Habib Bank Zurich Plc – Pillar 3 Disclosures

31 December 2016

Table of Contents

1. Overview 3
2. Governance Framework 4
3. Risk Management Framework 6
4. Significant Risks 10
5. Capital Management and Capital Adequacy 15
6. The Internal Capital Adequacy Assessment Process (ICAAP) 16
7. Leverage Ratio 17
8. Impairment Provisions 17
9. Asset Encumbrance 18
10. Employee Remuneration Policy 18

1. Overview

1.1 Company information

Habib Bank AG Zurich (HBZ or Parent bank) established its branch in UK in the year 1974. In 2014, HBZ established a 100% owned subsidiary, Habib Bank Zurich Plc ("the Bank"). The Bank acquired the operations of the branch on 01 April 2016, subsequent to authorisation from the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) and successfully transferred business of UK Branch of Habib Bank AG Zurich, Switzerland to the Bank, vide business transfer scheme ("Scheme") under Part VII of the Financial Services and Markets Act 2000 ("FSMA").

1.2 Purpose

The Disclosures in this document are set out in accordance with the requirements of Pillar 3, set out in the EU's Capital Requirements Regulation ("CRR"), and are based on data as at 31 December 2016. Pillar 3 requires firms to publish a set of disclosures, which allow market participants to assess key pieces of information on that firm's capital, risk exposures and risk assessment process. The disclosures contained in this document cover the qualitative and quantitative disclosure requirements of Pillar 3.

The framework requires the institutions to maintain and ensure the following:

1.1.1 Pillar 1 Minimum Capital Requirements with defined rules for the calculation of credit risk, counterparty credit risk, market and operational risk.

1.1.2 Pillar 2 includes Individual Capital Guidance (ICG) as pillar 2A that frames the requirements for the institution to hold additional capital against risks that are not fully captured under Pillar 1. The institution's internal models and assessments support this process. The details of the assessment are contained in the Bank's "Internal Capital Adequacy Assessment Process" ("ICAAP"), elements of which are disclosed within this document. The PRA expect that firms should meet Pillar 2A capital requirement with at least 56% of Common Equity Tier1 capital (CET1).

1.1.3 Bank requires maintaining specific CRD Buffers. One is Capital Conservation Buffer (CCB) that is designed to ensure that banks build up capital buffers outside periods of stress which can be drawn down as losses are incurred and the other is Countercyclical Buffer (CCyB) that aims to ensure that banking sector capital requirements take account of the macro-financial environment in which bank operates. PRA sets a buffer called 'PRA Buffer' as incremental to Pillar 1 and Pillar 2A and CRD buffers.

1.1.4 Pillar 3 – External communication of risk and capital information, which complements the Pillar 1 and Pillar 2 that allows market participants to assess the institution's capital adequacy.

1.3 Basis and frequency of disclosure

The Bank applied the provisions of CRR and Prudential Source Book to cover the qualitative and quantitative disclosure requirements of Pillar 3 based on data as at 31 December 2016. Pillar 3 requires firms to publish a set of disclosures, which allow market participants to assess key pieces of information on that firm's risk assessment process, risk exposure and capital.

This report is updated and published annually. The aim is to provide additional information to complement the Financial Statements, and should be read in conjunction with that information, in particular the section on risk, liquidity and capital management and corporate governance, as well as the Notes to the Financial Statements.

The disclosures are prepared by management, and reviewed and approved by the Board of Directors of HBZ UK ("the Board"), prior to publication on HBZ's website.

1.4 Principal activities

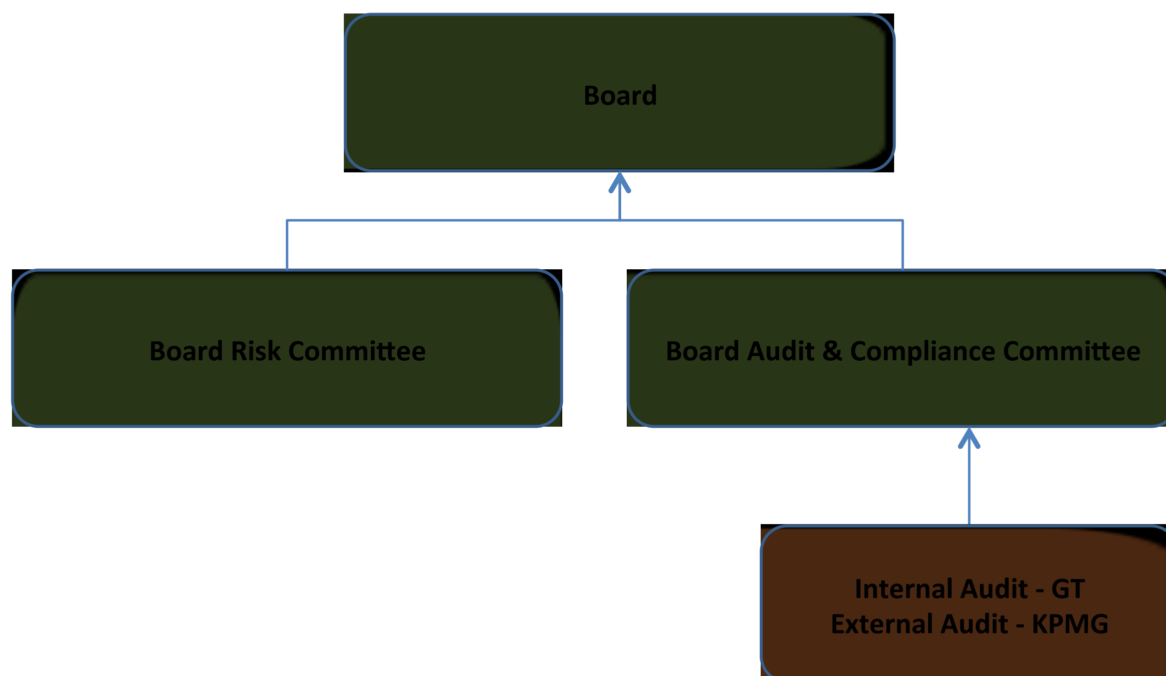
The Bank offers product lines combined with personalised relationship management through conveniently located network of eight branches in London, Manchester, Leicester and Birmingham. It also offers fixed term bonds accessible directly though the web-based channel. The Bank offers two main products; real estate finance and commercial banking services apart from regular retail banking. In line with the customer needs, the Bank's product suite is comprised of real estate loans, commercial loans, working capital finance, current accounts, savings accounts, term deposits and treasury services.

2. Governance Framework

The Board of Directors is responsible for the establishment of overall strategic direction and oversight by setting up the overall governance and risk management framework of the Bank. The Bank's risk appetite is set by the Board of Directors and takes into account the Bank's Strategic Intent. To implement an effective governance process the Board has established a Board Risk Committee and Board Audit and Compliance Committee (BACC).

The Committees keeps an oversight on the key risks such as credit, liquidity, compliance, conduct and operations. Members of the Committees keep close interaction with senior management and receive regular information from management committees. The independent internal audit function reports into BACC and conduct reviews of all key risk areas including the risk management framework. Reports are presented to BACC and the Board.

The governance model, roles and responsibilities and reporting is shown below:



2.1.1 Board Responsibilities:

The Board monitor and periodically assess the effectiveness of governance arrangements and takes appropriate steps to address any deficiencies. The Board evaluates the principal risks to the Bank's business model and the achievement of its strategic objectives, including risks that could have material impact its capital or liquidity. The Board reviews risk management process and internal control systems and satisfy it self that they are functioning effectively and corrective action is being taken where necessary. The Board

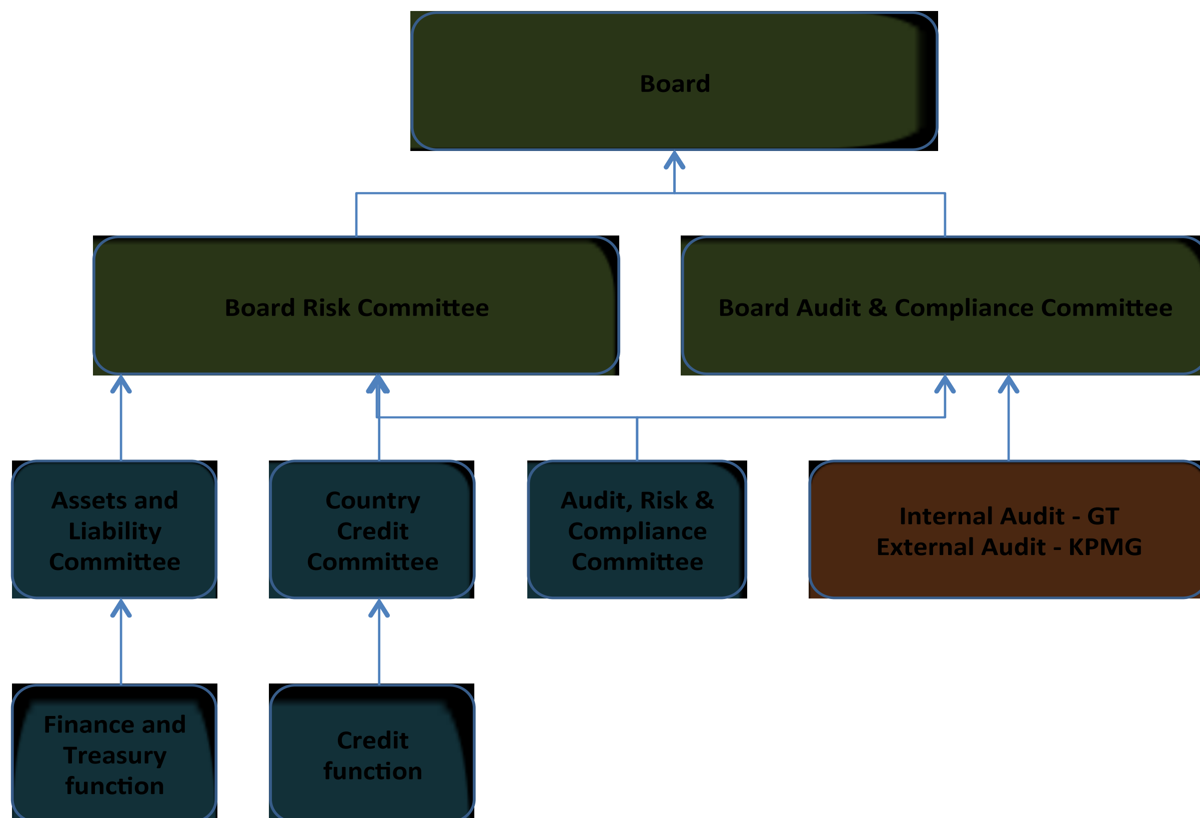
ensures that an appropriate risk culture is instilled in the Bank. It also ensures adequate succession planning for the senior management so as to maintain an appropriate balance of skills and experience within the Bank.

2.1.2 Board Risk Committee

The Board Risk Committee assists the Board in the review and oversight of Risk Management Framework, ICAAP, ILAAP and other governance documents. Board Risk Committee (BRC) is designed to raise awareness of the whole risk landscape and has responsibility of its oversight. BRC ensures that a wider management membership is engaged in the capital and liquidity management process cycle. This includes involvement in the formulation of stress tests, the reasonableness of assumptions and likely outcomes given current and prospective market conditions.

2.1.3 Management Responsibilities

The implementation of an effective Governance and Control framework is managed through a management committee structure:



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The management of the Bank through committee structure allows for Enterprise Wide Risk Management through the consideration of different aspects and challenge at decision-making levels. This structure ensures that management of the Bank's operations, strategic decision-making and risk management is undertaken on a consultative basis at committee level by experienced functional and business personnel.

The management committees as above have specific Risk Management responsibilities.

2.1.4 Executive Committee (EXCO)

Capital is fundamental to the effective management of a bank and requires the full engagement of the Executive Management and the support functions. The Executive Committee assess the availability of

adequate capital under normal going concern as well as under stressed scenarios and crisis conditions for the purpose of advance planning for remedial management.

The EXCO through the CEO assists the Board in drawing up strategies and polices for management of capital risks. It also supports the Board in determining the appropriateness of capital risk tolerance, keeping in view the Bank's business strategy, financial condition and funding capacity.

2.1.5 ALCO

The ALCO is responsible for determining the structure, responsibilities and controls for managing capital risk and report to the EXCO on capital risk profile. ALCO is also responsible for the supervision of the capital and liquidity risk exposures; risk limits adherence, early warning indicators as well as the review of capital planning and liquidity adequacy to support future business growth and stress and scenario testing to assess capital and liquidity adequacy with changing internal and external factors. Members include representatives from all functions that have duties to perform adherence of this Policy.

Members of ALCO through various reports continuously review the capital and funding position of the Bank.

2.1.6 Country Credit Committee (CCC)

The primary purpose of the CCC is to ensure the effective management of credit risk in the Bank.

CCC maintains an effective working relationship with the EXCO, other management committees, the Bank's Board and other committees as required ensuring effective functioning of the credit risk function.

CCC review Credit Line Proposals (CLP) along with the Risk report, position summary and any other relevant documents for credit decision-making purposes. Other sub committees such as Credit Policy Committee, Provisioning Committee and Active Credit Portfolio Monitoring also support CCC in performing its responsibilities.

2.1.7 Audit Risk and Compliance Committee

The ARCC is responsible for providing independent assurance on the bank-wide risk management framework and monitoring the overall risk profile of Bank through effective control processes. ARCC ensure that risks are identified, accepted, measured, controlled, monitored and reported independent from the business. This is performed through a fully embedded risk event reporting process, which allows employees to report risk events to the independent Risk Assurance function. All risks reported are assessed and addressed with escalation at an appropriate level. Risk Assurance function also carries out root cause analysis of reported risks and makes appropriate recommendation for changes in systems and controls to the reverent function and committee.

3. Risk Management Framework

3.1 Overview

An effective and robust Risk & Control Framework is a fundamental prerequisite to the success and stability of the Bank. The Bank's approach to Risk Management is built on the principle of low to medium risk appetite and Investment return horizon, which is medium to long term. In order to achieve this, the Bank's business strategy is built upon a defined target market; relationship based banking service and comprehensive governance and control framework.

The Bank's Risk management strategy is founded on the principles of Enterprise Risk Management with key emphasis on:

- Proactive approach to risk management;
- Ownership of risk across the organisation;
- Multiplier effect of risk to account for combined stress scenarios;
- Monitoring and review of key risks at both Management and Board level.

The Bank maintains an internal controls system, with clear responsibilities for risk management, applying governance model, which enables oversight and management of risks. These specific responsibilities includes:

- Review and determine the risk appetite of the Bank;
- Identify and evaluate the principal risks to the Bank's Business model and the achievement of its strategic objectives, including risks that could threaten its capital or liquidity;
- Review of the risk management and internal control systems and satisfy itself that they are functioning effectively and corrective action is being taken where necessary;
- Capital, liquidity and earnings are protected by the effective controlling of the risk exposures across all material risk types and businesses;
- Ensure that an appropriate risk culture is instilled in the Bank; and
- A strong ethical and risk culture is maintained so that risk awareness is embedded into all activities.

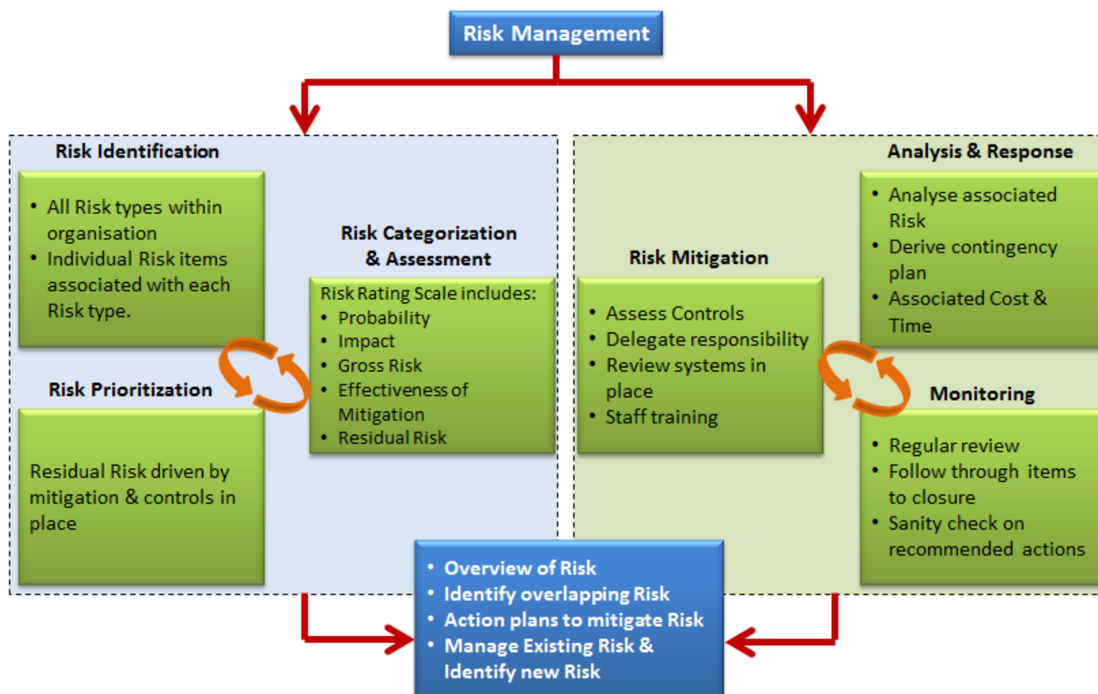
The implementation of Risk Management Framework and Risk Appetite is driven by policies and procedures, controls and ongoing monitoring. These different components enable effective implementation of risk management objectives of the Bank.

3.2 Risk Management Process

3.2.1 Risk Management Cycle

Effective Risk Management is the combination of identification, assessment, and prioritisation of risk followed by coordinated and economical application of resources to minimise, monitor, and control the probability and /or impact of risk events.

Risk Management cycle can be broken down in two broad sections with first focusing on the identification, categorisation and prioritisation of risk. The second section focuses on the mitigation and monitoring of the risks. The diagram below represents the main activities undertaken in the two broad sections:



Identification of individual Risks within the broad risk types allows the Bank to focus on the key threats. The risk identified is weighted based on the probability of occurrence and the impact it will have on the organisation. Low probability and impact is acceptable and preferred, however the controls and mitigation in place derive the final residual risk.

Residual risk forms a key indicator for the Bank to prioritise the various risks posed and focus on the areas identified to mitigate the risk by enhancing controls and prioritising independent reviews through audits to establish the effectiveness of risk mitigation.

3.3 Risk Appetite

The Bank's risk appetite is set by the Board of Directors and takes into account the Bank's Strategic Intent. The executive management of the Bank is responsible for implementation of the risk appetite throughout the Bank's operations and business. The Board Risk Committee maintains oversight of the business performance against the risk appetite. Management review is conducted by the relevant management committee and monitoring by Audit, Risk & Compliance Committee (ARCC).

The bank's risk appetite articulates the type and quantum of risk that the bank is able and willing to accept in pursuit of its strategy. Risk appetite is based on qualitative statements, which articulate the risk taking intent of the Bank, and is supported by quantitative limits and controls. The primary objective of the risk appetite is to protect the Bank from an unacceptable level of financial performance volatility, conduct and compliance failures and adverse reputational impact.
The Board of Directors (BOD) approves the Bank's risk appetite statement, and the BRC maintains oversight of the Business Performance against the Risk Appetite (RA). Management review is conducted by the Country Credit Committee (CCC) and monitoring by the Audit Risk & Compliance Committee (RCC).

3.4 3 Lines of Defence

For smooth running and effective risk / threat identification and mitigation, the Bank operates on the 3 lines of defence model.

3.4.1 Risk Governance - roles and responsibilities

Line 1 - Business Operations

- Have primary responsibility for day to day risk management
- Accountable and responsible for their day to day activities
- Every employee is therefore responsible
- Ensure all key risks within their activities and operations identified, mitigated and monitored

Line 2 - Risk & Control Functions

- Provide oversight, support, monitoring & reporting
- Role is to ensure that the Bank's Risk Appetite Statement is observed in relation to the risks
- Providing assurance, oversight and challenge
- Establishing frameworks to identify and measure the risks
- Monitoring the performance of the key risks

Line 3 - Internal Audit

- Provides independent & objective assurance on the overall effectiveness of the risk governance framework
- The Internal Audit function is independent of both the Bank's day to day operations and its management thereby providing assurance that risks to the Bank has been properly considered and reviewed

3.5 Scenario Analysis and Stress Testing

A stress test is commonly described as the evaluation of a bank's financial position under a severe but plausible scenario to assist in a forward-looking decision making within the bank.

Stress testing is an important risk management tool that is used by the Bank and supplements other risk management approaches and measures. It plays a particularly important role in:

- providing forward-looking assessments of risk;
- feeding into capital and liquidity planning procedures;
- informing the setting of a Bank's risk appetite and thresholds; and
- facilitating the development of risk mitigation or contingency plans across stressed conditions.

The Board and senior management are involved in ensuring the appropriate use of stress testing in the Bank's risk governance and capital planning. This includes setting stress testing objectives, defining scenarios, discussing the results of stress tests, assessing potential actions and decision-making.

The Board has ultimate responsibility for the overall stress-testing programme, whereas senior management is accountable for the programme's implementation, management and oversight.

The Stress Testing scope covers the following key risk areas:

- Capital
- Liquidity
- Credit Risk & Provisions
- Earnings – P&L

The Stress testing scenarios cover Bank specific risks, market specific risks and a combined impact to arrive at the impact on the key measures of capital, liquidity, provisions and earnings. The frequency of review is once a year except for the property stress test, which is conducted twice a year.

The process for reverse stress testing involves defining the point of failure of the firm (in this case full capital erosion) and working backwards to identify the scenarios leading to that. The challenge in the exercise is to identify scenarios that are both sufficiently extreme and relevant to the Bank.

Details of stress testing, related financial impact and actions to deal with the stressed scenarios are covered in the ICAAP & ILAAP.

4. Significant Risks

The key risks as assessed by the Bank are as follows:

4.1 Credit Risk

Credit Risk is defined as of loss of principal or loss of a financial reward stemming from a borrower's failure to repay a loan or otherwise meet a contractual obligation resulting in financial loss to the Bank. Credit risk is the risk that obligors or counterparties are unable to meet their obligations to the Bank. Credit risk arises principally from lending and investment activities involving on and off balance sheet instruments.

The Country Credit Committee (CCC) is primarily responsible for managing and monitoring of credit risk with oversight from Board Risk Committee. The CCC has also formed sub committees to concentrate to various elements of credit such as Credit Policy Committee (CPC) reviews changes in developing trends in the market, which may impact the borrowers, or the value of collaterals. CPC also reviews detailed management information to assess various risk such as concentration risk, collateral risk and make recommendations to the CCC related to LTV, pricing and sector exposures limits.

4.1.1 Counterparty credit risk

A Counterparty Credit Risk (CCR) Exposure is the risk of financial loss in derivative, foreign exchange trading or securities financing activities, due to a counterparty’s failure to perform at any time from trade date to settlement date. It is the credit risk of the counterparty and is additionally subject to market risk. The exposure is calculated based on the regulatory requirement.

4.1.2 Credit Risk Ratings

For the purpose of credit risk ratings, the Bank segregates its loans and advances portfolio into two categories namely, Property Sector lending and Other Lending (primarily comprising of commercial lending). Property sector lending covers major portion of the total lending portfolio. The Bank follows a program based lending approach for property sector lending with clearly defined Risk Acceptance Criteria (RAC) for this segment rather than a credit risk rating methodology.

The Bank recognises loans and advances as past due when the customer does not meet its contractual payment obligations.

The Bank regards a loan and advance or a debt security as impaired if there is objective evidence that a loss event has an impact on future estimated cash flows from the asset. Financial assets split by external rating, where applicable:

Amount in £

	Cash and balances with central bank	Due from banks	Loans and advances to customers	Financial investments	Derivatives	Contingent liabilities and commitments	Total
AAA to AA-	91,200,000	532,133	-	99,139,322	-	-	190,871,455
A+ to A-	-	277,582	-	-	-	-	277,582
BBB+ to B-	-	35,338,688	-	-	483,383	17,951,129	53,773,200
Unrated	1,024,488	6,084,274	350,395,286	-	64,626	54,949,852	412,518,526
	92,224,488	**42,232,677**	**350,395,286**	**99,139,322**	**548,009**	**72,900,981**	**657,440,763**

Bank uses the external credit agencies Fitch, S&P and Moody’s to obtain ratings for its credit exposures relating to financial institutions, banks and sovereign agencies or entities.

4.1.3 Concentration of Risk

Concentration arises when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar features that would cause their ability to meet contractual obligations to be affected by changes in economic, political or other conditions. The Country Credit Committee primarily manages concentration risk. The Bank Assets and Liabilities Committee also monitor credit concentration. All material exposures are reported to the Board Risk Committee, which escalates material concerns to Board of Directors.

Segmental concentration of financial assets and credit related contingent liabilities:

Amount in £

	Cash and balances with central bank	Due from banks	Loans and advances to customers	Financial investments	Derivatives	Contingent liabilities and commitments	Total
Super-nationals	91,200,000	-	-	99,139,322	-	-	190,339,322
Financial Institutions	-	42,232,677	-	-	483,383	17,951,020	60,667,080
Industrial & commercial	-	-	285,993,365	-	64,626	52,235,356	338,293,347
Individual	-	-	64,401,921	-	-	2,714,605	67,116,526
Other	1,024,488	-	-	-	-	-	1,024,488
	92,224,488	**42,232,677**	**350,395,286**	**99,139,322**	**548,009**	**72,900,981**	**657,440,763**

Super-nationals include investment made by the Bank in high rated bonds issued by sovereigns and multilateral development banks.

Geographical concentration of financial assets and credit related contingent liabilities:

Amount in £

	Cash and balances with central bank	Due from banks	Loans and advances to customers	Financial investments	Derivatives	Contingent liabilities and commitments	Total
United Kingdom	92,224,488	25,842,165	348,386,633	5,667,800	361,179	62,081,239	534,563,504
Europe excluding UK		1,984,760	-	77,298,650	186,830	5,905,746	85,375,986
United States of America	-	5,209,536	-	16,172,872	-	-	21,382,408
Africa		5,291,550	-	-		3,661,712	8,953,262
Others	-	3,904,666	2,008,653	-	-	1,252,284	7,165,603
	92,224,488	**42,232,677**	**350,395,286**	**99,139,322**	**548,009**	**72,900,981**	**657,440,763**

4.1.4 Collateral Management

Collateral Risk is mitigated through the use of readily marketable collateral, avoidance of collateral with high volatility and use of haircuts as per approved Bank's policy.

Collateral values are assessed by professional valuers. The Bank uses panel of valuers selected through a robust due diligence process. Residential or commercial collateral used by the Bank are on vacant possession, which provides fair degree of conservativeness to the values used for calculating LTV. The Bank generally performs valuation of properties every five years.

Key threat arising along with controls & mitigations in place are tabulated below:

Collateral Risk	Controls & Mitigation in Place
Risk Arising from reduction in collateral values	▪ Generally acceptable collateral - Cash, Residential & Commercial Property, Bank Guarantees, Shares & Bonds & life insurance with surrender value. ▪ Lien is marked against cash taken as collateral ▪ Charge is recorded in Bank's name in land registry relating to residential and commercial properties taken as collateral.

	▪ Other collateral like Bank Debenture, Stocks, Receivables, Personal Guarantees also available but discounted for lending and provision decisions. ▪ Well defined haircuts for all collateral with Property haircuts arrived at on the basis of type of property, location and market conditions ▪ Property Stress tests conducted every six months
Risk arising from inadequate perfection of Security for Customer Borrowing	▪ Credit Administration unit centralised ▪ Standardisation of documents and processes for Risk mitigation ▪ Duly reviewed & approved panel of solicitors & valuation firms

The Bank accepts collateral subject to legal review and appropriate documentation in accordance with the Credit Risk Management Policy. The Credit Department keeps a comprehensive record of collateral received and is responsible for regular updates to the valuation of the underlying collateral. The documentation entered into with the obligor specifies the Bank's rights and ability to liquidate the collateral, if required. The Country Credit Committee is responsible for decisions regarding liquidation or appropriation of collateral based on recommendations from the Head of Credit and advice from the Legal Department. Further details of collateral can be found in the audited financial statements.

The carrying amount of financial assets recorded in the balance sheet, net of any allowances for losses, represents the Bank's maximum exposure to credit risk without taking account of any collateral obtained.

4.1.5 Credit Risk Weighted Exposures

The Bank has adopted Standardized Approach as set out by CRR and approved by the PRA under which Credit risk weighted exposures are calculated on the basis of the rating regime as prescribed in Standardised Approach by PRA Supervisory Statement SS10/13.

Credit Risk RWAs calculated as follows:

Exposures	On Balance Sheet (£)	Off Balance Sheet (£)	Total (£)
Retail	51,363	-	51,363
Secured by mortgages on immovable properties	226,194,651	-	226,194,651
Exposures in default	22,399,021	-	22,399,021
Contingencies and commitments	-	20,292,832	20,292,832
Institutions	16,246,858	-	16,246,858
Corporates	8,980,000	-	8,980,000
Counterparty credit risk	-	669,208	669,208
Other	15,193,418	-	15,193,418
	289,065,311	**20,962,040**	**310,027,351**

4.1.6 Credit Risk Mitigation

Risk mitigation mechanisms are employed to minimize credit risk in the event of credit quality deterioration. This primarily includes cash and bank guarantees. The reported credit risk weighted assets in the above schedule are reflected after employing the risk mitigation techniques.

4.2 Liquidity Risk

Liquidity risk is the risk that the Bank is unable to meet its obligations as they fall due and in the currency in which they are due. Typically, this arises from a mismatch in the cash flows arising from assets, liabilities and contingencies. To limit this risk, the Bank manages the maturities of its assets and liabilities and its cash flows on a daily basis.

The Bank's liquidity risk is clearly articulated in its "Liquidity Risk Management Policy" (LRMP) approved by the Board of Directors. The Bank maintains adequate liquidity levels all the time to cover its short and medium-term liquidity risks over an appropriate set of time horizons for both BAU and stressed conditions. The Bank keeps a liquid asset buffer of High Quality Liquid Assets as required by European Union (EU) regulations. The Bank also maintains substantial liquidity in the Bank of England Reserve account and in short term deposits to meets its liquidity requirements.

The Bank has put in place strategies, policies, processes and systems that enable it to identify measure, manage and monitor liquidity risk over an appropriate set of time horizons, including intraday, so as to ensure that it maintains adequate levels of liquidity buffers. The Bank's liquidity policy is based on maintaining sufficient liquid resources to ensure there is no significant risk that its liabilities cannot be met as they fall due.

The Bank has the following liquidity profile that analysis assets and liabilities into relevant maturity buckets based on the remaining period to contractual maturity. The maturity profile is the representative of its contractual undiscounted cash flows.

Amount in £

	Carrying amount	Gross nominal inflow/(outflow)	Within 1 month	1-3 months	3 months-1 year	1-5years	> 5 years
Financial asset by type							
Non-derivative assets							
Cash in hand & with central bank	92,224,488	92,243,852	92,243,852	-	-	-	-
Due from banks	42,232,677	42,466,474	27,364,919	5,618,635	9,482,919	-	-
Loans & advances to customers	350,395,286	394,254,893	56,727,967	13,773,866	24,870,315	81,449,972	217,432,774
Financial investments							
- Available for sale	99,139,322	100,010,302	-	11,022,311	6,495,080	70,945,768	11,547,143
	583,991,773	**628,975,521**	**176,336,738**	**30,414,812**	**40,848,313**	**152,395,740**	**228,979,917**
Derivative assets							
Risk management	548,009						
Outflow		18,460,295	3,521,415	8,251,312	6,687,568	-	-
Inflow	-	(17,893,949)	(3,300,972)	(8,006,533)	(6,586,444)	-	-
	548,009	**566,346**	**220,443**	**244,779**	**101,124**	**-**	**-**
Financial liability by type							
Non-derivative liabilities							
Due to banks	24,918,790	(24,934,719)	(24,934,719)	-	-	-	-
Due to customers	479,619,902	(482,766,840)	(233,287,502)	(56,952,893)	(187,046,742)	(5,479,703)	-
Subordinated liabilities	20,000,000	(20,179,000)	-	-	-	(20,179,000)	
	524,538,692	**(527,880,559)**	**(258,222,221)**	**(56,952,893)**	**(187,046,742)**	**(25,658,703)**	**-**
Derivative liabilities							
Risk management	502,923	-	-	-	-	-	-
Outflow	-	17,532,669	3,116,939	7,819,153	6,596,577	-	-
Inflow	-	(18,053,593)	(3,328,880)	(8,047,036)	(6,677,677)	-	-
	502,923	**(520,924)**	**(211,941)**	**(227,883)**	**(81,100)**	**0**	**0**

The Bank has disclosed a contractual maturity analysis for its financial instruments. This includes a maturity analysis for financial assets that it holds as part of its managing liquidity risk - e.g. financial assets that are expected to generate cash inflows to meet cash outflows on financial liabilities - because the Bank considers that such information is necessary to enable financial statement users to evaluate the nature and extent of its liquidity risk.

4.3 Interest rate risk in the banking book

Interest rate risk arises from the possibility that changes in interest rates will affect future profitability or the fair value of financial instruments. Interest rate risk at the Bank is well managed and contained and the Bank has no significant long term or complex interest rate positions. The Bank seeks to minimise the negative impact on net interest income of adverse movement in interest rates. The Bank uses its own base rate for pricing of products, which can be changed with 60 days' notice to the customers. Therefore any significant fluctuation in interest rate is unlikely to have a material impact on the Bank as it can re-price its lending and customer deposit books.

The Bank is exposed to interest rate risk on part of its HQLA investment portfolio maintained to meet the LCR requirement. However this is only limited to fixed rate investments against, which the Bank has allocated capital as Pillar 2A add-on to cover interest rate risk. HQLA is valued on a mark to market on a weekly basis to assess variation in book and market value. At present above 80% of HQLA is invested in fixed rate instruments. The Bank has plans to reduce the fixed rate HQLA portfolio in future.

4.4 Operational Risk

Operational Risk is defined as the risk of direct or indirect loss resulting from inadequate or failed internal processes, people and systems, or from external parties. Specifically this includes: employees (e.g. fraud or key man dependencies), third party intermediaries, information technology (systems), and processes including failure to meet regulatory/legislative requirements or internal procedures.

Operational Risk is the risk that the Bank triggers one or more of the below situations due to failed internal processes, people and systems – these can be internal or external to the Bank:

- Adversely impacts customers (customers are defined as customer of the Bank as well as internal "customers" such as colleagues with a dependency on particular output or service)
- Incurs losses e.g. operational losses (this includes temporary losses i.e. where recovery is made or is in progress of being made)
- Breaches in regulatory requirements or other policies and practices of the Bank

The Bank's operational processes exist to support the servicing of customers and to maintain compliance with relevant regulation. These imperatives will be robustly protected. The Bank will ensure that it remains compliant with the latter but its approaches to the former will vary according to priority and need. In terms of customer service the Bank will actively employ flexible approaches to maintaining and protecting delivery and to this end will incur reasonable costs as required.

The Bank has adopted the Basic Indicator approach for calculating Operational Risk capital as set out in the CRR and consequently embarks on rigorous risk identification exercises to establish any Pillar 2 requirements for Operational Risk.

4.5 Cyber Risk

In today's modern banking landscape banks are expected to provide multiple transactional gateways to their customer in order for the customers to access their bank account and conduct transactions round the clock. Banks are expected to provide these transactional capabilities to their customers ensuring they are authenticating the customers at various levels throughout the transactional journey. In opening up multiple transactional channels the banks are exposed to risk and threats, which exist today in the cyber space.

Habib Bank Zurich Plc takes risks associated with Cyber Security extremely seriously and is constantly engaged in not only improving and strengthening its transactional gateways but also its internal operating environment. For the Bank it is equally important to ensure that its internal infrastructure on which employees are operating is secure and fit for purpose. The Bank has successfully completed various infrastructure-hardening projects some of which are mentioned below

- Deployment of Managed Switches: To ensure only authorised devices are allowed on Internal Network and to isolate any device within the network
- End Point Security: Deployment of centrally administered AV to ensure all user end points are protected
- Proxy Servers: Roll out of new proxy server operating on HBZ Group approved policies ensuring only permitted websites are accessible

- Thin Client: Planned roll out thin client systems using Citrix ensuring only permitted activities can be conducted and authorised applications are installed on end points
- Verified by Visa: HBZ UK successfully completed certification of VBV service to provide its customer secure online shopping experience

The Bank recognises risk associated with Cyber threats and is constantly taking proactive measures to strengthen its operating environment in order to provide secure banking experience to internal as well as external stakeholders.

4.6 Regulatory Compliance Risk

"Regulatory Compliance" means compliance with relevant UK and other regulatory rules and requirements. At its highest level this means the Bank's "arrangements" to ensure that it comply with the regulators threshold conditions, Statements of Principle, rules, codes and guidance and any relevant directly applicable provisions of a European or group Directive or Regulation.

The Bank has an effective compliance function, which operates independently and, which has the following responsibilities:

- to monitor and, continually assess the adequacy and effectiveness of the measures and procedures put in place in accordance with SYSC 6.1.2 R, and the actions taken to address any deficiencies in the firm's compliance with its obligations; and
- to advise and assist the relevant persons responsible for carrying out regulated activities to comply with the Bank's obligations under the regulatory system.

The Compliance function measures and monitors regulatory compliance through the HBZ UK Compliance Monitoring Plan, and through its interactions with first line of defence.

5. Capital Management and Capital Adequacy

The primary objective of capital management is to maintain strong capital to support medium to long-term business growth. An effective capital management process provides resilience arising from both internal and external factors resulting in additional capital requirements. The Bank maintains strong capital ratios not only to support its business and maximise shareholders' value but also to maintain depositors' and market confidence. The Prudential Regulation Authority sets and monitors the capital requirement for the Bank.

The Bank's capital has been invested by the Parent bank to support long-term business growth of the Bank, which includes capital resources to meet Pillar 1, Pillar 2, CRD Buffers and PRA Buffer. The Bank also maintains internal capital buffer over and above the minimum regulatory capital requirement. The Bank also takes into account changes in economic conditions; risk characteristics of its activities and regulatory requirement in managing its capital structure and make adjustments to it in the light of such changes.

	£ 000'
Called up share capital	60,000
Retained earnings	3,031
Available for sale reserves	219
Tier 1 capital before regulatory adjustments	63,250
Regulatory adjustments:	
- Available for sale reserves	(219)
Tier 1 capital after regulatory adjustments	63,031
Tier 2 capital (Subordinated liabilities)	20,000

5.1 Own Funds (Capital Resources)

Own funds or capital resources are the minimum amount of capital the institution must hold as per relevant regulatory rules and Individual Capital Guidance (ICG) received from the PRA. This is also called as regulatory capital. The Bank in accordance with CRDIV requirements must hold sufficient quantity and quality of own funds.

Bank's own funds comprises of Tier 1 and Tier 2 capital. Bank successfully complied with the capital requirements throughout the year 2016 and actively managed capital base to cover risks exposed to the Bank.

The table below summarizes the composition of regulatory capital for the Bank on a solo basis as at 31 December 2016.

Tier 1 Capital - Called up share capital includes 60 million of ordinary shares fully paid up.

Tier 2 Capital - Subordinated liabilities include the loan of £20m issued by Habib Bank AG Zurich, the parent Bank. The loan carries interest at a rate of 6-month libor plus 125 bps per annum to be paid semi-annually. The initial term of the loan is five years. The term of loan can be extended for one additional year on each anniversary with the mutual consent of both lender and borrower after the expiry of the initial term.

5.2 Own Funds Requirements

Bank successfully maintained its regulatory capital substantially above what actually required.

The table below provides the detail of own funds or capital requirement for the bank:

£ 000'	**Risk Weighted Assets**	**Capital Requirement**
Credit Risk	310,219	24,817
Operational Risk	25,183	2,015
Market Risk	1,139	91
Pillar 1 Total (8% of RWAs)	**336,541**	**26,923**
Pillar 2A (3.69% of RWAs)	**336,541**	**12,418**
Total Pillar 1 and Pillar 2A (11.69%)	**336,541**	**39,341**
PRA Buffer (2.94% of RWAs)	**336,541**	**9,894**
Capital Conservation Buffer (0.625% of RWAs)	**336,541**	**2,103**
Total Capital Requirement - £ 000'	**336,541**	**51,339**
Total Capital Requirement - %		**15.3%**

Capital Adequacy Ratio of the Bank as at 31 December 2016 is as under:

- Risk Weighted Assets - £ 000'	336,541
- Regulatory Capital - £ 000'	83,031
- Capital Adequacy Ratio - %	24.67%

6. The Internal Capital Adequacy Assessment Process (ICAAP)

The Bank's capital adequacy assessment process demonstrates its sound and effective Risk Management Framework. The ICAAP has been structured to evidence the on-going processes established to ensure existing and new risks to the Bank's corporate objectives and operations are promptly identified and the impact assessed to ensure the Bank has sufficient capital to meet these risks.

The document quantifies the risks in the Business Plan and summarises the impact of those risks on capital. Having assessed the risks, the document sets out the management and mitigation of these risks.

The ICAAP is undertaken annually ensuring the Board governing process that includes reviews and approvals. ICAAP process includes the analysis of the Pillar 2 capital required in addition to the risks not covered under Pillar 1 requirements. Additionally this process also accounts for various stress testing exercises and their potential impacts on Bank's capital and profitability.

The upfront and more than adequate capital demonstrate the commitment of the group to operate a sustainable and viable franchise in the UK. The ICAAP also demonstrates the adequacy of non-financial resources (in the form of people, systems, policies and procedures) to manage the adequacy of these financial resources on an on-going basis.

7. Leverage Ratio

The Basel III framework introduced a simple, transparent, non-risk based leverage ratio to act as a credible supplementary measure to the risk-based capital requirements. The leverage ratio is intended to:

- restrict the build-up of leverage in the banking sector to avoid destabilising deleveraging processes that can damage the broader financial system and the economy; and
- reinforce the risk-based requirements with a simple, non-risk based "backstop" measure.

The Basel III leverage ratio is defined as the capital measure (the numerator) divided by the exposure measure (the denominator), with this ratio expressed as a percentage:

- Leverage ratio = Capital measure / Exposure measure

The PRA has proposed that the leverage ratio requirements will apply to all banks from 1 January 2018. This proposed requirement comprises of a minimum ratio of 3%. As at 31 December 2016 Bank has a leverage ratio of 9.6%.

8. Impairment Provisions

Impairment reviews including recommendations for new impairment provisions or releases of previously recognized impairment provisions are carried our regularly. These include both specific and collective impairment provisions.

Certain factors determine whether a specific impairment / individual should be considered, and these include, but are not limited to:

- Significant financial difficulty of the borrower;
- A breach of contract such as default or delinquency in payment of interest or principal;
- Forbearance, where the Bank, for economic or legal reasons relating to the borrower's financial difficulty, grants to the borrower a concession that it would not otherwise consider;
- It becoming probable that the borrower will enter insolvency or other financial reorganization;
- The disappearance of an active market because of financial difficulties; or
  Observable data indicating that there is measurable decrease in the estimated future cash flows.

In addition, a collective impairment assessment has been carried out for a set of financial assets with similar risk characteristics using management's best judgement. This involves application of judgemental assumptions including impairment on default and forced sale discounts supported by discounted cash flow analysis prepared on a case by cases basis for the relevant assets, which are impaired as at the period end.

The Bank reviews all loans and advances on an individual and collective basis at each balance sheet date to assess whether an impairment loss should be recorded in the income statement. Individual and collective impairment is calculated in the following manner:

Individual impairment
In particular, judgement by management is required in estimation of the amount and timing of future cash flows when determining the impairment loss. In estimating these cash flows, the Bank makes judgements about the borrowers' financial situation and the net realisable value of collateral. These estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the impairment loss allowance.

Collective impairment
The Bank also accounts for collective impairment provision. The assumptions used involves the use of historical information related to past loan losses, which is supplemented with management judgement to assess whether current economic and credit conditions are such that the actual level of inherent losses which have been incurred but not reported is likely to be greater or less than that suggested by historical experience.

Movement for Provision for impairment during the year 2016 was as follows:

	£ 000'
Balance transferred from branch as at 01 April 2016	16,012
Impairment charged to profit and loss	2,345
Recovered/reversed during the period	(1,050)
Written off/ others	(446)
Total provision for impairment *	16,861

* This includes the collective provision of £1.2million

9. Asset Encumbrance

Certain assets are pledged as collateral to secure liabilities under Credit Support Annex ("CSA") for derivative liabilities and as security deposits relating to FX forward transactions. The holders of these securities do not have the right to sell or re-pledge the asset except where specifically disclosed. The aggregate amount of collateral pledged under CSAs is £150,000.

10. Employee Remuneration Policy

10.1 Remuneration governance and decision-making

The UK Human Resource Committee (the HRC) assists the Executive Committee in employees' development strategies and plans, including their Continuous Professional Development. The HRC review and approve performance appraisal process. It ensure that the Bank has put in place required procedures to ensure effective implementation and continuous compliance with the requirements of all relevant UK employment rules and regulations including Senior Management and Certification Regime.

The Board is responsible for review and approval of Bank's HR Policy including remuneration practices. The Board on the recommendation of Chief Executive Officer approves annual staff remuneration plan for the year along with total remuneration for senior executive staff.

10.2 Performance and reward

The Bank's remuneration policy is in line with market practice and is weighted towards performance-based development. The Bank is fully cognisant of having a remuneration policy, which is aligned with its long-term objectives and can provide support in the successful implementation of its business strategy. The remuneration policy has been developed while keeping in view the core values of the Bank, which has trust as its core supported by integrity, team work, respect, responsibility and commitment. Values are upheld continuously and embedded at all levels of the organization.

The Bank recognises that robust performance assessment is essential for the sustained success and development of the Bank and its employees. The Bank's performance assessment creates a shared vision of the purpose and aims of the Bank and ensures that each employee understands how he or she makes their contribution.

Performance is reviewed annually against pre-defined measures and efforts are recognized through a combination of monetary and non-monetary benefits. The performance management framework is managed through the Bank's HR Committee and senior executive management.

The Bank's objectives, organisation structure, and HR policies are integrated for best results. This works within an effective control framework and focus on the customer in order to implement the Bank's business strategy.

The Bank's remunerations structure is not linked to any pre-defined business targets for front-end staff. Annual performance rewards are based on overall performance of the Bank and then of the employee based on overall achievement during the year. A key consideration given in evaluating the performance of employees is there overall conduct and compliance with relevant rules and competencies demonstrated during the year.

Annual performance is a self- assessment process where employees assess their own performance against their job profile, which is evaluated, agreed objectives with the line manager. Compliance function also provides their input in on adherence of certification regime staff with their required competencies

HBZ has been designated as a Level 3 firm by the FCA and as such is not required to have a deferral policy. There is no deferred portion of bonus applicable, and the bonus is paid in cash only). There are currently no Long Term Incentive Plans or other executive incentive schemes in place and Bank has no plans to implement any in the future.