risk management team which assesses credit risk, supported by a Credit Committee with significant credit experience.

## 6.7 Credit Risk – Rating of Exposures

Credit risk exists in relation to:

- Treasury assets where the Bank has placed deposits with, or acquired assets which are exposures on, other financial institutions. The Bank’s policy is currently to place such deposits or acquire assets which are rated principally at least F1 by Fitch. Hence, the Bank considers that the credit risk of such assets is relatively low. As the Bank does not maintain a trading book, all such assets are placed or acquired with the intention of holding to maturity. Some of these assets are held as a part of the Bank’s liquid assets buffer (see section 9 below).
- Other exposures, typically relating to trade finance exposures, a material part of which is supported by cash collateral.

The relevant capital requirement is calculated using the Standardised Approach, in accordance with the PRA’s regulations. Credit ratings used in the determination of such exposures are provided by Fitch, Moody’s and Standard & Poor’s<sup>7</sup>.

<b>Exposure Value by External Rating</b>					<b>AA+ to AA-</b>	<b>A+ to A-</b>	<b>BBB+</b>	<b>Unrated</b>	<b>Total</b>
					<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>
<b>31 December 2017</b>									
Cash and Balances at Central Banks					423,125	-	-	-	423,125
Loans and Advances to Banks					38,965	131,892	21,928	67,489	260,274
Fixed rate Bonds					26,730	17,168	-	-	43,898
CDs and other debt instruments					28,562	243,011	15,210	-	286,783
Derivatives					2,170	1,890	528	72	4,659
Other					-	-	-	4,256	4,256
<b>Total</b>					<b>519,552</b>	<b>393,960</b>	<b>37,667</b>	<b>71,816</b>	<b>1,022,995</b>
<b>31 December 2016</b>									
Cash and Balances at Central Banks					458,053	-	-	-	458,053
Loans and Advances to Banks					43,885	118,303	25,836	765	188,789
Fixed rate Bonds					12,209	6,531	4,048	-	22,788
CDs and other debt instruments					20,341	156,017	4,858	-	181,216
Derivatives					2,813	7,380	6,118	90	16,401
Other								46,567	46,567
<b>Total</b>					<b>537,301</b>	<b>288,231</b>	<b>40,860</b>	<b>47,422</b>	<b>913,814</b>

<sup>7</sup> The external rating applied is based on the number of external ratings available. If only one rating is available, this rating is used. If two ratings are available, the higher of the two ratings is used. If three ratings are available, the highest rating is excluded, and the highest of the two lowest ratings is used.

None of the Treasury assets noted above were past due<sup>8</sup> or impaired.

Credit ratings are based on the specific obligor to whom the Bank is exposed.

### Cash placements

Credit risk of Bank counterparties is controlled through the Treasury Policy and the Risk Appetite and Tolerances Statement which limits the maximum exposure by entity where the Bank may place cash deposits. All institutions need a sufficiently high long term and short-term rating at inception.

### Derivatives

All derivative contracts are cash collateralised. As at 31 December 2017, all such counterparties were either based in the UK or in jurisdiction with regulatory equivalence.

## 6.8 Credit Risk Concentration

Concentration risk exists through having high or excessive exposures to a concentration of certain counterparties, regions or sectors. Concentration risks from credit exposure activities are managed and controlled through the adoption of concentration limits through the Risk Appetite and Tolerances Statement (RATS). Reported exposures against concentration limits are regularly monitored.

## 6.9 Counterparty Credit Risk

The Bank is exposed to counterparty credit risk from derivative transactions for the purposes of reducing exposures to fluctuations in interest rates and exchange rates; such derivatives are not used for proprietary trading purposes.

Counterparty credit risk is the risk that a counterparty to a derivative instrument to which the Bank has an exposure could default.

The Bank calculates counterparty credit risk exposures using the mark-to-market method. Exposure is calculated as the positive mark-to-market value of outstanding contracts plus an additional potential future credit exposure that varies according to the transaction.

Key data in respect of the Bank's derivative contracts is as follows:

	2017 £'000	2016 £'000
Net derivative credit exposure	4,659	16,401
Notional principal	613,707	463,962
Gross positive fair value	1,257	11,762

The net derivatives credit exposure, which represents the credit exposure to forward foreign exchange contracts only, is stated after including potential future credit exposures as required in the calculation of exposure.

Counterparty credit limits are established for authorised counterparties and are updated on a periodic basis to take account of any ratings migration and the Bank's assessment of the credit risk for the institution. The maximum exposure limit is set below the 100 per cent of the Bank's regulatory capital level, although each counterparty is assessed on individual merit. Exposures to central banks;

<sup>8</sup> ie the repayment of any capital or interest remains contractually outstanding for more than 90 days.

multilateral development banks; other public-sector institutions; and any other entities which carry a zero per cent risk weighting as per the Standardised Approach, have limits set at up to 100 per cent of the Bank's capital resources. The exposure limit for each institution is maintained in an Authorised Counterparties List which is reviewed at least annually or more frequently should a change in ratings occur.

The Bank has no credit derivatives. During the year, a number of the Bank's assets were encumbered. (See Section 10).

## 6.10 Reconciliation to Statutory Accounts

The reconciliation of the assets from the Bank's 2017 Statutory Accounts to the credit risk exposure is as follows:

<b>Reconciliation to Statutory Accounts</b>		<b>2017</b>	<b>2016</b>
		<b>£000</b>	<b>£000</b>
	Total Assets per Accounts	993,045	867,412
	less: Assets deducted from Regulatory Capital		
	Intangible Assets	(4,092)	(2,836)
	Deferred Tax Asset	(913)	(776)
	less: Derivative Assets	(1,257)	(11,762)
	Other Adjustments	-	27
	Add: Off Balance Sheet Exposures		
	Trade Finance	31,553	45,348
	Derivatives	4,659	16,401
	<b>Total Credit Risk Exposures</b>	<b>1,022,995</b>	<b>913,814</b>

Further details relating to the reconciliation of other items, including Own Funds, are provided at **Appendix 3**.

## 7. Market Risk - Interest Rate Risk

Interest rate risk is the risk of loss through mismatched asset and liability positions sensitive to changes in interest rates.

**Risk Appetite and Tolerances Statement – Approach:** exposure to interest rate movements arises when there is a mismatch between interest rate sensitive assets and liabilities. This risk is managed by limiting the mismatch allowed in predetermined time bands.

**Risk Appetite and Tolerances Statement – Appetite:** low - limited mismatch permitted.

### 7.1 Management of Interest Rate Risk

The Bank's balance sheet is liability led, in that assets are not generated unless a corresponding liability has arisen from customer deposits.

Interest rate risk primarily arises from where the maturities of assets do not match those of the liabilities.

The Bank aims to minimise interest rate risk and has a policy of placing funds with market counterparties or purchasing assets against its fixed term client deposits.

As market circumstances permit, the Bank will mismatch its book to enhance returns. This can happen when the Bank chooses to match short term client fixed deposits with overnight assets to take advantage of preferable Bank of England call account rates or when the Bank puts longer term assets against its "behaviouralised" current account balances to take advantage of better yields. In both cases interest rate risk is minimal although in the first case a cut in rates would have an effect until the deposits mature and the rates can be adjusted.

The Bank monitors its interest rate risk by calculating the economic gain/loss of a 200 bp shift in the yield curve (both up and down) and comparing it against a Board approved limit (currently a loss of £2,500K). The Bank also monitors the earnings (net interest income) gain/loss (over a twelve month period) of a similar 200 bp parallel shift. The results are as follows:

	31 Dec 17 £'000	31 Dec 16 £'000
<b>Economic Gain/(Loss)</b>		
200 pb upward shift	(1,349)	(291)
200 bp downward shift	1,397	299
<b>Earnings Gain/(Loss)</b>		
200 pb upward shift <sup>9</sup>	(1,799)	(697)
200 bp downward shift	1,799	697
<b>Pillar 2A capital add-on re IRR</b>	2,096	2,000

<sup>9</sup> In practice a 200bp upward shift would not be passed on to the Bank's call/ overnight liabilities in full. Assuming the Bank's call/ overnight liabilities were repriced by only 100bp, the Bank's earnings would increase by £2,799K (2016 - £2,178K).

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The Bank does not fair value any of its interest bearing assets or liabilities<sup>10</sup>. As a result, there will be no immediate accounting gain or loss following any change in interest rates.

Both metrics are monitored on a daily basis and ultimately reported to both ALCO and the Audit & Risk Committee.

## 7.2 Asset-liability Gap Risk

As noted above, the Bank's balance sheet is liability led, in that assets are not generated unless a corresponding liability has arisen from customer deposits, creating a natural hedge.

All the Bank's assets and liabilities are fixed rate exposures, hence a natural hedge arises through the appropriate management of the book with respect to the maturity profile of those assets and liabilities. The Bank does not hedge the interest rate risk in any other way.

Given timing differences and the price of hedging small gaps, it is not cost effective to have an absolute match of assets and liabilities. In addition to the monitoring noted above, the risk exposure of the overall asset-liability interest rate profile is controlled by the close measurement of the quantum of "behaviouralised" deposits (i.e. current accounts which have historically been shown to be sticky) held at any time.

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<sup>10</sup> The Bank accounts under Financial Reporting Standard 102 and has chosen to adopt Sections 11 and 12 in respect of financial instruments.

## 8. Market Risk - Currency Risk

Foreign Exchange Risk is the risk of loss through mismatched asset and liability currency positions which are sensitive to changes in exchange rates.

### **Risk Appetite and Tolerances Statement – Approach:**

- Currency risk is managed by adherence to limits for intra-day and overnight positions. Risk Management independently review positions.
- Currency risk on transactional currency exposures which arise from income in currencies other than Sterling, the Bank's operating (or functional) currency, is mitigated by hedging, where appropriate. Hedging is undertaken using forward FX deals to cover the anticipated net cash flows.

**Risk Appetite and Tolerances Statement – Appetite:** low - limited mismatch permitted with low levels of overnight positions and hedging where appropriate.

### 8.1 Management/Mitigation

As with other risks, the Bank's tolerance of its foreign exchange risk is set out in the RATS. In general, the Bank has a very low tolerance of such risks and ensures that the risk is kept within the stipulated limits via the forward sale/purchase of foreign currency in line with the maturing of the relevant assets/ liabilities.

### 8.2 Measurement/Control

The control of the Bank's foreign exchange risk is the responsibility of the Treasurer.

The underlying currency mismatch is measured and reported daily for any further action by management as appropriate.

The level of that mismatch as at 31 December 2017 and 2016 was as follows:

<i>Functional currency (£'000 equivalent)</i>	US Dollar	Euro	Yen	SA Rand	Other	Total
<b>2017</b>						
Assets/(liabilities)	(376,100)	14,127	6,578	(2,087)	(15,000)	(372,482)
Net forward purchases/(sales)	<u>377,174</u>	<u>(14,259)</u>	<u>(6,569)</u>	<u>2,120</u>	<u>15,937</u>	<u>374,403</u>
	<u>1,074</u>	<u>(132)</u>	<u>9</u>	<u>33</u>	<u>937</u>	<u>1,921</u>
<b>2016</b>						
Assets/(liabilities)	(370,961)	31,310	(32,889)	(37,068)	(11,567)	(421,175)
Net forward purchases/(sales)	<u>371,967</u>	<u>(31,313)</u>	<u>32,906</u>	<u>37,277</u>	<u>11,647</u>	<u>422,484</u>
	<u>1,006</u>	<u>(3)</u>	<u>17</u>	<u>209</u>	<u>80</u>	<u>1,309</u>

## 9. Market Risk – Other Risks

Market risk is the risk that the value of, or net income arising from, the Bank's assets and liabilities changes as a result of changes to market forces, in particular interest rates or exchange rates both of which are considered in further detail below.

The Bank holds certain assets, notably its fixed rate bond portfolio, for which an active market exists, and which are therefore potentially subject to market risk. The portfolio is as follows:

	2017	2017	2016	2016
	£'000	£'000	£'000	£'000
Asset Type	Book Value	Market Value	Book Value	Market Value
<b>Fixed Rate Bonds</b>	<b><u>43,763</u></b>	<b><u>43,394</u></b>	<b><u>22,760</u></b>	<b><u>22,235</u></b>

The Bank accounts under Financial Reporting Standard 102 and records such assets at amortised cost (ie does not fair value/ mark to market such assets). Furthermore, the Bank's policy is to hold such assets to maturity thereby effectively eradicating any market related risk. As a result, the Bank would normally only be exposed to:

- the underlying credit risk of the issuer and
- any foreign exchange risk, although the Bank effectively mitigates the substantial part of any such risk (see Section 9).

Generally, the Bank has a highly restricted appetite to Market Risk; it does not operate a trading book and therefore is exposed to Market Risk primarily through its small exposures to such capital instruments, together with currency exposures arising through its daily funding, payments and trade finance activities. It should also be noted that the Bank permits only low levels of intraday and overnight exposures to market or interest rate movements.

### 9.1 Controls & Mitigation

The Bank maintains risk management systems to identify, measure, monitor, and control market risk including the daily distribution of spot and forward Foreign Exchange ("FX") and other positions, the resultant calculation of the relevant capital requirement against those positions and the movements in market valuations noted above. Under Pillar 1, the market risk is calculated at 8% of the Sterling equivalent open position for FX positions. The Bank does not enter into any financial derivatives contracts other than forward FX.

The ALCO meets on a monthly basis and is charged with responsibility for Market Risk. The Audit & Risk Committee and the Board set the Market Risk and Foreign Currency policies which govern the management of Market Risk.

Interest rate and currency movements are considered as part of the Bank's programme of stress testing.

### 9.2 Other Market Risks

The Bank's instruments are also exposed to other forms of market risk e.g. credit spread risk. Prices are monitored on a day to day basis to ensure that the Bank is aware of any material diminution in value. The Bank does not carry out proprietary trading in assets or equity which are actively traded or otherwise.



## 10. Liquidity Risk

### **Risk Appetite and Tolerances Statement – Approach:**

- A substantial proportion of customer accounts are current accounts that, although repayable on demand, have historically formed a stable deposit base.
- Liquidity is subject to daily monitoring against guidelines above those set by the PRA and periodic stress tests both idiosyncratic and market wide.

**Risk Appetite and Tolerances Statement – Appetite:** low - short-term maturity balance sheet with significant levels of funds placed with instant access at the Bank of England.

Liquidity risk is perceived as very low, given the Bank's business model, which is deposit driven, rather than asset led. The Bank's liquid assets are:

- High Quality Liquid Assets ("HQLAs") (as defined by CRD IV) typically call deposits at the Bank of England and certain high quality bonds.
- Cash, certificates of deposit and other high quality bonds.

### 10.1 Controls & Mitigation

Liquidity risk is the risk that the Bank is not able to meet its financial obligations as they fall due or can do so only at excessive cost. The risk can arise because:

- The Bank has insufficient funds to pay the amounts that it owes (either to depositors or creditors);
- The Bank has sufficient funds but they are not readily accessible; or
- The Bank's credit rating, asset quality or reputation deteriorates to such an extent that it is prevented from refinancing its borrowings on maturity.

Liquidity is measured and monitored daily based on metrics and limits set out RATS. Liquidity risk is considered by ALCO and its monthly meetings. The Bank's Treasury policy sets the limit of any mismatch limits to be followed which, together with any Individual Liquidity Guidance ("ILG") set by the PRA, is monitored and measured on a daily basis.

To protect the Bank and its depositors against liquidity risks, the Bank maintains a liquidity buffer which is based on the Bank's liquidity needs under stressed conditions. The liquidity buffer is monitored on a daily basis to ensure there are sufficient liquid assets at all times to cover cash flow movements and fluctuations in funding and to enable the Bank to meet all financial obligations and to support anticipated asset growth.

Liquidity risk is specifically assessed through the ILAAP, which is approved by the Board. As part of this process, the Bank has assessed the level of liquidity necessary to prudently cover systemic and idiosyncratic risks and the ILAAP sets out the minimum level of liquidity to be held at any time, taking into account the specific nature of the deposit base.

The ILAAP requires the Bank to consider all material liquidity risks in detail and has documented the Bank's analysis of each key liquidity risk. Liquidity risks are specifically considered by ALCO each month.

Based on the business model of funding primarily through wholesale deposits, the Board has set a liquidity risk appetite which it considers to be appropriate to provide it with the assurance that the

relevant liquidity risk drivers should be considered and appropriately stressed and that the Bank is able to meet liabilities beyond the targeted survival period.

The Bank’s key liquidity buffer is its holding of HQLAs, which primarily consists of its reserve account held with the Bank of England as shown below:

	<b>31 December 2017 £'000</b>	31 December 2016 £'000
Bank of England reserve account	423,125	458,053
Other QLAs – Fixed rate Bonds	10,084	-
<b>Total HQLAs</b>	<b>433,209</b>	<b>458,053</b>
Total HQLA liquidity buffer as a % of funding liabilities	46.3%	56.1%

## 10.2 Liquidity Ratios

Banks are currently subject to two key liquidity metrics. The Liquidity Coverage Ratio (‘LCR’) aims to improve the resilience of banks to liquidity risks over a 30 day period. The Net Stable Funding Ratio (‘NSFR’) aims to ensure that banks have an acceptable amount of stable funding to support their assets over a one year period of extended stress.

### 10.2.1 Liquidity Coverage Ratio (“LCR”)

The detailed rules for the calculation of the LCR are set out in the Liquidity Coverage Requirements Delegated Act, which have been directly applicable to the Bank since 1 October 2015, as well as PRA rules and supervisory statements on CRD IV Liquidity.

Under the rules, the LCR is calculated as:

$$\frac{\text{High Quality Liquid Assets}}{\text{Cash outflows – capped cash inflows}}$$

High Quality Liquid Assets, cash outflows and capped cash inflows are defined in the Act.

Based on these rules, the Bank’s LCR as at 31 December 2017 is 158% (2016: 264%) which is significantly in excess of the minimum requirements of 100%, which is effective from 1<sup>st</sup> January 2018.

Further details underlying the calculation of the LCR together with quarterly information can be found at **Appendix 4**<sup>11</sup>.

<sup>11</sup> The detailed disclosure requirements are set out in EBA/GL/2017/01

The only material foreign currency inflows and outflows involved are US\$ and €, both of which are readily convertible into and out of £.

### 10.2.2 Net Stable Funding Ratio (“NSFR”)

The NSFR is the Banks stable funding, which is typically its capital together with its deposits including various levels of discount, divided by its required stable funding, typically its exposures to third parties, again including various levels of discount. The NSFR came in to force as a regulatory requirement with effect from 1 January 2018, when it was set at a minimum of 100%.

The Bank’s NSFR as at 31 December 2017 is 198% (2016 187%), substantially in excess of the 100% minimum requirement.

## 10.3 Key Liquidity Risk Drivers

This section provides an overview of the Bank’s key liquidity risk drivers.

### 10.3.1 Deposit funding risk

The deposit funding risk is the primary liquidity risk driver for the Bank and this could occur if there was a concern by depositors over the current or future creditworthiness of the Bank. Although the Bank seeks to operate in such a way as to protect depositors, an extremely low proportion of deposits are currently protected by the government’s Financial Services Compensation Scheme (“FSCS”). The FSCS currently provides £85,000 of protection to eligible depositors.

### 10.3.2 Wholesale funding

The Bank mainly finances its operations through wholesale deposit taking, although it does not have long term wholesale funding lines in place. The Bank does have relationship banking facilities in place which are used to hedge against currency exposures.

### 10.3.3 Payments systems

The Bank does not form part of the UK payment system. However, in the event there are problems with one of the payment systems, the Bank has access to other facilities with which to make payments if needed.

### 10.3.4 Liquidity contingency plan

As a regulated firm, the Bank is required to maintain a Liquidity Contingency Plan (“LCP”). The plan which ties in to the Bank’s Recovery Plan (“RP”), involves a two-stage process, covering preventative measures and corrective measures to be invoked when there is a potential or actual risk to the Bank’s liquidity or capital position. The LCP/RP provides a plan for managing a liquidity or capital situation or crisis within the Bank, caused by internal events, external events or a combination thereof. The plan outlines what actions the Bank could take to ensure it complies with the liquidity adequacy rules, maintains sufficient capital and operates within its risk appetite and limits, as set and approved by the Board.

## 10.4 Encumbered Assets

As at 31 December 2017, the Bank’s only encumbered assets were on demand loans to other financial institutions totalling £1,711K (2016 - £nil) all of which supported derivative foreign exchange contracts with the institutions concerned. Further details can be found at **Appendix 5**.<sup>12</sup>

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<sup>12</sup> the detailed regulatory disclosure requirements are set out in the EBA’s Regulatory Standard EBA/RTS/2017/03 as amended by the PRA’s Supervisory Statement SS11/14 - CRD IV: Compliance With The European Banking Authority’s Guidelines On The Disclosure of Encumbered And Unencumbered Assets. Where no data is provided the data point is not applicable or nil.

## II. Operational Risk

Operational risk is the risk of financial and / or non-financial impact resulting from inadequate or failed internal processes, people and systems, or from external events including financial crime. This risk includes IT, information security, project, outsourcing, tax, legal, fraud and compliance risks.

### **Risk Appetite and Tolerances Statement – Approach:**

- *Business units are responsible for managing operational risk, with measurement and monitoring carried out by Risk Management.*
- *Internal controls include procedures, segregation of duties, reconciliations, exception and exposure reporting, business continuity planning and authorisation processes, and are based on management information.*
- *Risk Management provides an independent assessment of the strength of the operational risk framework to the Board.*

**Risk Appetite and Tolerances Statement – Appetite:** *moderate - high growth phase and fast-changing internal environment, mitigated by strict controls and corporate governance.*

The markets in which the Bank operates are generally perceived to have high levels of corruption, and this increases the Bank's exposure to the possibility of internal and external fraud, and / or financial crime related risks

### II.1 Controls and Mitigation

The Bank has an Operational Risk Policy which is reviewed periodically by EXCO and the Audit & Risk Committee. The Compliance and Operational Risk Committee meets regularly to discuss operational issues. It has responsibility for monitoring all the key operational risks facing the organisation, including compliance and operational risks.

Key control standards include new product/increased volume reviews; levels of authority and individual approval limits; detailed procedures; segregation of duties; regular and timely reconciliations; succession planning and business continuity. Regardless of value, all operational incidents are recorded by the business, and reviewed and investigated by Risk Management, who may recommend additional controls and procedures where appropriate.

The Basic Indicator Approach set out in the EU Capital Requirements Directive is used to assess capital requirements for operational risk. Stress testing and scenario analysis shows that the current regulatory requirement for Operational Risk is sufficient to cover the risks identified.

## 11.2 Management of Operational Risk

The Bank aims to maintain robust operational systems and controls and seeks to operate within a defined level of operational risk. The operational risk appetite considers risk events, the assessment of internal controls as well as holding additional capital for certain operational risks.

As part of the operational risk management process, the Bank has an Operational Risk Policy, undertakes a Risk & Control Self-Assessment process across the Bank, and has business continuity plans in place. The Bank records all operational risks and risk events.

Through the establishment of, and investment in, sound systems, controls and audit functions, the Bank aims to minimise operational failures.

The Bank has placed emphasis on ensuring that the IT infrastructure, performance, resilience, and security meet the on-going needs of the business.

The operational risk charge for the Bank under Pillar 1 is calculated using the Basic Indicator Approach, whereby a 15 per cent multiplier is applied to the average net income over a rolling three-year period. The capital requirement calculated under this approach is as follows:

Operational Risk Requirement	<b>31 Dec 2017</b> £000	31 Dec 2016 £'000
Average net income over preceding three years	<b>9,932</b>	7,385
Capital requirement at 15%	<b>1,490</b>	1,108

The capital Risk Weighted Assets equivalent is set out in the table in section 4.2 above.

## 12. Compliance (including Regulatory) Risk

### ***Risk Appetite and Tolerances Statement – Approach:***

- *The bank has a daily monitoring system where it monitors regulatory compliance such as capital adequacy and required liquidity.*
- *These daily controls feed into monthly reviews and periodic reporting to the PRA.*
- *The Bank continues to deliver staff training programmes to ensure its staff are both aware of and comply with regulations.*
- *The Bank has zero tolerance for financial crime, Regulatory Risk, and Conduct of Business Risk, but recognises that some markets for its activities are higher risk areas, which may heighten its exposure to such risks from time to time.*

***Risk Appetite and Tolerances Statement – Appetite:*** *minor - activities in high risk jurisdictions mitigated by stronger and stricter compliance framework than industry standards.*

The Bank seeks to comply at all times with all rules, regulations and laws to which it is exposed through all of its activities and continues to develop staff training programmes to ensure its staff are both aware of and comply with such. As a result, while it has zero tolerance for financial crime, Regulatory Risk, and Conduct of Business Risk, it recognises that some markets for its activities are higher risk areas, which may heighten its exposure to such risks from time to time.

In respect of legal risk, as mentioned above, the Bank makes every effort to comply with its obligations, however cannot control the actions of its clients, counterparties and others with whom it may from time to time come into contact. However, the Bank aims to have ‘best in class’ Anti Financial Crime policies, in order to minimise this risk as far as possible.

### 12.1 Controls & Mitigation

The Bank keeps abreast of banking regulations through receipt of PRA, FCA, UK Finance and EBA bulletins. Staff regularly attend workshops to ensure that their knowledge on regulatory issues is up to date. Staff receive regular training in respect of Financial Crime risk (see 15 below) and all clients are assessed as to the level of risk they pose in respect of Money Laundering and Bribery and Corruption. The Financial Crime Policy is regularly reviewed and approved by the Board. The Bank has a compliance and monitoring testing programme in place which is regularly reviewed.

The Bank continually reviews the resources dedicated to combatting Financial Crime and throughout the year has been actively recruiting to enhance its Financial Crime staffing.

The Compliance and Operational Risk Committee meet monthly to discuss compliance issues. An in-house legal team advises on any legal issues which may arise.

## 13. Strategic Risk

Strategic risk is the risk which can affect the Bank's ability to achieve its corporate and strategic objectives. Strategic risk is particularly important as the Bank continues its growth strategy. The Bank seeks to mitigate strategic risk by focusing on a sustainable business model which is aligned to the Bank's business strategy.

The strategy of the Bank is established through the creation of a rolling five-year plan, agreed by the Board. Each year an Annual Operating Plan and budget, which dovetails with the overarching strategic plan is created and agreed by the Board.

The Bank and its parent are prepared to accept a risk that earnings will fluctuate to maintain risk appetites at agreed levels.

Strategic risk can arise from both internal and external factors. The Bank seeks to identify and mitigate the individual components of strategic risk through the application of the Risk Management Framework.

The Bank's strategic direction and performance is impacted by external factors (similar to those impacting other financial institutions) and internal operational factors.

### 13.1 External Factors

External factors include uncertainty around future interest rate movements and increased competition, especially from new entrants to the market, which may challenge product and pricing margins. The Bank closely monitors competitor activity, pricing, and customer behaviour and feedback and reflects this in pricing and marketing plans.

As a regulated business, the Bank must also comply with the complex and changing regulatory environment. Prudential and conduct regulation continues to evolve, and the Bank maintains regulatory monitoring activity to understand future requirements and how this may affect the Bank. To comply with current prudential regulatory requirements, the Bank maintains adequate capital and liquidity resources to satisfy these requirements at all times. Notwithstanding, the Bank's borrowing costs and capital requirements could be affected by future prudential regulatory developments.

There remains a keen focus on capital management to ensure that the Bank has an appropriate capital structure in place to support the Bank's growth strategy.

The Bank has a zero risk appetite for material regulatory breaches. To ensure compliance with regulatory requirements, the Bank has policies, processes and standards which provide the framework for business activities and staff to operate to which are in accordance with the laws, regulations and voluntary codes which apply to the Bank and its activities. Compliance with regulation incurs significant costs which are factored into the operational cost and are considered in relation to the specific products and services that the Bank offers.

### 13.2 Internal Factors

Internal factors which impact strategic risk include the adequacy of IT systems, data security, project management, supplier and outsourcing arrangements and from internal and third-party fraud and compliance failings. As the Bank grows it continues to monitor the adequacy and ability of its third-party suppliers to support the Bank, now and in the future and where necessary will seek alternative arrangements.

### 13.3 Controls & Mitigation

Targets are regularly reviewed as part of the Bank's strategic review process, and its discussions with its stakeholders over expected contribution levels. EXCO meets monthly to review progress against plans. Forecasts and budgets are continually updated.



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## 14. Conduct Risk

Conduct risk is the risk of detriment caused to the Bank's customers due to the inappropriate execution of its business activities and processes. The Bank extends the definition of 'customer' to include SME and wholesale customers (but excludes intermediaries and other third parties) across all business segments, including both regulated and non-regulated activities, thereby applying its conduct risk policies to all credit exposure and deposit-taking activities.

The Bank has a zero appetite for systemic unfair outcomes, which may result in significant detriment to the Bank's customers. Systemic unfair outcomes may arise from poor product design, poor sale processes or unacceptable operational practices which risk repeated or continual outcomes which are detrimental to customers.

However, occasional failures in operational processes may occur, for example administration and processing errors or interruptions to IT systems. These occasional events may have an impact on customers, leading to customer detriment.

The risk is that customers can suffer detriment due to actions, processes or products which originate from within the Bank. Conduct risk can arise through the design of products that do not meet customers' needs, mishandling complaints where the Bank has behaved inappropriately towards its customers, inappropriate sale processes and exhibiting behaviour that does not meet market or regulatory standards.

Customer detriment could affect the Bank's reputation, lead to loss of market share due to damage to the Bank's brand, may lead to customer redress payments and could lead to regulatory action and censure.

The Bank mitigates conduct risk by monitoring various operational metrics and by tracking activities which affect customers, monitoring customer complaints, implementing process improvements and adhering to service standards. The conduct risk metrics (which include among others, staff performance levels, training, customer feedback and complaints, product retention rates and cancellations and customer service standards) vary across the business lines and consist of individual business line conduct risk KPIs, the sum of which is measured against the risk appetite.

Conduct risk metrics and KPIs are in place to evidence fair outcomes, identify any emerging issues and document remedial actions. Each customer-facing area is responsible for implementing controls designed to manage and report on conduct risk, which includes understanding how customer detriment may occur, how it is identified and how it is prevented going forward. Conduct risk is monitored by CORC.

## 15. Financial Crime Risk

Financial Crime risk is the risk of losses arising from financial crime events including Money Laundering, Terrorist Financing, Fraud, Market Abuse and Corruption due to failed internal processes, people and systems.

The Bank operates and seeks new business internationally and this can expose the Bank to a higher level of financial crime risk than many domestically operating banks. Financial crime risk is tightly controlled, and the Anti-Financial Crime department undertakes oversight and supervision of the Bank's control environment associated with the prospective client on-boarding and ongoing monitoring. The Bank endeavours to tightly control financial crime risk exposures to at least the standards of those laid down by Money Laundering regulation and the Joint Money Laundering Steering Group (JMLSG) Guidance.

The Bank does not actively seek financial crime and associated risks and as such seeks to minimise residual risk exposures, using the proportionate risk-based approach as laid down by JMLSG. All prospective clients are subject to proportionate risk based due diligence prior to taking them as clients, as well as risk-based monitoring controls thereafter.

## 16. Insurance Risk

The Bank has arranged its own insurance. Comprehensive insurance cover has been taken out with reputable third-party insurance companies including professional indemnity, public and employers' liability. The levels of cover, policy excesses, and the financial strength of the insurer are reviewed and discussed annually with brokers.

## 17. Pension Obligation Risk

Historically, certain of the Bank's staff have been members of either or both:

- the defined benefit pension scheme operated by the Bank's previous parent, Crown Agents Limited (closed to both new members and further accruals).
  - The Bank had historically paid contributions and costs to the scheme as determined by the fund actuaries.
  - On an actuarial basis at last valuation date there was no deficit. On an accounting basis there is a deficit. Given the stock market rise of the last few years, and the current growth of the UK economy, it can be reasonably expected that the value of assets will grow as well which will have an impact on any overall deficit.
  - While the Pensions Regulator can require the Bank to contribute towards any deficit in the scheme, the length of time over which that contribution needs to be made is not prescribed. Prior to the Sale, the Bank considered it may have had a secondary pension obligation risk in respect of the defined benefit scheme. However, as part of the Sale, Crown Agents Limited contractually agreed to taken on responsibility for any such liability.
- the Bank's defined contribution pension scheme. The Bank has no liability regarding such a scheme.

## 18. Remuneration

The PRA has defined certain requirements relating to remuneration, referred to as the Remuneration Code ('the Code'). Firms that fall within the scope of the Code (which includes banks) must establish, implement and maintain remuneration policies, procedures and practices that are consistent with and promote sound and effective risk management. Policies and procedures must be comprehensive and proportionate to the nature, scale and complexity of the firm's activities.

A firm must maintain a record of its Code Staff (being those staff whose professional activities have a material impact on the firm's risk profile) and take reasonable steps to ensure Code Staff understand the implications of their status.

The disclosure requirements of Pillar 3 are defined by CRR Article 450. Data is provided for remuneration received by Code Staff for the year ended 31 December 2017.

During the year, the Bank designated a total of 30 individuals (including Non-Executive Directors) who were classed as Code Staff. Of these, 10 were categorised as Senior Management (being the Executive and Non-Executive Directors who served during the year, and members of the Executive Committee), as well as 20 individuals categorised as Other Code Staff.

### 18.1 Approach to Remuneration

The Bank's remuneration policies are designed to comply with the Code and the Bank is committed to adherence to its practices and guidelines in respect of Code Staff.

The key principles behind the Bank's remuneration policy are those that we believe are critical to the business and reflect our values and recognise the need to be competitive. The policy is to set remuneration levels which are aligned within the overall Bank stated risk appetite and ICAAP measures, and to ensure that the Executive Directors, Senior Management and employees are fairly and responsibly rewarded in return for high levels of individual and business performance.

The overall aim of the policy is to attract, motivate and retain Executives of high calibre who can deliver sustained performance consistent with strategic goals, appropriate risk management and to reward them for enhancing value.

The following key principles underpin these themes:

- Attract and retain high calibre individuals – employee turnover will be monitored for the proportion attributable to remuneration policy and practices; the performance management framework will be maintained to ensure it continues to reflect and support business goals; assessment of the value of roles will be through an objective measurable methodology, that ensures value is attached to tangible services and outputs of the role;
- Remuneration will not be excessive – losses associated with remuneration set in excess of market rates will be avoided through the regular application of comparisons against independent third-party data;
- Remuneration is aligned to the long-term success of the Bank – performance related components of remuneration will be aligned to risk adjusted financial measures which reflect achievement of the Bank's longer-term business plan;
- Proportion of variable pay is appropriate, predominantly cash based and may be deferred – where a significant proportion of remuneration is variable, it will be designed to reward longer term success. The ratio of fixed to variable remuneration will differ depending on the specific incentive schemes in operation across the business, however as a general rule the Bank seeks to ensure that the majority of an individual's remuneration is fixed; and

- No reward for poor performance - the performance management framework focuses on objective measurement of outputs along with behavioural measures which assess the way in which work is done.

## 18.2 Decision-making Process for Determining Remuneration Policy

In line with regulatory guidance, remuneration is overseen by the Remuneration Committee ('the Committee') a Board sub-committee. The Committee is responsible for:

- Reviewing the appropriateness and relevance of the remuneration policy;
- Determining and regularly reviewing the policy, terms, objectives and content of the Executive Directors' service contracts;
- Approving the design of and determining targets for any performance-related pay schemes applying to the Executive Directors;
- Determining the policy and scope of pension arrangements for the Executive Directors;
- Reviewing and approving the introduction of any new incentive arrangement across any part of the organisation;
- Overseeing any major changes to the Bank's employee benefits structures;
- Overseeing remuneration policy throughout the Bank, noting the risks posed by remuneration policies; and
- Overseeing the annual pay review budget.

## 18.3 Remuneration Policy for Code Staff

The objective of the remuneration policy is to ensure that appropriate incentives are awarded for individual contributions to the success of the Bank and encourage enhanced performance. The policy in relation to the various elements of remuneration structures for Executive Directors and other Code Staff is set out below.

### 18.3.1 Basic salary

The basic salary of the Executive Directors and other members of the senior leadership team (as for all employees) is determined by taking into account the responsibilities and experience of the individual director and having regard to relevant market comparisons. Progression is reflected through the annual salary and personal review processes.

### 18.3.2 Variable pay

The Executive Directors and other Code Staff participate in a non-pensionable performance incentive scheme, the metrics of which reflected the Bank's key objectives. These elements are all set to provide challenging objectives, giving the Executive Directors an incentive to perform at the highest level.

As noted below certain Code Staff are also part of the Group's Long Term Incentive Plan.

### 18.3.3 Benefits

Each Executive Director is provided with benefits which comprise pension arrangements, private medical insurance, critical illness cover, life assurance and income protection insurance. Other Code Staff are entitled to similar benefits.

### 18.3.4 Link between pay and performance

Performance-based remuneration is awarded by the Remuneration Committee in a manner which promotes sound risk management (within the Bank's stated risk appetite and ICAAP measures) and does not induce excessive risk-taking.

The Bank's remuneration policy focuses on ensuring sound and effective risk management through:

- A stringent governance structure for setting goals and communicating these to employees;
- Making all variable remuneration awards at the discretion of the Remuneration Committee and subject to individual, business unit, overall Bank performance, stated risk appetite and ICAAP measures.

In practice all remuneration decisions are approved by the CEO and Human Resources before implementation and as part of this would also be reviewed from a risk perspective. The remuneration decisions of Executive Directors and Other Code Staff are reviewed and approved by the Committee.

### 18.3.5 Design and structure of remuneration

There are three main elements of remuneration available to Code Staff:

- Basic salary;
- Variable awards (re the performance incentive scheme); and
- Benefits (pension and insurance).

Certain Code staff are also part of the Group's Long Term Incentive Plan.

All the current Executive Directors have entered into contracts that can be terminated after the relevant notice period has been served or by the payment by the Bank of an amount equivalent to the remuneration payable during such notice period. Service contracts for Other Code Staff have notice periods which vary depending on the particular role.

Non-Executive Directors are appointed by letter for an initial term of three years and will generally be expected to serve a second three year term. Non-Executive Directors are not eligible for variable compensation.

The variable incentive scheme is operated in a manner which promotes sound risk management (within the Bank's stated risk appetite and ICAAP measures) and does not induce excessive risk-taking. This is done by ensuring:

- An appropriate balance between fixed and performance-based components;
- Awards are made by assessing both individual performance against KPIs and underlying Bank performance (using an appropriate combination of financial & non-financial metrics). Individuals performance within control functions are assessed against the achievement of objectives linked to their functions which are independent of the financial performance of the business area that the individual controls;
- The outcomes are also moderated by the extent to which personal objectives had been achieved and based on any input from the Exco with regards to any adjustments required for risk; and
- The awarding of performance-based remuneration for Executive Directors and other Code Staff is at the full discretion of the Committee.

## 18.4 Salary and Fees

All Code Staff, other than Non-Executive Directors, receive a basic salary that reflects the risks and responsibilities attached to each specific role. Salaries are reviewed by the Remuneration Committee on an annual basis with consideration given to external market data for similar roles in the financial services sector. Other factors considered by the Remuneration Committee include the individual's skills, experience and performance.

Non-Executive Directors receive fees for their services. Fees are reviewed and approved by the Nomination Committee on an annual basis with consideration given to the level of fees at comparable organisations.

## 18.5 Variable Awards

The Bank makes only one type of variable award scheme available to Code Staff – a performance incentive scheme. In 2017, the Executive Directors and Other Code Staff participated in a non-pensionable performance incentive scheme, the metrics of which reflected the Bank's key objectives. Non-executive directors are not eligible for variable compensation.

When considering the performance of the Bank and participants the Committee will assess progress against a number of key financial and operational drivers including:

- Profit before tax;
- Return on assets / return on equity;
- Cost/income ratio;
- Stated risk appetite;
- ICAAP measures;
- Progress in the Bank's focus areas; and
- Compliance with internal business procedures.

The performance of individuals within control functions is assessed independently of the financial performance of the business area that the individual controls.

These measures were all set to provide challenging objectives that are aligned with the Bank's strategy, giving the Executive Directors an incentive to perform at the highest level. The financial outcomes were also moderated by the extent to which personal objectives had been achieved.

Where individual KPIs are achieved but the underlying performance of the Bank is unsatisfactory, annual performance-based payments may be reduced in part or withheld altogether at the Committee's discretion.

Payment of performance-based remuneration will be subject to any deferral requirements as required by the Committee at their discretion.



## 18.6 Remuneration Paid to Code Staff

The following tables display the remuneration for the Bank's Executive Directors, Non-Executive Directors, Senior Management and staff whose professional activities have a material impact on the risk profile of the company (together, Code Staff).

<b>2017</b>	<b>Senior</b>	<b>Other Code</b>	<b>Total</b>
<b>Fixed and variable remuneration to Code Staff</b>	<b>Management*</b>	<b>Staff</b>	
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
Fixed remuneration	1,235	1,467	2,702
Variable remuneration	152	237	389
Total remuneration	1,387	1,704	3,091
Number of Code Staff	10	20	30

\* those designated as Senior Management under the FCA's Senior Management regime (including non-executive directors).

The fixed remuneration detailed above includes a severance package paid to one person totalling £352,870.

No Code Staff were paid more than €1 million.

No sign-on payments were paid to Code Staff.

The variable remuneration includes a share based taxable benefit received by Senior Management (the Long Term Incentive Plan) totalling £34,856 and by Other Code Staff totalling £19,012. All other remuneration is paid in cash apart from sundry staff benefits (such as medical insurance and pension contributions) which is included within the fixed remuneration figures.

None of the remuneration is deferred.

- Appendix 1      Group Structure**
- Appendix 2      Senior Management Structure**
- Appendix 3      Balance Sheet Reconciliation**
- Appendix 4      Liquidity Coverage Ratio Metrics**
- Appendix 5      Asset Encumbrance**

# Crown Agents Bank Ltd

CAB

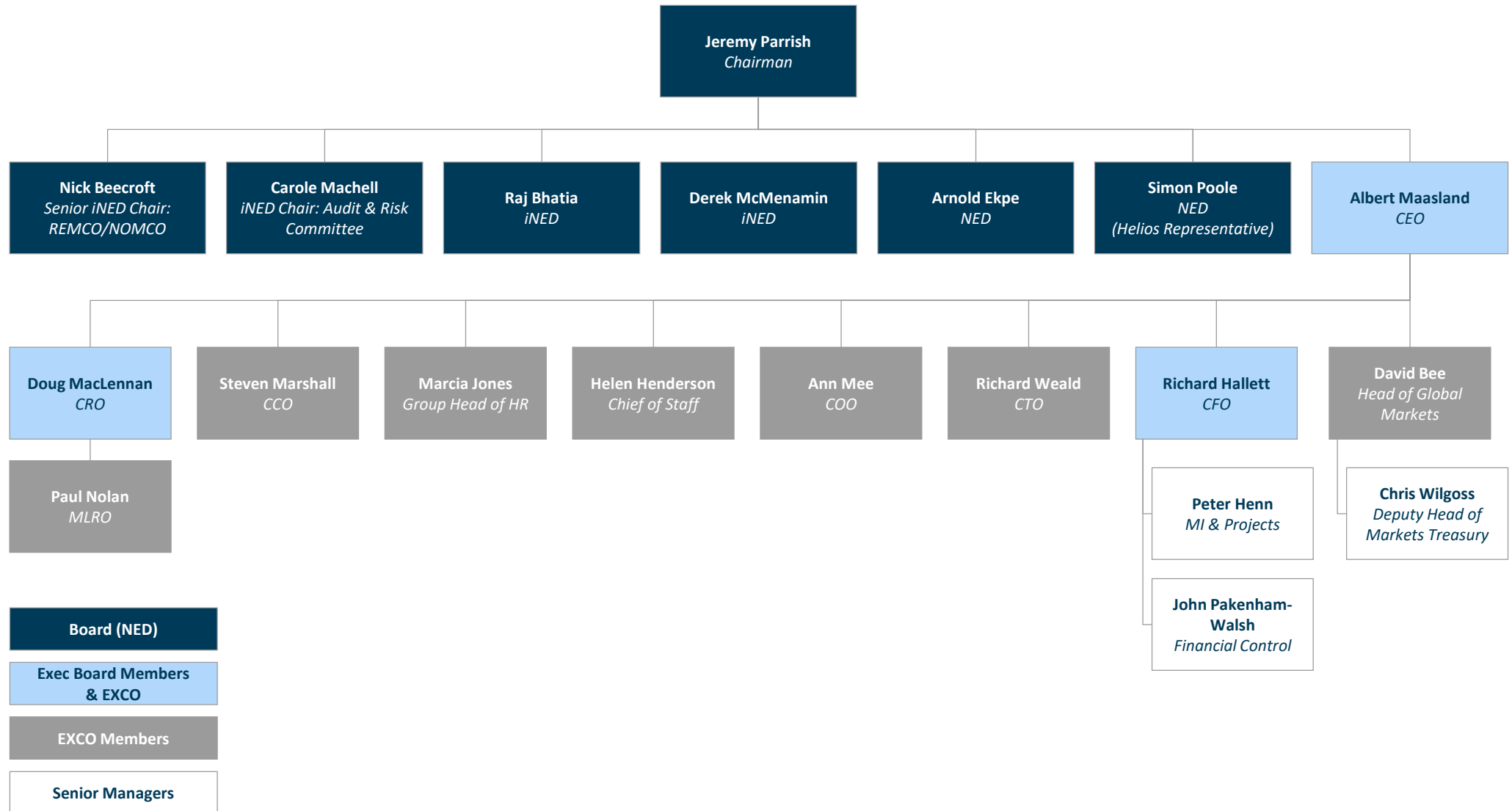
## Group Structure Chart



# Crown Agents Bank Ltd

CAB

## Senior Management Structure – December 2017 \*



\* Updated as at 31st May 2018

## Balance Sheet Reconciliation

As at 31 December 2017	Accounting Balance Sheet as per Published Financial Statements £'000s	Regulatory Adjustments (Deductions from Regulatory Own Funds) £'000s	Regulatory Balance Sheet £'000s	Subject to Credit Risk £'000s	Subject to Counterparty Credit Risk £'000s	Regulatory Own Funds £'000s
<b>Assets</b>						
Cash and balances at central banks	423,127	0	423,127	423,127		
Loans and advances to banks	228,721	0	228,721	228,721		
Cheques in the course of collection	-	0	-	-		
Debt securities	330,522	0	330,522	330,522		
Derivatives	1,257	0	1,257		1,257	
Intangible assets	4,092	(4,092)	-	-		
Tangible assets	514	0	514	514		
Deferred tax	913	(913)	-	-		
Other assets	3,067	0	3,067	3,067		
Prepayments and accrued income	832	0	832	832		
<b>Total Assets</b>	<b>993,045</b>	<b>(5,005)</b>	<b>988,040</b>	<b>986,783</b>	<b>1,257</b>	<b>-</b>
Add: Off Balance Sheet Exposures						
Trade Finance				31,553		
Derivatives				4,659		
<b>Total Credit Risk Exposures</b>				<b>1,022,995</b>		
<b>Liabilities</b>						
Customer accounts	923,881	0	923,881			
Bank overdrafts	-	0	-			
Items in course of transmission	287	0	287			
Derivatives	6,052	0	6,052			
Deferred tax liabilities*	192	(192)	-			
Other liabilities*	2,729	0	2,729			
Accruals and deferred income	2,240	0	2,240			
Called up share capital	41,200	0	41,200			41,200
Retained earnings	16,464	0	16,464			16,464
Total shareholders' funds	57,664	0	57,664			
<b>Total Equity and Liabilities</b>	<b>993,045</b>	<b>(192)</b>	<b>992,853</b>	<b>-</b>	<b>-</b>	<b>57,664</b>
Deductions from regulatory capital		(4,813)				(4,813)
<b>Total Own Funds</b>						<b>52,851</b>

\* These two items combined are reported as other liabilities in the accounting (statutory) balance sheet.

The table shows the reconciliation between the accounting balance sheet prepared in accordance with FRS102 and the regulatory balance sheet. It provides the allocation of the amounts reported to the different risk categories and the items considered for regulatory own funds.

## Liquidity Coverage Ratio Metrics

	Quarter Ending	Total Unweighted Value (Average) - £'000				Total Weighted Value (Average) - £'000			
		Mar-17	Jun-17	Sep-17	Dec-17	Mar-17	Jun-17	Sep-17	Dec-17
Number of data points used in the calculation of the averages (units - not '000)		885	889	910	1113	885	889	910	1113
<b>High Quality Liquid Assets (HQLAs)</b>									
1	Total HQLAs					466,061	391,586	280,113	433,209
<b>Cash - Outflows</b>									
2	Retail deposits and deposits from small business customers, of which:	449	66,861	58,306	35,403	41	6,613	5,753	3,478
3	Stable deposits	75	1,468	1,547	1,256	4	73	77	63
4	Less stable deposits	374	65,394	56,759	34,147	37	6,539	5,676	3,415
5	Unsecured wholesale funding	672,369	534,890	568,266	724,045	259,631	225,803	242,797	312,371
6	Operational deposits (all counterparties) and deposits in networks of cooperative banks	361,051	302,037	345,705	439,781	90,263	75,509	86,426	109,945
7	Non-operational deposits (all counterparties)	311,318	232,853	222,560	284,264	169,369	150,294	156,370	202,426
8	Unsecured debt	0	0	0		0	0	0	0
9	Secured wholesale funding					0	0	0	0
10	Additional requirements	2,422	5,535	2,792	420,859	2,422	5,535	2,792	420,859
11	Outflows related to derivative exposures and other collateral requirements	2,422	5,535	2,792	420,859	2,422	5,535	2,792	420,859
12	Outflows related to loss of funding on debt products	0	0	0	0	0	0	0	0
13	Credit and liquidity facilities	0	0	0	0	0	0	0	0
14	Other contractual funding obligations	0	0	0	0	0	0	0	0
15	Other contingent funding obligations	60,066	65,997	58,992	31,553	3,003	3,300	2,950	1,578
16	TOTAL CASH OUTFLOWS					265,098	241,250	254,292	738,285
<b>Cash - Inflows</b>									
17	Secured lending (e.g. reverse repos)	0	0	0	0	0	0	0	0
18	Inflows from fully performing exposures	81,252	75,090	126,464	105,005	49,317	53,454	92,231	51,144
19	Other cash inflows	24,109	20,719	33,001	413,923	23,984	20,594	32,876	413,797
EU-19a	(Difference between total weighted inflows and total weighted outflows arising from transactions in third countries where there are transfer restrictions or which are denominated in non-convertible currencies)					0	0	0	0
EU-19b	(Excess inflows from a related specialised credit institution)					0	0	0	0
20	TOTAL CASH INFLOWS	105,361	95,809	159,465	518,927	73,300	74,048	125,106	464,942
EU-20a	Fully exempt inflows								
EU-20b	Inflows subject to 90% cap					73,300	74,048	125,106	464,942
EU-20c	Inflows subject to 75% cap					73,300	74,048	125,106	464,942
<b>TOTAL ADJUSTED VALUE</b>									
21	LIQUIDITY BUFFER					466,061	391,586	280,113	433,209
22	TOTAL NET CASH OUTFLOWS					191,798	167,202	129,185	273,343
23	LIQUIDITY COVERAGE RATIO (%)					243%	234%	217%	158%

## Disclosure on Asset Encumbrance (£'000)

## Template A-Assets

	Carrying amount of encumbered assets*	Fair value of encumbered assets*	Carrying amount of unencumbered assets		Fair value of unencumbered assets	
				Eligible For HQLA's		Eligible For HQLA's
	010	040	060	080	090	100
<b>010 Assets of the Reporting Institution (see note 1)</b>	3,910		934,072	395,795		
020 Loans on demand	3,910		30,006	0		
030 Equity instruments	0	0	0		0	0
040 Debt securities	0	0	303,846	10,073	303,692	10,069
080 of which issued by financial corporations	0	0	303,846	10,073	303,692	10,069
100 Loans and advances other than loans on demand	0		585,056	385,722		
120 Other assets	0		19,639	0		

\* none of which are notionally eligible for HQLA's (columns 030 and 060)

## Notes

1. As required by regulation, the disclosures above relate to the median of the quarterly medians (rather than the year end position). As per EBA/RTS/2017/03 2.3.4(a) the figures in row 010 are the medians of the sums which are not necessarily the sums of the medians.
2. The PRA have waived the requirement to disclose Template B (Supervisory Statement SS11/14 - CRD IV: Compliance With The European Banking Authority's Guidelines On The Disclosure of Encumbered And Unencumbered Assets).
3. Templates C and D are nil returns/ not applicable.