Habib Bank Zurich Plc – Pillar 3 Disclosures

31 December 2017

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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 revised Pillar 3 disclosure requirements issued by Basel Committee of Banking Supervision (BCBS) on January 2015 and Pillar 3 disclosure requirements – consolidated and enhanced framework issued by BCBS on March 2017. The information is based on data as at 31 December 2017.

The March 2017 BCBS Pillar 3 disclosure document requires the institutions to disclose composition of capital, the leverage ratio, the Liquidity Coverage Ratio (LCR), the Net Stable Funding Ratio (NSFR), the countercyclical capital buffer, interest rate risk in the banking book and remuneration.

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 Total Capital Requirement (TCR) 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.

1.1.5 Leverage ratio disclosure requirements as per BCBS, Basel III leverage ratio framework and disclosure requirements, January 2014.

1.1.6 The BCBS committee issued disclosure requirements for the LCR and NSFR in January 2014 and June 2015 respectively.

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 2017. 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.

1.4 Principal activities

The Bank offers standard commercial, SME and retail products combined with personalised relationship management. Service is delivered through the branch managers, specialist lending relationship managers and personal bankers for deposit mobilisation. The customer takes comfort in continuity with a relationship manager and quick turnaround on their requests as well as continued access to the decision makers at the Bank.

The products offered to its customers include retail banking, saving accounts and deposits, commercial lending, trade finance, Internet deposits, cash management and treasury services. The Bank is covered by the Financial Services Compensation Scheme (FSCS).

1.5 IFRS 9

The Bank has adopted IFRS 9 “Financial Instruments” from 1st January 2018. The Bank has updated its relevant credit processes and impairment requirements which relates to model and data governance, credit impairment and value adjustments. ICAAP document has been updated to incorporate these changes. To arrive at an Expected Credit Loss (ECL) in relation to financial assets held by the Bank, models have been developed with support of external consultants, which underwent detailed user acceptance testing. The Bank has completed the process of assessing the initial impact of ECL, which mainly relates to lending portfolio.

The Bank has followed a simplified approach in designing ECL methodologies, which are commensurate with its size, complexity, structure, economic significance and profile of exposure. The approach taken is considered proportionate in the context of the size of the Bank within the UK financial market, its relative lack of complexity as well as minimal volatility in its credit losses over the past five years.

IFRS 9 Impairment applies to financial instruments that are not measured at fair value through profit and loss (FVTPL). Financial assets falling within the scope of impairment are provided for by calculating their Expected Credit Loss (ECL). This requires considerable judgement regarding how changes in economic factors affect ECLs, which will be determined on a probability-weighted basis. ECL is an estimate of present value of cash shortfalls over the life of the financial instrument, and is computed as a product of probability of default (PD), loss given default (LGD) and exposure at default (EAD). The present value of cash shortfalls is calculated by taking into account the time value of money and forward-looking information.

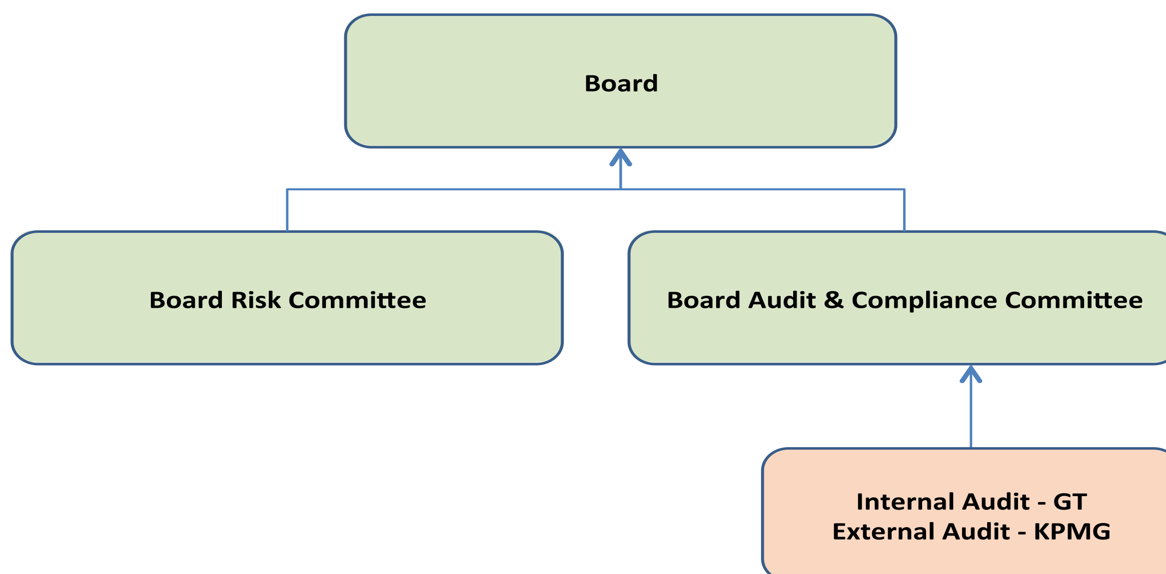
2. Governance Framework

The Governance and Control framework of the Bank is managed through a Board Structure and a Management Committee Structure. The Board structure comprises of a Board of Directors, which acts as the highest governance authority in the organisation and two Board Committees namely, a Board Risk Committee and a Board Audit and Compliance Committee.

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.

The Board's responsibilities specific to risk include:

- 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
- Ensure that an appropriate risk culture is embedded in the Bank.
- Review and approval of the Enterprise Risk Management Framework.
- Approval of the Bank's ICAAP, ILAAP, Recovery and Resolution Plan

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 Board Audit and Compliance Committee

Board Audit and Compliance Committee (BACC) oversees and challenges the internal audit, external audit functions and Compliance function to ensure that governance arrangements, and system and internal

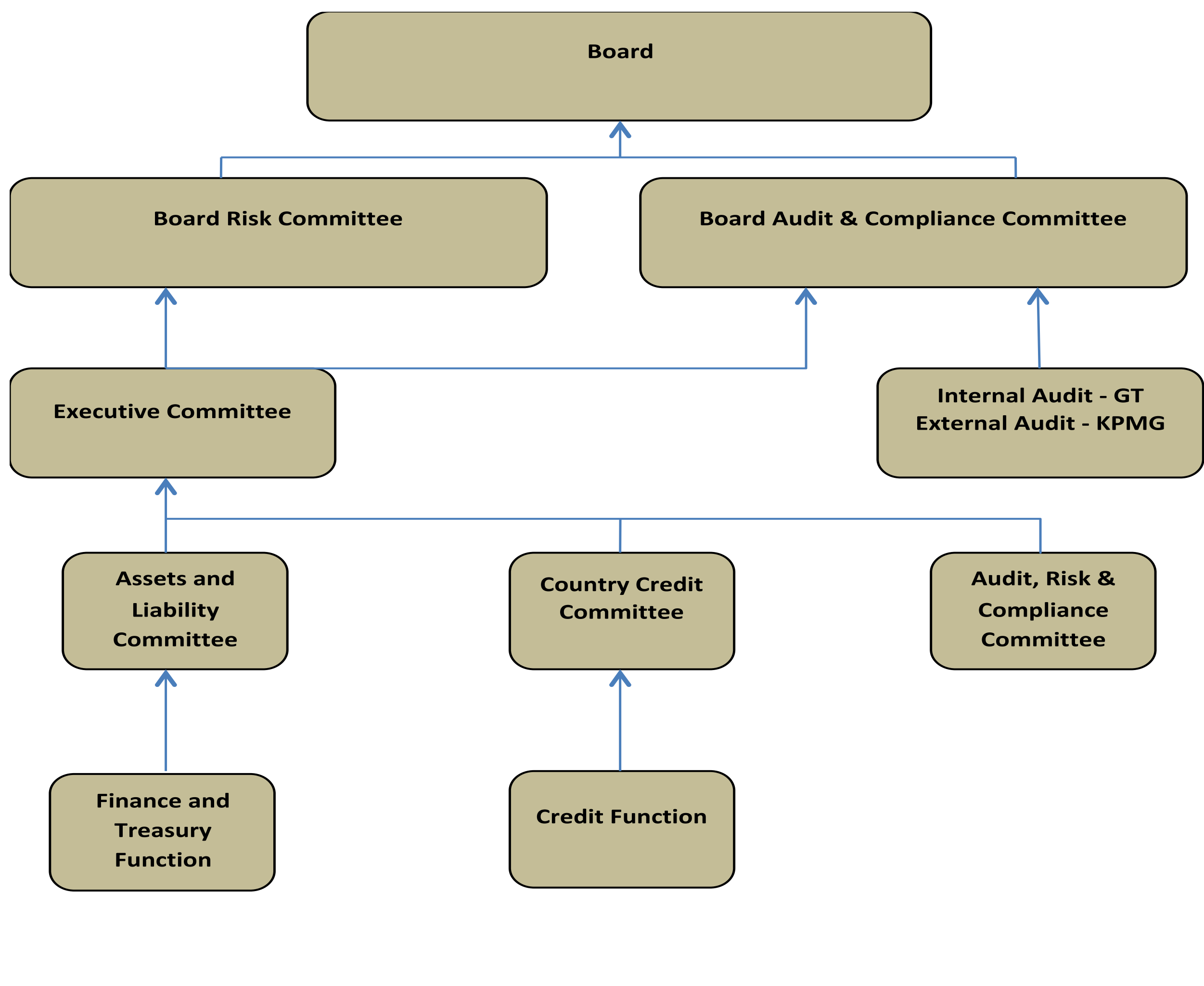
controls are evaluated and managed properly. BACC reviews and approve key financial risks, assess effectiveness of system of financial reporting. The Committee also approve accounting policies and changes therein to comply with the requirements of International Financial Reporting Standards.

2.1.4 Management Responsibilities

The Management committee structure comprises of the Executive Committee ("EXCO) and five sub-committees. The EXCO presides over the committees and is responsible for implementing Bank's strategic objectives and managing the business with adequate controls within the risk appetite of the Bank.

The ALCO is the responsible committee to review and recommend to the EXCO the capital calculations, capital structure and the ICAAP. The EXCO reviews and further recommends the same to the Board through the BRC for its consideration, review and approval.

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



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.

2.1.5 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.

2.1.6 ALCO

ALCO ensures that Board approved capital and balance sheet strategies and policies are appropriately executed. ALCO oversee the development and implementation of appropriate risk measurement strategies, risk tolerance, policy and stress testing as approved by the Board.

The ALCO ensures that capital risk management limits are established and communicated in a manner that allows all levels of management to clearly understand the Bank's approach to managing the capital risk. This is carried out by ALCO through implementation of appropriate procedures and systems and controls.

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 process.

Members of ALCO monthly review the capital position of the Bank. In addition changes in the assets book is monitored by the EXCO on a daily basis. As part of Enterprise Risk Monitoring, the Audit Risk & Compliance Committee monitors capital related compliance and thresholds/breaches.

2.1.7 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.

2.1.8 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

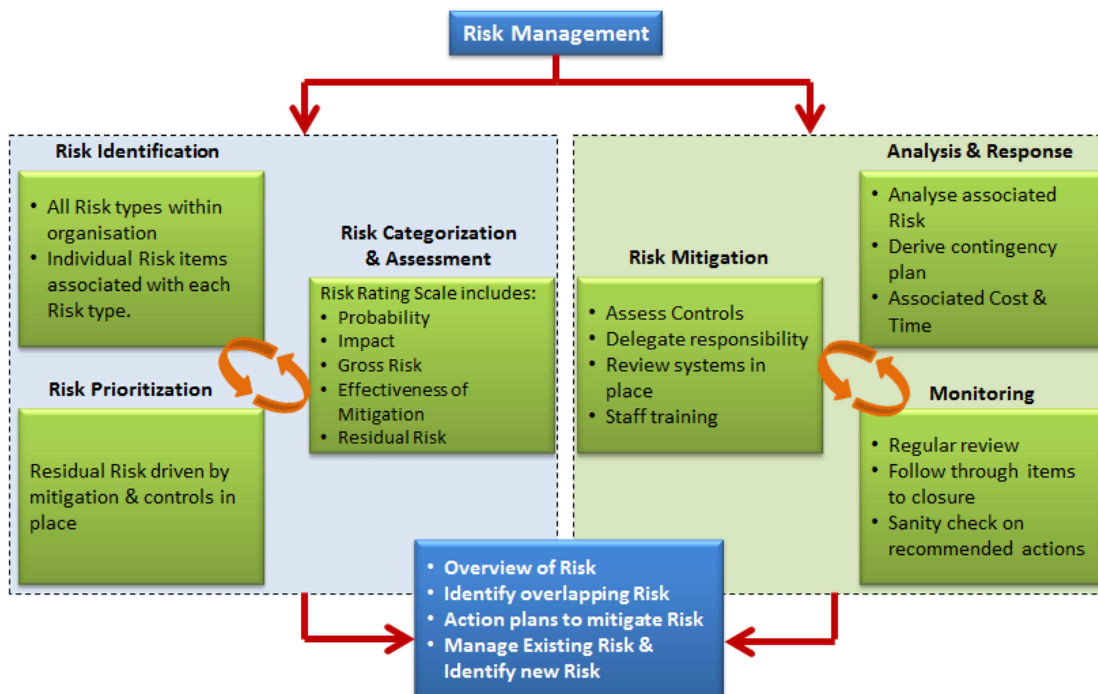
The Bank's Risk Management Strategy and its Risk Appetite are derived from its Strategic Intent leading to the optimum risk appetite with thresholds for monitoring and Risk mitigation.

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 Strategic Intent

Strategic Intent	Service with Security				
Brand Promise	Dedicated to focus on the customer, give full measure and to aim to deliver beyond the commitment				
Values	Trust, Integrity, Responsibility, Respect, Commitment, Teamwork Staff to work with Integrity, Discretion, Fairness and provide personalised customer service going the extra mile while remaining within the ambit of ethics and regulations				
Approach	As a community bank, to focus on delivering personalised service with security to a broad base of business and personal customers from our niche markets				
Commitment to Stakeholders	**Customers** To provide a range of products aligned to the needs of the target market in a relationship based banking service with focus on fairness and transparency	**Our People** To provide a platform and environment for professional growth and enable individuals to achieve their potential	**Communities** Maintain and enhance the brand image dedicated to Trustworthiness and Service standards	**Investors** Sustainable growth and superior return to shareholders	**Regulators** Be compliant with regulatory requirements and maintain open and transparent relationship

3.4 Overall 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).

The Overall Risk Appetite of the Bank is set out below:

Capital

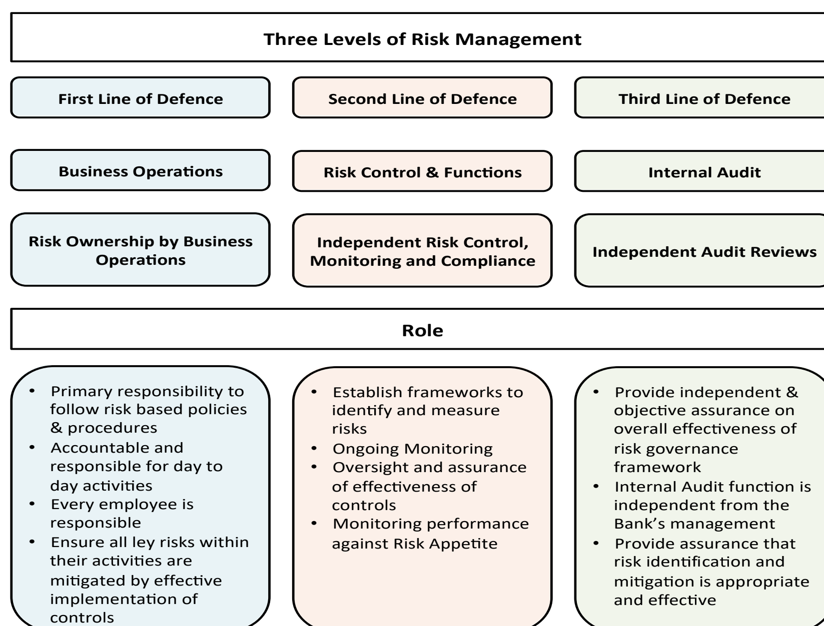
- Maintain capital of 2% over and above the minimum regulatory capital requirement.

Liquidity

- Minimum survival period of 90 days under firm own stress test
- Minimum LCR of 120%
- AD ratio not to exceed 100%

3.5 3 Lines of Defence

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



3.5.1 Risk Governance - roles and responsibilities

First Line of Defence
As the first line of defence, the business functions, as the owners of the risk manage exposures arising in the Bank on a day-to-day basis. These business functions may be the front office, the back office or support functions.
The business functions identify, assess, control, and mitigate risks. As the first line of defence, they are also responsible for implementing corrective actions to address any process and control deficiencies. They also develop and implement internal policies and procedures ensuring that activities are consistent with goals and objectives of the Bank. The relationship managers also review and escalate any credit issues related to lending customers to the Country Credit Committee (CCC) to ensure timely action. This process has been re-emphasized during the implementation process of IFRS9 to avoid erratic movement between Stage 1 and Stage 2.

Second Line of Defence
The Bank has established a second line of defence to help build and/or monitor the first line of defence controls and provide appropriate challenge to assumptions and assertions made by the business. At the Bank typically Risk, Compliance and Finance act as the second line of defence, however if these departments are the owner of a business process and act as first line of defence, then other departments become the second line of defence.

These functions facilitate and oversee the implementation of effective risk management and assist risk owners in defining the target risk exposure and reporting adequate risk-related information to the Bank, the Parent Bank and to the Regulators.

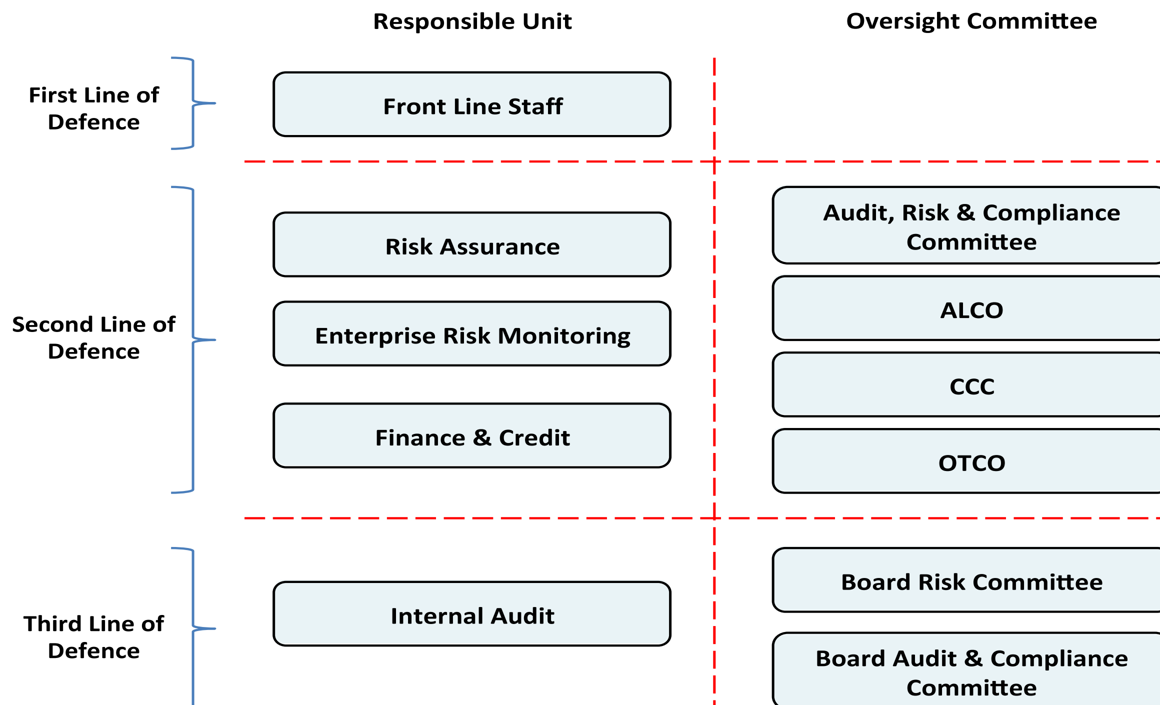
The senior management and committees such as ALCO, EXCO and ARCC are also part of overall second line of defence providing an oversight, challenge and monitoring of the adequacy and implementation of effective internal control and risk management practices.

With the implementation of IFRS9 the second Analytics function working under Head of Credit closely monitors overdue accounts and providers reminders to relationship managers for recovery and identification of problems loan at an initial stage. This process is reviewed at CCC and other sub committees such as Credit Policy and MI and Remedial Management committee.

Third Line of Defence
Audit, as the third line of defence provides independent assurance on the operations and the performance of the first two lines of defence. The Board Audit and Compliance Committee (BACC) has defined the internal audit program and outsourced the performance of the internal audit function to an independent audit firm in order to provide assurance on the efficiency and effectiveness of operations, safeguarding of assets, reliability and integrity of reporting processes and compliance with laws, regulations, policies, procedures, and contracts.

The BRC provides oversight to the overall effectiveness of enterprise risk management framework.

Three Lines of Defence Oversight Process:



The Bank regularly review, monitor and update the 3LOD model to ensure it remains current as part of overall review of Risk Management Framework.

3.6 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 a 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. It is also measured in terms of credit losses or provisions charged to the profit and loss account. Qualitative information also used to assess issues related to the effectiveness of the risk appetite.

The Bank's risk appetite statement is approved by the Board of Directors (BOD), 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 (ARCC).

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-	64,610,164	84,427	-	79,252,690	-	-	**143,947,281**
A+ to A-	-	184,121	-	11,390,601	-	-	**11,574,722**
BBB+ to B-	-	56,404,777	-	-	7,749	11,587,107	**67,999,633**
Unrated	986,879	2,786,307	379,996,167	-	271,506	40,222,464	**424,263,323**
	65,597,043	**59,459,633**	**379,996,167**	**90,643,291**	**279,254**	**51,809,571**	**647,784,959**

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	64,610,164	-	-	79,252,690	-	-	143,862,854
Financial Institutions	-	59,459,633	-	11,390,601	7,749	12,281,379	83,139,362
Industrial & commercial	-	-	310,923,270	-	271,506	37,475,611	348,670,387
Individual	-	-	69,072,896	-	-	2,052,581	71,125,477
Other	986,879	-	-	-	-	-	986,879
	65,597,043	**59,459,633**	**379,996,167**	**90,643,291**	**279,254**	**51,809,571**	**647,784,959**

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	65,597,043	22,753,905	337,697,945	4,354,852	271,697	36,949,924	**467,625,367**
Europe excluding UK	-	2,671,362	6,259,896	71,398,991	7,557	11,553,839	**91,891,646**
Asia	-	24,336,714	13,463,736	-	-	23,214	**37,823,664**
North America	-	203,112	17,676,963	-	-	220,370	**18,100,445**
Africa	-	9,193,114	4,897,627	-	-	3,062,224	**17,152,965**
United States of America	-	255,381	-	14,889,447	-	-	**15,144,828**
Australia	-	46,044	-	-	-	-	**46,044**
	65,597,043	**59,459,633**	**379,996,167**	**90,643,291**	**279,254**	**51,809,571**	**647,784,959**

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. The fair value of collateral and security enhancements held against loans or advances to customers is shown below:

Collateral Type	2017		2016	
	Collateral Value	Advances	Collateral Value	Advances
Commercial real estate	558,914,497	268,466,689	590,706,965	215,654,178
Residential real estate	224,692,811	95,359,453	231,826,630	99,640,670
Cash collateral	36,840,896	24,420,145	32,593,707	14,745,244
Other collateral	2,331,453	1,049,011	6,290,179	1,415,779
Guarantees	300,000	280,878	5,479,839	2,138,491
Unsecured	-	3,296,489	-	33,661,791
Total	**823,079,657**	**392,872,665**	**866,897,320**	**367,256,154**

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.

Following table provides the breakdown of credit risk exposures post credit risk mitigation (CRM) and credit conversion factors (CCF) as at December 2017 segregated as per the sectors:

Amount in £

Exposures as per Sectors	On Balance Sheet 2017 (£)	Off Balance Sheet 2017 (£)	Total 2017 (£)	Total 2016 (£)
Retail	29,480	-	29,480	51,363
Secured by mortgages on immovable properties	244,522,342	-	244,522,342	226,194,651
Exposures in default	31,876,878	-	31,876,878	22,399,021
Contingencies and commitments	-	13,572,986	13,572,986	20,292,832
Institutions	22,473,403	-	22,473,403	16,246,858
Corporates	-	-	-	8,980,000
Counterparty credit risk	-	407,034	407,034	669,208
Other	17,119,115	-	17,119,115	15,193,418
	316,021,218	**13,980,020**	**330,001,238**	**310,027,351**

Following table provides the breakdown of credit risk exposures post credit risk mitigation (CRM) and credit conversion factors (CCF) as at December 2017 as per geographical breakdown:

Country wise Exposures	2017	2016
United Kingdom	279,204,588	297,128,103
Europe excluding UK	9,087,676	1,957,689
Asia	15,069,249	2,116,946
North America	14,735,742	1,026,521
Africa	8,698,372	3,011,363
United States of America	3,196,403	4,774,944
Australia	9,209	11,785
	330,001,238	**310,027,351**

4.1.6 Credit Risk Mitigation (CRM)

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 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.

4.3 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.

4.4 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.

4.5 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. 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 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 £

2017	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	65,597,043	65,624,480	65,624,480	-	-	-	-
Due from banks	59,459,633	59,959,783	32,994,138	26,389,416	576,228	-	-
Loans & advances to customers	379,996,167	424,842,682	42,278,118	7,730,488	21,360,472	71,952,268	281,521,337
Financial investments							
- Available for sale	90,643,291	91,672,029	3,722,859	-	20,458,184	53,820,092	13,670,894
	595,696,133	**642,098,975**	**144,619,595**	**34,119,904**	**42,394,884**	**125,772,360**	**295,192,231**
Derivative assets							
Risk management	279,254						
Outflow		12,661,562	2,651,577	4,887,832	5,122,153	-	-
Inflow	-	(12,409,172)	(2,585,360)	(4,754,305)	(5,069,507)	-	-
	279,254	**252,390**	**66,217**	**133,527**	**52,646**	**-**	**-**
Financial liability by type							
Non-derivative liabilities							
Due to banks	15,847,500	(15,847,692)	(15,847,692)	-	-	-	-
Due to customers	495,251,794	(498,173,204)	(263,951,613)	(74,972,248)	(158,807,252)	(45,000)	-
Subordinated liabilities	20,000,000	(20,179,000)	-	-	-	(20,179,000)	
	531,099,294	**(534,199,897)**	**(279,799,306)**	**(74,972,248)**	**(158,807,252)**	**(20,224,000)**	**-**
Derivative liabilities							
Risk management	225,482	-	-	-	-	-	-
Outflow	-	10,360,308	2,453,510	4,757,717	3,149,081	-	-
Inflow	-	(10,316,614)	(2,266,926)	(4,865,531)	(3,184,157)	-	-
	225,482	**43,694**	**186,584**	**(107,814)**	**(35,076)**	**-**	**-**

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.

5.1 Liquidity risk management (EU LIQA)

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 liquidity and funding management and liquidity oversight ranges from high-level annual strategic plans and firm wide management engagement in stress-testing exercises, through to daily liquidity monitoring and management. The Bank has established and continues to develop a business strategy of balanced and manageable growth in light of known capital and funding resources and the prospective economic environment.

5.2 Liquidity and funding risk management governance

The Bank has a governance structure in place to ensure that its liquidity position is kept under close review, principally under the supervision of the ALCO. Treasury department is responsible for day-to-day management of liquidity and funding. Finance Department is responsible for daily monitoring and reporting

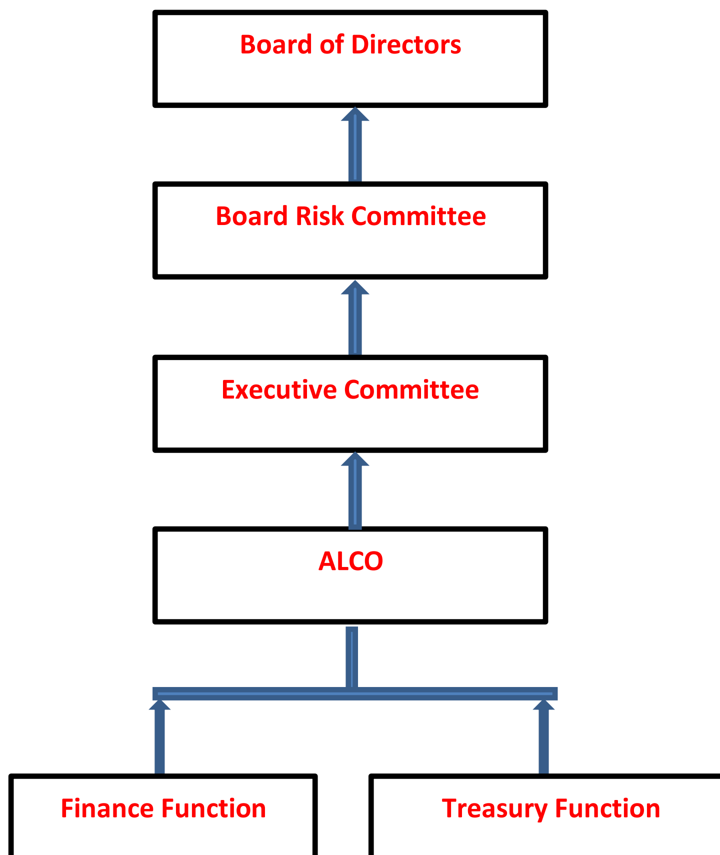
on liquidity positions. Risk management as part of Enterprise Risk Management Framework keeps an oversight on the liquidity risk indicators. The ALCO and EXCO get the daily liquidity MI that includes regulatory thresholds as well as the assurance on the Bank's 90 days survivability.

The primary goal of liquidity risk governance is to establish operating parameters and hold people accountable for performance. The Bank has established a governance framework to ensure that all risks are covered adequately and monitoring is effective at all levels.

The model helps the Bank's stakeholders in effective and efficient risk management as it provides a simple and effective way to enhance communications on risk management and control by clarifying essential roles and duties under the departmental level Functional Charters.

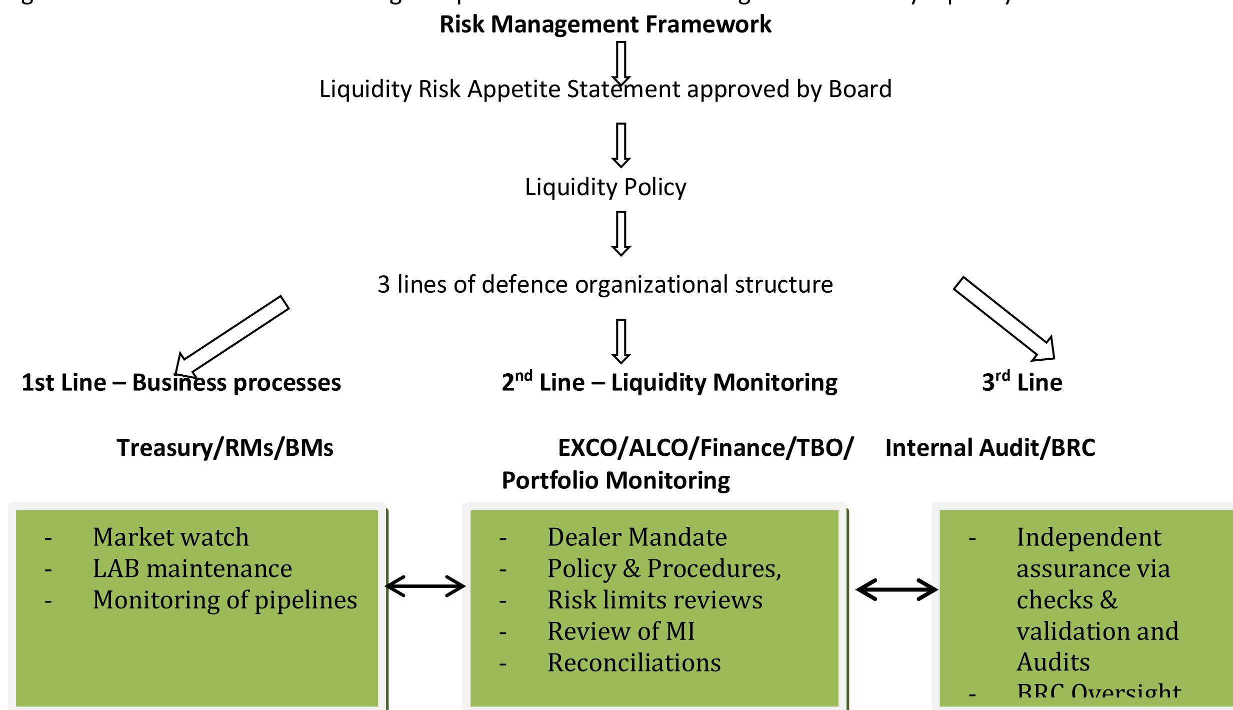
The Bank has undertaken an assessment regarding the adequacy of its liquidity risk management processes against the requirements of OLAR and SS24/15 issued by. The Board understands that while a strong capital base provides a level of comfort against losses and market uncertainties, an effective liquidity risk management framework allows the Bank protection against uncertainty of not meeting liabilities as they fall due. An effective risk management process must not see different risk in silos, as a credit default could lead to liquidity risk. Therefore, greater emphasis is made on developing an integrated view of risk across all the risk types.

5.3 Liquidity governance structure



5.4 Three lines of defence

The Bank has implemented the 3 lines of defence model (as summarized below) to further enhance governance & control and ensuring independent assurance of mitigation of the key liquidity risks.



5.5 Liquidity risk drivers and limits

The Bank manages its liquidity risk at both strategic and operational level. The Liquidity Risk Management Framework has been embedded into the organization at all levels, which is monitored at the strategic level through effective governance arrangements, which includes risk appetite and policy implementation and monitoring. The bank has defined its liquidity risk appetite in both quantitative and qualitative terms for monitoring.

At operational level the monitoring is carried out through review of internal and external reports and monitoring of treasury operations. The Bank's Liquidity Risk Appetite Statement is attached in the Appendix; however key monitoring items are summarized below:

Some of the key risk drivers, which the ALCO monitors, are set out below:

Risk Drivers	Risk Limits	30/06/2018 position	Responsibility	Monitoring frequency
Minimum Survival Period	The Bank will maintain net cash flow which will be less than HQLA over 3 months period	Complied	ALCO	Semi-Annually by Finance
LCR	The bank maintains LCR at all time in excess of 110%	244%	ALCO	Daily by finance
NSFR	The bank maintains NSFR at all time in excess of 100%	140%	ALCO	Monthly by finance
AD Ratio	AD Ratio will be kept at maximum 100%	74.7%	ALCO	Daily by finance
Deposit concentration	▪ No deposit from a single customer to exceed 10% of total deposit amount ▪ Total amount of top 10 depositors' balance not to exceed 30% of total deposits	Complied	ALCO	Weekly by finance

Maximum open currency exposure	Maximum up to £1 million with maximum of £250,000 in a single currency	Less than £500k	ALCO	Daily by treasury function
Marketable Investments	The Bank does not invest in any marketable instrument which has a maturity of more than 5 years Market price variation of 5% on LAB eligible securities	Complied	ALCO	At the time of new investments by the Treasury function Weekly valuation of LAB assets

The Bank has considered the ten liquidity risks as prescribed under OLAR and classified the same into material and less material/less relevant risks to the Bank.

The table below sets out the material risks:

Risk Indicators	Mitigation	Monitoring
Retail funding risk	▪ The Bank's business strategy is mainly based on personalised banking which is relationship based for affluent customer class. Over the years this strategy has helped the Bank in developing a sticky customer base, which is unlike the volatile deposits generated through and offering high interest rates. ▪ This is also demonstrated by 50% of the customers having relationship of more than 5 years ▪ The Bank has a small portion of retail deposits generated through Fixed Rate Bonds (FRB)(Internet deposits) since it was launched in 2016.	▪ Monitoring is performed by ALCO in monthly meetings through review of inflow and outflow deposits in general and top customers in particular. ▪ Analysis of deposits covering - Types of deposits - Customers' type - Maturities – original and residual - Cost - Currencies ▪ Percentage of retail deposits vs wholesale ▪ Fixed Rate Bonds-FRB (internet deposits) are not likely to exceed 10% of total deposits by 2020 Bank on a daily basis monitor inflow of funds from FRB
Funding concentration risk	▪ The Bank has put a limit of 10% as maximum amount of deposit from a single customer. ▪ Total amount of top 10 depositors' balance not to exceed 30% of total deposits.	ALCO monitors the risk monthly
Liquidity coverage ratio (LCR)	▪ Bank's HQLA over the net cash outflows over 30 days. It measures the Bank's very short-term liquidity adequacy.	The Bank maintains sufficient HQLA against the net cash outflows over a 30 days horizon on a daily basis. The Bank maintains its LCR above regulatory threshold at all times and monitors daily. Internal threshold is 120% against the regulatory requirement of 100%.
Funding tenor risk (survivability period)	▪ Bank's minimum survivability in terms of the liquidity adequacy is at least 3 months. The survivability is as net positive cumulative cash flows after taking into account of its HQLA and other highly liquid marketable securities on any given day within the next 3 months from any cut-off date.	The Bank actively monitors its survivability on day-to-day basis. The Bank has also applies a haircut of 2.5% on the HQLA while calculating the net cash flows over 90 days.
Low point/ Cliff Risk	▪ Deposit maturity profile is monitored by ALCO	Granular LCR for 1-90 day is produced bi annually as part of the stress testing regime, both with prescribed and Bank own assumptions
Other Risk Drivers considered less material/relevant		
Wholesale funding risk	▪ The Bank does not have any material wholesale funding risk. The outflow from SME deposits is adequately covered by inflow by interbank placement ▪ The SME deposits classified as wholesale deposits are from business, which have long-term relationship with the bank. These businesses are owned individuals from South Asian diaspora, falling within the Bank's target market. The Bank considers these deposits to remain sticky even under stress conditions.	▪ Finance function monitors the risk on daily basis through review of deposit outflows ▪ Monthly review by ALCO

	▪ This is also demonstrated by 50% of the customers having relationship of more than 5 years	
Net stable funding ratio (NSFR)	The Bank's Available Stable Funding (ASF) over the Required Stable Funding (RSF) i.e. NSFR = ASF / RSF, where: i) ASF captures all funding sources, weighted by stability factors; and ii) RSF captures all assets and off-balance-sheet commitments, weighted by illiquidity factors.	The Bank has a 5 year subordinated loan, which cannot be recalled by the Parent Bank before the expiry of the term ending on March 2021. Rate is re-priced on a 6-month basis as per the terms of the loan agreement. ▪ The Bank meets the regulatory threshold of 100%.
Intra-day liquidity risk	▪ Except for being a direct clearing member of Image Clearing System for cheques the Bank does not directly participate in any other payments systems. The Bank keeps £3.0 million in reserve account with BOE determined on stressed net flow to cover any clearing obligation. ▪ The Bank maintain working capital of £ 10 million in Nostro account or short term placement with UK banks ▪ Funds are maintained with RBS to meet clearing requirements ▪ Funds maintained with BOE are significantly higher than required to meet the LCR.	▪ Treasury reviews daily inflows and outflows and coordinates with the Relationship Manager network for expected cash flows. ▪ Lending inflow and deposit maturities are monitored through system generated reports ▪ Treasury has access to lending pipelines to review expected outflow. Treasury also coordinates with Credit Administration Department (CAD) as to the expected dispersal dates.
Intra-group liquidity risk	▪ N/A	N/A
Cross-currency liquidity risk	▪ The Bank's assets and liabilities position in different currencies is fairly matched ▪ Funds received in USD are placed in interbank market and/or in investment portfolio either in HQLA or corporate/FI assets. ▪ ZAR deposits received as collateral against trade finance facility are placed on matching basis in interbank market ▪ The Bank's net open currency position should not exceed £1 million or sub-currency limit of £250,000. ▪ Majority of FX trades are spot with low volume of forward transactions. Usually the NOP is less than £250,000.	▪ Daily monitoring is performed by Treasury department ▪ Currency wise position is monitored through system based reports with input from trade finance, CPU and CAD ▪ The system also allows Treasury to see the FX open position (whether long or short) in the original currency. ▪ If the FX exposure limit is breached, Treasury can access system based report, which will give a breakdown for all cross currency transactions done on any given day. This is a useful tool as it will break down all transactions passed, not only generated by Treasury, but across the HBZ UK network. It breaks it down by currency and will also tell Treasury what FX rate has been applied.
Off-balance sheet liquidity risk	▪ The Bank's off balance sheet exposure mainly comprises of unutilised LC balances and bankers acceptances, which are secured against collateral ▪ The Bank monitors undrawn loan commitments, which typically does not exceed £30 million. ▪ Overdraft facilities mostly remain utilised up to 90% by customers ▪ The Bank does not provide any liquidity support in respect of its off-balance sheet activities beyond its contractual obligations ▪ The Bank has not provided any committed funding lines to any other bank or lending institutions ▪ The Bank does not support securitisation programmes ▪ The Bank has not issued any debt or commercial paper other than £20 million subordinated loan with the parent.	▪ Day to day monitoring by the Treasury of cash inflows and outflows from trade finance activities ▪ Daily monitoring of pipeline tracking report (lending commitments) by treasury ▪ Daily monitoring of FX forward sale and forward purchase position ▪ monthly tracking by ALCO of off balance sheet liquidity risk

Franchise - viability liquidity risk	▪ The Bank is a 100% owned subsidiary. ▪ The Bank's viability in the UK was demonstrated by real stress scenarios during 2007-2012. ▪ During and after the exit of half its deposit base under regulatory direction, the remainder of the deposit base remained stable; ▪ During the financial crisis of 2007-2010, the Bank actually experienced an inflow of customer deposits reflecting the trust in the Habib Brand. ▪ The Bank did not experience any outflows when it rationalised the deposit rates.	Board and EXCO to assess the impact of any regulatory action reputational risk related to the parent bank on UK operations
Marketable assets risk	Bank maintains HQLA and non-HQLA securities in GBP and USD with a maximum maturity of 5 years. Refer to the banks Investment Policy. ▪ Other liquid assets are funds placed in interbank market with short term maturity of up to 3 months ▪ These funds are placed with Banks having minimum investment grade rating ▪ All investment portfolio assets are unencumbered and available for sale. Interbank placements are up to 3-month tenor.	▪ Investments decisions including limits are based on an approved risk appetite statement from the Board. ▪ All treasury limits are also reviewed and approved by the Group to ensure compliance with counterparty limits on a group basis. ▪ Treasury operates within pre-approved limits set by ALCO, which is monitored monthly. ▪ Investment portfolio is monitored daily by the finance function with mark to market valuation carried out weekly.
Non-marketable assets risk	Due to market wide liquidity stress customers will pay with delays. Increased monitoring of customers with frequent delayed payments	Monitored by CCC in their meetings
Funding concentration risk	The Bank's main source of funding is customer deposits and shareholders' funds in the form of equity share capital and five years subordinated loan. The Bank does not rely on funding from credit institutions or participants of wholesale funding market for meeting its liquidity requirement. As the main source of funding is from customer deposits the ALCO during monthly meeting, reviews top depositor's balance. This should not exceed 30% of total deposits.	Monthly monitoring by ALCO

5.6 Summary of liquidity stress tests and outcomes

The Bank assesses the adequacy of its liquidity resources on an ongoing basis against the liquidity risk that it faces and, in particular, in respect of the outputs of the stresses. The stresses demonstrate that the liquidity profile held enables the Bank to meet its liabilities as they fall due.

The table below clearly demonstrates that the Bank has more than sufficient liquidity to meets its obligation under the 30 days period. LCR under the combined stress scenario reduced to 143%. However, this ratio is higher than both regulatory requirement of 100% and Bank's own internal requirement of 120%.

Description	Idiosyncratic Stress Test	Macroeconomic Stress Test	Combined Stress Test
Stress applied on various categories of retail and non-retail deposits*	15% to 50% top up of regulator's requirement	15% to 50% top up of regulator's requirement	100% top up of regulator's requirement
Deposit concentration risk	10% stress on large depositors	10% stress on large depositors	12.5% stress on large depositors
Stress applied on other wholesale liabilities	100% outflow on 30 days maturities	100% outflow on 30 days maturities	100% outflow on 30 days maturities
Stress applied on unfunded liabilities	20% outflow on 30 days maturities	20% outflow on 30 days maturities	25% outflow on 30 days maturities

Stress applied on undrawn lending commitments	30% top up of regulator's requirement	50% top up of regulator's requirement	50% top up of regulator's requirement
Stress applied on Nostro balances	10% stress applied	30% stress applied	20% stress applied
Stress applied on MM Placements	10% stress applied on 30 days inflow	50% stress applied on 30 days inflow	20% stress applied on 30 days inflow
Stress applied on Trade Finance inflow	30% stress applied on 30 days inflow	20% stress applied on 30 days inflow	10% stress applied on 30 days inflow
Net Outflow / HQLA requirement for LCR	£30m	£43m	£46m
HQLA maintained	£73m	£67m	£66m
LCR - Calculated	246%	157%	143%
LCR - Internal threshold	120%	120%	120%
Net Outflow / HQLA requirement with internal threshold	£35m	£51m	£55m
Excess / (short) HQLA maintained over internal requirement	£37m	£16m	£11m
LCR - Regulatory threshold	100%	100%	100%
Net Outflow / HQLA requirement with regulatory requirement	£30m	£43m	£46m
Excess HQLA maintained over regulatory requirement	£43m	£24m	£20m
Excess funds after meeting 90 days net outflow (Survivability)	£27m	£9m	£3m

5.7 Bank's liquidity contingency plan

The Bank has a sound and executable Liquidity Contingency Plan (LCP) for emergency circumstances to meets its liquidity requirements. The LCP contains number of actions for realization of the contingent funding. The EWIs under the LCP are monitored on daily basis and LCR, NSFR and survivability period of 90 days are calculated on daily basis. This demonstrates that liquidity risk management arrangements are appropriate and controls are in place.

6. 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.

	Amount in £
Called up share capital	60,000,000
Retained earnings	7,432,075
Available for sale reserves	307,719
Tier 1 capital before regulatory adjustments	67,739,794
Regulatory adjustments:	
- Available for sale reserves	(307,719)
Tier 1 capital after regulatory adjustments	67,432,075
Tier 2 capital (Subordinated liabilities)	20,000,000

6.1 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 Total Capital requirement (TCR) 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 2017 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 2017.

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.

6.2 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:

Amount in £	**Risk Weighted Assets**	**Capital Requirement**
Credit Risk	330,001,238	26,400,099
Operational Risk	29,496,600	2,359,728
Market Risk	443,148	35,452
Pillar 1 Total (8% of RWAs)	**359,940,986**	**28,795,279**
Pillar 2A (3.69% of RWAs)	**359,940,986**	**13,281,822**
Total Pillar 1 and Pillar 2A (11.69%) - TCR	**359,940,986**	**42,077,101**
PRA Buffer (1.76% of RWAs)	**359,940,986**	**6,334,961**
Capital Conservation Buffer (1.875% of RWAs)	**359,940,986**	**6,748,893**
Countercyclical Buffer (0. 5% of RWAs)	**359,940,986**	**1,799,706**
Total Capital Requirement - £ 000'	**359,940,986**	**56,960,661**
Total Capital Requirement - %		**15.825%**

Capital Adequacy Ratio of the Bank as at 31 December 2017 is as under:

- Risk Weighted Assets – Amount in £	359,940,986
- Regulatory Capital – Amount in £	87,432,075
- Capital Adequacy Ratio - %	24.29%

7. 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.

8. 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 2017 Bank has a leverage ratio of 9.92% (2016: 9.35%).

9. Impairment Provisions

The Bank assesses at each balance sheet date whether there is objective evidence that a financial asset or a portfolio of financial assets not carried at fair value through the profit or loss is impaired.

A financial asset or portfolio of financial assets is impaired and impairment losses are incurred if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the financial asset (a 'loss event') and that loss event has an impact on the estimated future cash flows of the financial asset that can be reliably estimated.

If there is objective evidence that an impairment loss on a financial asset or group of financial assets classified as held to maturity or *Loans and advances to customers* has been incurred, the amount of impairment loss is measured as the difference between the asset or group of assets carrying amount and the present value of estimated future cash flows from the asset or group of assets discounted at the effective interest rate determined on initial recognition.

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 2017 was as follows:

	2017 (£)	2018 (£)
Balance as at 1 January 2017	16,860,868	-
Balance transferred from branch as at 01 April 2016	-	16,011,820
Impairment charged to profit and loss	2,283,638	2,345,334
Recovered/reversed during the period	(2,462,518)	(1,049,760)
Written off/ others	(3,805,490)	(446,526)
Total provision for impairment *	**12,876,498**	**16,860,868**

* This includes the collective provision of £1.2million in which there was no movement during the year

10. 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.

11. Employee Remuneration Policy

11.1 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.

11.2 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.