



Habib Bank Zurich Plc – Pillar 3 Disclosures

31 December 2022

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1. Overview

1.1. Company information

Habib Bank Zurich plc (“the Bank”) was established as a 100% owned subsidiary of Habib Bank AG Zurich (HBZ or Parent bank) on 01 April 2016. The Bank acquired the operations of the UK branch of the Parent which was established in 1974, 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 the Capital Requirements Regulations, Part Eight and the rules of Prudential Regulation Authority revised disclosure requirements in the PRA Rulebook applicable from 1 January 2022 following the UK implementation of the remaining provisions of Capital Requirements Regulation II ('CRR 2').

The document includes information related to the Bank’s capital, liquidity, risk management and remuneration code and other relevant data. The Disclosures also provide useful information on the capital and risk profile and activities of the Bank.

The information in this document is based on data as at 31 December 2022, as appearing in the Audited Financial Statements for the year 31 December 2022. The statement has not been subjected to an external audit.

Audited Financial Statements can be found on website www.habibbank.com

2. Key metrics

The table below provides an overview of Bank's prudential regulatory metrics:

£000	2022	2021	2020
Share capital	70,000	70,000	60,000
Retained earnings	14,822	11,824	11,826
Common Equity Tier 1 Capital: instruments and reserves	81,361	81,824	71,826
Additional Tier 1 Capital	-	-	-
Total Capital (CET 1 + Tier 1)	81,361	81,824	71,826
Tier 2 Capital – Subordinated liabilities	20,579	20,386	20,540
Total Own Funds (CET 1 + Tier 1 + tier 2)	101,940	102,210	92,366
Total Risk-Weighted Assets	575,205	547,938	513,951
Risk-based capital ratios as percentage of RWA			
CET 1 ratio (%)	14.14%	14.93%	13.98%
Tier 1 (%)	14.14%	14.93%	13.98%
Total capital ratio (%)	16.43%	15.17%	16.32%
Capital Adequacy Ratio	17.72%	18.65%	17.97%
Additional CET1 buffer requirements as a percentage of RWA			
Capital conservation buffer requirement	2.50%	2.50%	2.50%
Countercyclical capital buffer (CCyB)* requirement	1%	-	-
Total of bank CET 1 specific buffer Requirement	3.5%	2.50%	2.50%
Basel III leverage ratio			
Total Basel III leverage ratio exposure measure	931,009	948,055	803,637
Basel III leverage ratio (%)	8.74%	8.63%	8.97%
Liquidity coverage ratio (LCR)			
Total high-quality liquid assets (HQLA)	108,775	107,915	117,491
Total net cash outflow	26,883	70,335	51,796
LCR ratio (%)	405%	153%	227%
Net stable funding ratio (NSFR)			
Total available stable funding	729,215	664,541	614,210
Total required stable funding	573,467	510,571	457,718
NSFR ratio	127%	130%	134%

3. Background

The Basel III regulatory framework commonly CRD IV are implemented through Capital Requirement Regulations (CRR) and Capital requirement Directive (CRD) requires firms to disclose quantitative and qualitative information on capital adequacy and key risks. Following Brexit, the United Kingdom ('UK') replicated the European prudential regime in UK legislation referred to as the Capital Requirements Directive ('UK CRD IV') and the Capital Requirements Regulation (575/2013) as amended by the Capital Requirements (Amendment) (EU Exit) Regulations 2018 ('UK CRR'). For the purpose of this document, references to CRD and CRR includes the equivalent legislation implemented into UK law.

Both CRD IV and the Basel framework set out a framework of regulatory capital requirements. The framework categorises the capital and prudential requirements under three pillars:

- Pillar 1 Minimum Capital Requirements, setting rules for the calculation of credit risk, counterparty credit risk, market and operational risk; and
- Pillar 2- Supervisory review, framing requirements for the institution to hold additional capital against risks that are not fully captured under Pillar 1. The subject process of assessing additional capital requirement to guard against risk elements, in addition to those categorised under Pillar 1, is adequately supported by the institution's internal models and assessments support. The details of the subject assessment are contained in the Bank's "Internal Capital Adequacy Assessment Process" ("ICAAP"), narrating the underlying assumptions and elements of related assessment. The adequacy of any additional capital requirement is also assessed by the PRA during its Supervisory Review and Evaluation Process and is considered while determining the overall capital resources required by the Bank.
- Pillar 3 – External communication which provides market participant key information about the Bank's capital, risk assessment process and risk exposure, which complements the TCR that allows market participants to assess the institution's capital adequacy.

3.1.1. The Bank maintains TCR through at least 75% of Common Equity Tier1 capital (CET1) and 25% from Tier 2.

3.1.2. Bank, as a mandatory requirement, maintains requisite CRD Buffers: i- Capital Conservation Buffer (CCB), designed to ensure that banks build up capital buffers outside periods of stress which can be drawn down as losses occur; ii- Countercyclical Buffer (CCyB), duly ensuring that banking sector capital requirements take account of the macro-financial environment in which bank operates.

3.1.3. PRA also sets a buffer called 'PRA Buffer' which is in addition to TCR and CRD buffers.

3.1.4. Leverage ratio disclosure requirements as per BCBS, Basel III leverage ratio framework and disclosure requirements as updated from time to time.

3.1.5. The Leverage ratio calculated as Bank's capital measure divided by total exposure measure calculated as per Leverage Ratio (CRR) effective 1 January 2022.

3.2. 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 2022. Pillar 3 requires firms to publish a set of disclosures, allowing market participants to assess key pieces of information on that firm's risk assessment process, risk exposure and capital.

The Bank annually updates and publishes the aforesaid disclosures, aiming to provide information in addition to the one provided in the Annual Financial Statements. The said report, read in conjunction with Annual Financial Statements, with particular focus on the sections concerning risk, liquidity, leverage ratio, and capital management and corporate governance along with the related Notes to the Financial Statements, enables the reader to make a more informed and calculated decision in relation to the Bank. The Bank is a single entity in the UK and no consolidation is performed.

Pillar 3 Disclosures have not been prepared for any other purpose. Therefore, it does not constitute any form of financial statement of the Bank nor does it constitute a forward-looking projection of the Bank.

The Bank has prepared this document to ensure compliance with the Pillar 3 disclosure requirements set out in the UK CRR. The Bank does not seek any exemption from disclosure on the basis of materiality or on the basis of proprietary or confidential information.

3.3. Principal activities

The Bank's business model is built on delivering high-quality products and services and taking a long-term view on building customer relationships. The model is geared towards focusing on selected segments to deliver their strategic objectives.

The Bank's target market in the UK is primarily geared towards real estate investments, trading activities, services and small-scale manufacturing. Our customers' banking needs are catered by conventional and Islamic retail and commercial banking products.

The business lines offered by the Bank to its customers include retail banking comprising current and savings accounts and commercial banking which offers real estate finance, trade finance, cash management and treasury services across various currencies. We also offer a range of Islamic personal and business banking products under the brand name "Sirat".

The Bank offers two main services; real estate finance and commercial banking services. The Bank also offers regular cash management, trade finance and retail banking in line with the customer needs. The Bank's product and service offering is comprised of buy to let finance, commercial loans, working capital finance, trade finance, current accounts, savings accounts, notice accounts, fixed term deposits, Internet deposits, cash management and treasury services. The intermediary channel remains a strong source of lending customer referrals and also provided the much-aspired diversification in our business acquisition channels. We foresee a deeper role of Intermediaries in expansion of lending business base through introduction of new to business customers.

The Bank combines modern and efficient banking services with a personal approach through a network of eight branches across the UK. We offer commercial and retail banking services to Small and Medium Sized (SME) enterprise focusing on their evolving business needs.

Services are mainly 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.

Intermediaries continue to offer their clients our lending products and services, while we maintaining full control of client relationships. This enables showcasing our product line, including commercial lending, residential and commercial buy-to-let and mixed use buy-to-let mortgages, showcased to the customers through intermediaries; while affording an opportunity to infuse flexibility and adaptability to our products so that they could get blended with the exact need and demand of the intermediaries and their clients.

The Bank is a member of Bank of England Sterling Monetary Framework with access to Reserve Account Discount Window Facility (DWF) and Indexed Long Term REPO (ILTR) facilities. This allows bank to borrow from BoE by placing eligible collateral as a tool which can be used in the event of any stress on liquidity without having to sell available eligible securities. The Bank also became member of 'Term Funding Scheme with additional incentives for SME (TFSME)' introduced by Bank of England and borrowed £70 million to support SMEs.

We feel proud in creating long-term value for our customers, employees, suppliers, communities we serve and our shareholders.

The Bank is covered by the Financial Services Compensation Scheme (FSCS).

3.4. Key changes since the last disclosure

3.4.1. Central Bank Monetary Policy Tightening

Post Covid-19 easing of the rules saw economic activity returned back to pre-pandemic levels in Q2 of 2022. The sudden jump in global economic activities took the industries and manufacturers by surprise causing a major supply chain issue, which led to rise in inflation. The Russian/Ukraine conflict magnified global inflation as supply of gas and commodities from the war inflicted region almost came to a halt. As a result of high inflation Central Banks around the World started tightening of the monetary cycle at an aggressive rate.

The Bank of England (BoE) increased base rate from 0.25% at the start of the year to 3.5%, which further increased to 4.75% in June 2023 to manage inflation, which reached levels not seen in the past four decades. Although, the inflation has started coming down from second quarter of 2023 the pace is much slow, which continues to put pressure on on-going cost-of-living crises. Mortgage market has also been impacted as borrowers are facing with interest rates only seen pre-2007-08 financial crises. The BoE may have to further increase rate to slow down the inflation in the coming months.

Increase in interest rate over the last 18 months also impacted Bank's cost of funds, which continues to increase due to competitors pressure and customers' expectations of higher return on their deposits. However, the bank was able to improve net interest income through increase in customer lending rates and better returns on money market placements and investments in debt instruments. The Bank through ALCO closely monitors the interest rate situation and its impact on overall net interest margin.

3.4.2. Operational resilience

A key priority for the Bank of England, Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) is to put in place a stronger regulatory framework to promote operational resilience of firms and financial market infrastructures (FMIs). To this end, they published a joint Discussion Paper on Operational Resilience 2018 to start a dialogue with the financial services industry. Based on responses received the supervisory authorities issued consultation papers related to important business services, outsourcing and third-party risk management which are considered as key part of operational resilience. Consultation papers also refers to operational capacity, technology infrastructure, data centres and cyber security as elements of overall operational resilience. The FCA and PRA policy statement was published in March 2021 with an effective date of March 2022.

Over the years, the Bank has enhanced its resilience capability with the following measures:

- Operational efficiency
- Digitisation
- Technology infrastructure enhancement
- Improvement in information/Cyber security
- Remote access arrangement

The Bank's new Operational Resilience Framework is based on our existing capabilities, including learnings from past experience, and follows an approach in line with the FCA's and PRA's objective. Key steps for achieving the desired objectives are summarised below:

- Leverages business impact assessments and recovery objectives covering the entire organisation
- Prioritises important business services for end users specific to the Bank's business model and customer type
- End to end process mapping largely complete for Important Business Services (IBS) covering people, processes, technology, internal and external dependency, premises
- Impact tolerances being established based on time metrics. Combination metrics being considered where secondary capability exists
- Scenarios being established specific to the Bank leveraging risk event reporting process for past events and near misses
- Submission of self-assessment document to the Board for approval summarising the activities that have been undertaken in year 1 to meet the March 2022 deadline.

The operational resilience framework in the Bank is subject to continuous improvements, process re-engineering design to increase effectiveness and robustness while maintaining secure and efficient service delivery to customers through minimising adverse impact due to operational disruption.

The Bank has considered four main areas in its business services to identify Important Business Services (IBS):

1. Deposits, Lending and Transaction Banking
2. Payments, Clearing and Settlement
3. Wholesale Funding
4. Investments & Money Markets

In line with its size and business model and share of the market, the Bank considers five elements of the business services - (1) Payments (2) Loan Disbursal (3) Balance Check (4) Cash Withdrawals and (5) Cash and Liquidity Management - to be of critical importance in the context of potential disruption impact on its own customers and safety and soundness of the Bank.

As a part of Phase I approach, the Bank has successfully completed the 1st transition period on 31 March 2022 and, as required, a Self-Assessment document summarizing the work carried out was approved by the Board.

Since the completion of Phase I, the bank has reviewed existing important business services, which has not resulted in changes or addition of a new IBS. Impact tolerance for each IBS was also reviewed, which identified no major change. The Bank also completed Initial IBS mapping exercise. It will continue with mapping process over the transition period to identify vulnerabilities. The Bank is currently working on other areas including scenario testing and communication.

The Management and the Board are playing an active role in building up of an effective operational resilience framework, through clear communication of its objectives to comply with operational resilience policy. This is mainly achieved through:

- appropriate management information available to inform decisions which have consequences for operational resilience: and
- articulate and maintain a culture of risk awareness and ethical behaviour for the Bank, which influences the Bank's operational resilience.
- have adequate knowledge, skills and experience in order to provide constructive challenge to senior management and meet their oversight responsibilities in relation to operational resilience

The Board is continuously provided with progress reports, issues highlighted, areas of improvement, areas of investment and on overall implementation of Operational Resilience framework.

3.4.3. Consumer Duty

In July 2022 the FCA published its final rules and guidance for the Consumer Duty that will set a higher standard for consumer protection across the financial services sector. The FCA anticipates the implementation of consumer duty will require a significant shift in both culture and behaviour by firms, given the expectation that the delivery of good outcomes for the customer should be at the centre of a firm's strategy and business objectives. The good outcome is expected in the areas of product and services, price and value, consumer understanding and consumer support.

In line with FCA published guidance the Board was presented with the Bank's Consumer Duty plan and approach. The plan provided the Board members details of the Consumer Duty Project and the key areas of focus including identified workstreams, project activities, indicative dates and assigned responsibilities within the Bank. The plan was approved by the Board.

The Bank has formed a Steering Committee comprising of senior management who are responsible for the workstreams relating to the four outcomes. They supervise different working groups drawn from all relevant departments who focuses on the identified work streams.

The Bank has completed an initial gap analysis to identify key areas that need attention based on assessment of current products, policies and processes along with identification of areas which requires improvement against the elevated standards of the new Consumer Duty. The work is in progress to address the gaps identified under oversight from Board Audit and Compliance Committee.

3.4.4. Climate Change

Climate Change is a much-discussed topic in recent times at a global level. Risks highlighted by scientific research and changes in natural phenomenon have played a significant role in attracting focus at governmental level across the globe. Various initiatives have been introduced in the UK including legislation and regulatory requirements.

The Bank has considered the effects of climate change on its business model and profile with oversight by the board and senior management. The Bank has also taken steps to embed consideration of climate change in the key decision making and risk management.

As part of its approach to manage climate change risk, the Bank undertook a review of the following areas to consider relevant physical and transition risks to assess the materiality:

- Business model
- Customer base and target segments
- Investment book and strategy
- Bank's physical footprint and supply chain

The Bank assessment included the primary target industry segments, customer profile and business activity, product offering, industry risk categorisation of segments combined with contractual terms of products and investments to arrive at the materiality view.

Overall, the Bank's customer base and target segments primarily comprise of real estate, wholesale and retail segments.

The lending exposures are focussed on real estate financing which is > 95% of the lending book. Consequently, the focus is on the property collateral. The Bank's focus is on residential, mixed use and commercial real estate with contractual loan terms not Climate Change is a much-discussed topic in recent times at a global level. Risks highlighted by scientific research and changes in natural phenomenon have played a significant role is attracting focus at governmental level across the globe. Various initiatives have been introduced in the UK including legislation and regulatory requirements.

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The lending exposures are focussed on real estate financing which is > 95% of the lending book. Consequently, the focus is on the property collateral. The Bank's focus is on residential, mixed use and commercial real estate with contractual loan terms not exceeding 5 years. The Bank does not offer finance for development and/or industrial units with high-risk characteristics.

In the context of the UK property market, the two relevant risks are flooding (physical risk) and cost of compliance with new/forthcoming climate related legislation (transition risk). Both risks are covered by the Bank's collateral review through a valuation by panelled surveyors for all real estate transactions with a consideration by the management committee where any relevant risks are highlighted.

The Bank's investment strategy includes a cap on max tenure of 5 years with an average maturity profile of 2.5 years. Whilst the existing holdings comprise less than 7% of exposure to segments considered as elevated risk, the Bank takes into account climate change risk in its decision-making process.

At present, the Bank deems the materiality of climate change risk as low based on its assessment.

The Board and the management are cognisant that climate change risk impact can have an effect on the Bank's financial position in terms of the collateral valuation leading to credit quality risk, valuation of assets, probability of default which can in turn impact the financial risk disclosures.

In view of the above and given its evolving nature, climate change risk type is subject to periodic review to take into consideration any material changes to strategy and profile along with new legislative or regulatory expectations.

3.4.5. Disclosures and Policy

The capital and liquidity disclosures contained in this document cover both the qualitative (e.g. processes and procedures) and quantitative (e.g. actual numbers) requirements. In addition, the disclosures should be read in conjunction with the Bank's most recent Annual Report.

The capital and liquidity disclosures are required to be made on at least an annual basis and, if appropriate, some disclosures will be made more frequently. The capital and liquidity disclosures are prepared by management, and reviewed and approved by the Board of Directors of the Bank. The Bank has an Accounting Reference Date of 31 December, and such disclosures are made as soon as practicable after publication of the Annual Report and Accounts.

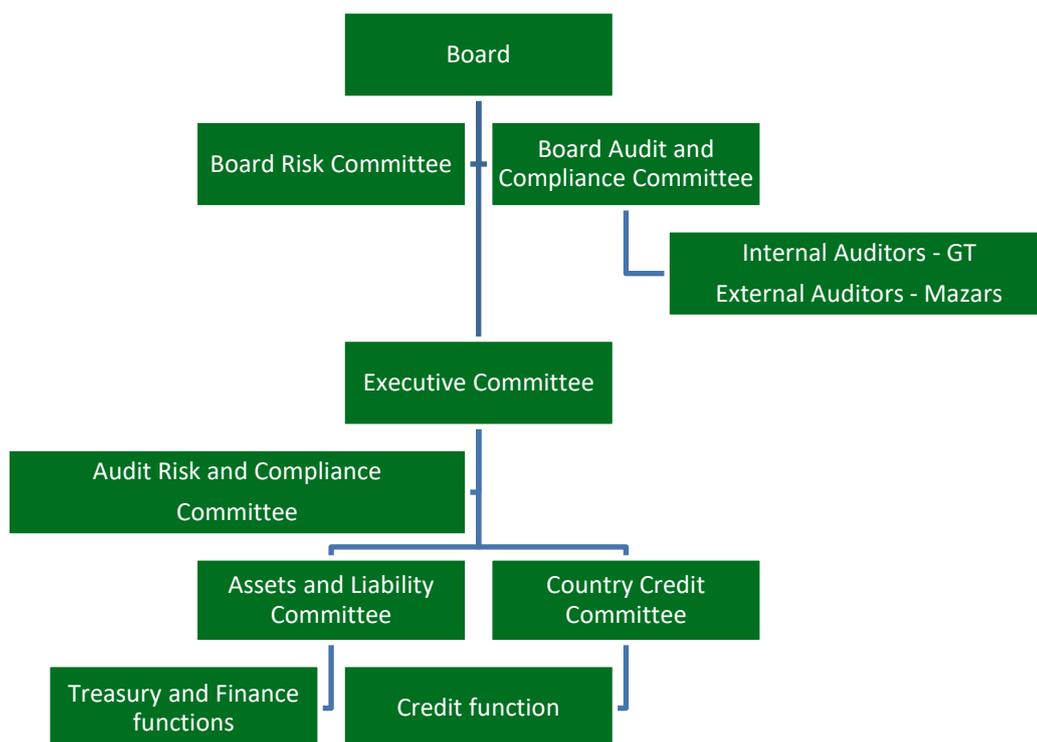
4. Governance Framework

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 sub-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 (BRC) and Board Audit and Compliance Committee (BACC).

The sub-committees keep an oversight on the key risks such as credit, liquidity, compliance, conduct and operational risk. Members of the sub-committees maintain close interaction with senior management and receive regular information from management committees. The BRC oversees and challenges the risk management function to ensure that governance arrangements, risk framework and systems and controls are evaluated and managed properly. 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 are shown below:



4.1.1. Board Responsibilities:

The Board monitors and periodically assesses 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 itself

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

4.1.2. Board Risk Committee

The Board Risk Committee (BRC) assists the Board in the review and oversight of Risk Management Framework, ICAAP, ILAAP and other governance documents. The 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. The BRC periodically review the risk framework to evaluate its adequacy and appropriateness under the prevailing business environment and in light of major changes in internal or external factors. It provides assurance on the Bank-wide risk framework and monitors the overall risk profile of bank through effective control processes. The BRC annually review the Risk Appetite Statement and consider the adequacy of risk limits and returns.

4.1.3. 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. The BACC reviews and approves key financial risks, assesses effectiveness of system of financial reporting. The Committee also approves accounting policies and changes therein to comply with the requirements of International Financial Reporting Standards. The BACC is also responsible to ensure that the Bank has an effective compliance monitoring program in place. It also ensures that recommendations to combat money laundering, terrorist financing and financial crime risks are incorporated into the Bank's on-going procedures and monitoring infrastructure. BACC has also oversight of adequacy of processes put in place by the management to manage Conduct Risk including Culture and Ethics and effective implementation of Consumer Duty Rules.

4.1.4. Management Responsibilities

The Management committee structure comprises of the Executive Committee ("EXCO) and six 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 aforesaid executive committee style of management enables the firm to benefit from an enterprise-wide integrated approach to managing risk by involving a great many experts in the risk assessment process and thereby drawing on information dispersed among many thoughtful and prudent minds. 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.

4.1.5. 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 policies 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.

4.1.6. Asset & Liability Committee (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 are 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.

4.1.7. 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.

4.1.8. Operations and Technology Committee

The OTCO is the governing forum for Operational Risk, which is defined by the Basel Committee on Banking Supervision “as the risk of losses stemming from inadequate or failed internal processes, people and systems or from external events. OTCO receive and review management information and reports based on the data pertaining to the Operational Risk matters, including but not limited to the Operational Risk, Business Continuity and Disaster Recovery. The Operations & Technology Committee (“OTCO”) provides governance and oversight in ensuring matters related to

- Operations
- Technology
- Information security
- Business continuity
- Operational resilience
- Regulatory compliance within O&T and IS domain.

4.1.9. 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 relevant function and committee.

The ARCC is jointly chaired by Chief Risk Officer (CRO) and Head of Compliance. The CRO is responsible for overseeing all aspects of risk management within the Bank including the implementation and effectiveness of the risk management framework, which review of risk appetite statements and align them to mitigate impact any emerging risks.

5. Risk Management Framework

5.1. Overview

The Bank's approach to risk management is built upon risk identification and risk response in order to minimise crystallisation of risk and have a cost-effective way of dealing with it if it does occur.

The approach is driven by 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 clearly defined target market (selected customer and industry segments);
- conventional products & service offering;
- robust governance and control framework.

5.2. The Bank's Risk Management Strategy

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

- Understanding Firm-wide Risk Profile
- Articulated Risk Appetite
- Proactive approach to risk management
- Ownership of risk across the organisation
- Multiplier effect of risk to account for combined stress scenarios
- Oversight of key risks at Management and Board level

The key elements of the Bank's risk management framework are as follows:

- Governance at the Board and Management level
- Risk Oversight
- Risk management controls

The Bank's risk management strategy and risk appetite are aligned with its motto 'Service with Security', Core Values and strategic intent of delivering sustainable growth.

5.3. Risk Management Process

5.3.1. 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 are acceptable and preferred, however the controls and mitigation in place derive the final residual risk.

Residual risk sets the basis for the organization's willingness to accept a level of risk in a given scenario or to allocate resources to bring it down to the acceptable level.

5.4. 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 cascading the organisation's operational risk appetite throughout the Bank's operations and business. The Board Risk Committee maintains oversight of the business performance against the risk appetite. The relevant management committees conduct the review, while monitoring is performed 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 110%
- AD ratio not to exceed 100%

5.5. Risk Register

Risk Register is the culmination of the full Risk Management Cycle and is maintained to capture and monitor details of the relevant risks within the identified risk families. Each item is also rated for Impact and Probability as per the guidelines, for each to arrive at the Gross Risk value. Controls & Mitigation in place are used to assess and arrive at the final residual risk. These ratings allow management to classify each risk item into Low, Medium or High-Risk categories and the Board Risk Committee to have an effective oversight of the process.

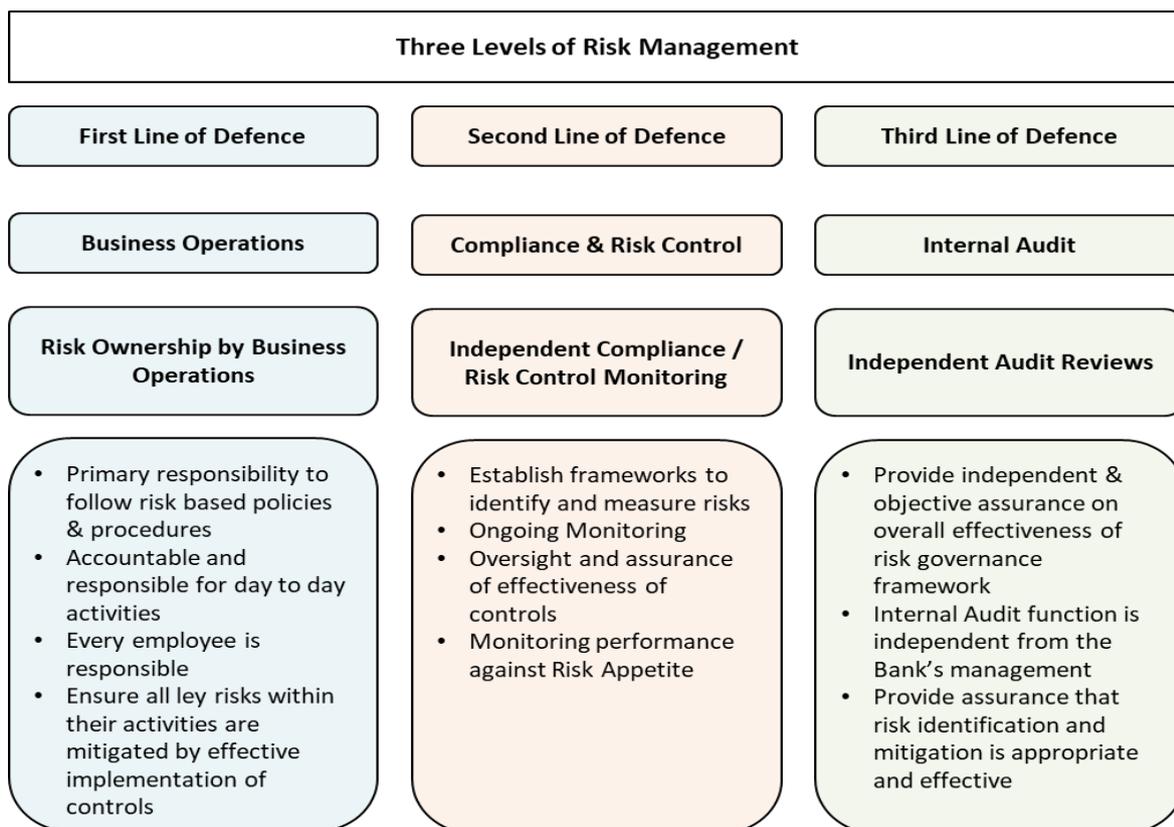
The Risk register allows the Bank to:

- Have an overview of all Risk posed to the organisation
- Identify overlapping Risk so that Risk is not considered in isolation and its related implications are also reviewed & analysed
- Review systems & controls in place for effective Risk mitigation
- Derive action plans to mitigate Risk along with assigning ownership & target dates for task completion
- On-going monitoring & management of Risk

Independent Internal Audit Function plays a key role in testing the effectiveness of risk management process.

5.6. 3 Lines of Defence

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



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

5.6.1. 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 with 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 to challenge the assumptions and assertions made by the business. Usually Risk, Compliance and Finance functions act as the second line of defence, however, if subject functions set to be the first line of defence in their capacity as the owner of a business process, other departments act as 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 generating adequate risk-related information for the Bank, the Parent Bank and the Regulators.

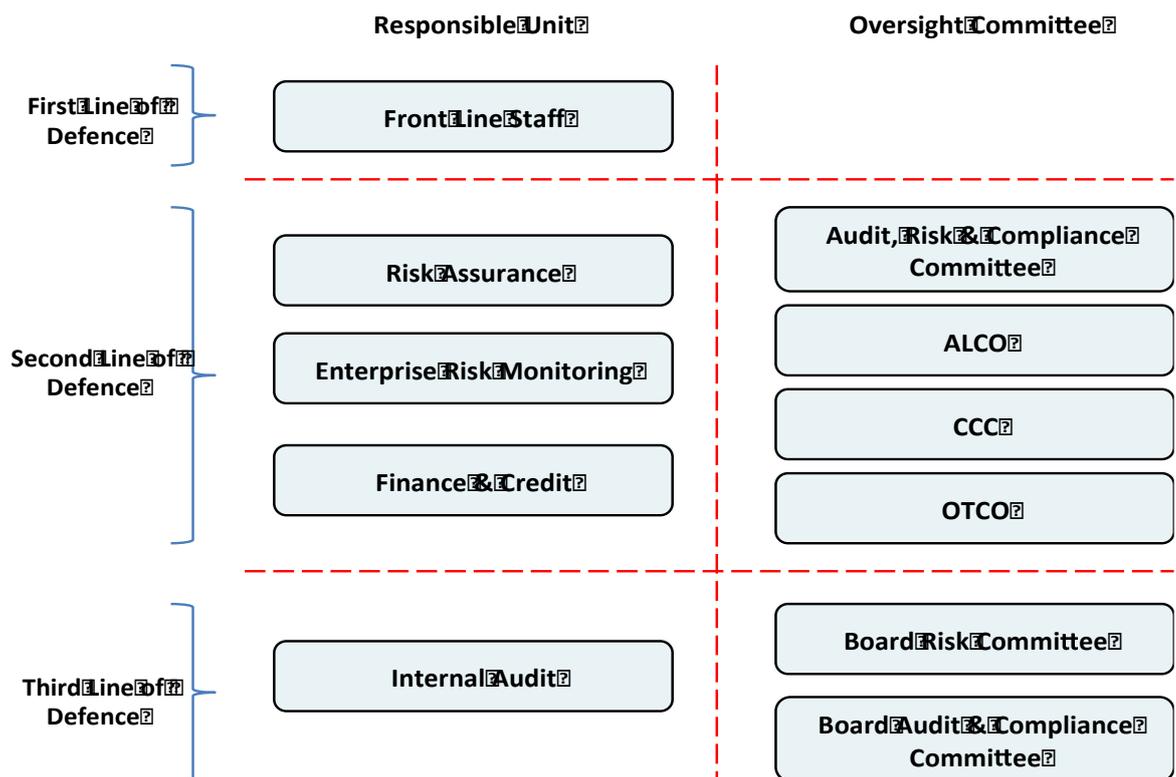
The senior management and committees such as ALCO, EXCO, OTCO and ARCC are also part of overall second line of defence providing an oversight, challenge and monitoring of the adequacy and implementation of effective internal control and risk management practices.

With the implementation of IFRS9 the second Analytics function working under Head of Credit closely monitors overdue accounts and issues 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.



- OTCO – Operations & Technology Committee
- ALCO – Asset Liability Committee
- CCC – Country Credit Committee
- ARCC – Audit, Risk & Compliance Committee
- HRC – Human Resources Committee

5.7. Risk Appetite for different Risk Types

Risk Type	Low	Medium	High	Owner	Oversight	Responsible Management Committee	Board Oversight Committee
Reputation				Business Heads	CEO	ExCO	BoD / Chair
Liquidity				CFO	CRO	ALCO	BRC
Financial & Tax				CFO	CRO	ExCO	BRC/BACC
Investment				CFO	CRO	ALCO	BRC
Credit				Head of Credit Risk	CRO	CCC	BRC
Country				CFO / Head of Trade & FI	CRO	CCC	BRC
Market				CFO/ Head of Credit Risk	CRO	ALCO	BRC
Financial Crime				Bus Head / Head of Ops	MLRO	ARCC	BACC
Compliance				Bus Head / Head of Ops	Head of Compliance	ARCC	BACC
Conduct Risk				Business Heads / Head of Ops	Head of Compliance/CRO	ExCO	BACC
Operations				Head of Operations	CRO	OTCO	BRC
Technology				Head of Technology	CRO	OTCO	BRC

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.

The implementation of Risk Management Framework is based on three lines of defence model for governance and control and independent assurance of mitigation of key risks.

5.8. Key Risk Policies

The Key Risk policies are used to implement and operationalise the Risk appetite and are a key component of the Risk management strategy. This helps in effective risk management of the identified key risks for the Bank.

- Credit Risk Management Framework
- Liquidity Risk Policy
- Investment Policy
- Operational Risk Policy
- Financial Crime
- AML/CTF Handbook
- Fraud Prevention Policy
- Conduct Risk Framework
- Market Risk Policy
- Data Protection Policy

The above list is not exhaustive. Various policies are in place for management and mitigation of other risks.

5.9. Internal Audit

The Bank has engaged Grant Thornton to perform its internal audit function. This enables independent reviews and wide expertise to provide assurance to the Board on the effectiveness of its processes and control framework.

The Internal Auditor appointment is deliberated and approved by the Board Audit & Compliance Committee. Internal Audit reports to the BACC with representation at each committee meeting.

The Internal Audit Plan is reviewed and approved at the BACC with oversight and monitoring of the Chair of the BHACC. Risk based annual internal audit plan is approved by the BACC.

Internal Audit also maintains regular engagement with the senior management and Chair of BACC to keep them apprised of key issues, emerging risks, good practice and forthcoming regulatory changes and challenges.

5.10. IFRS 9 – ECL methodologies

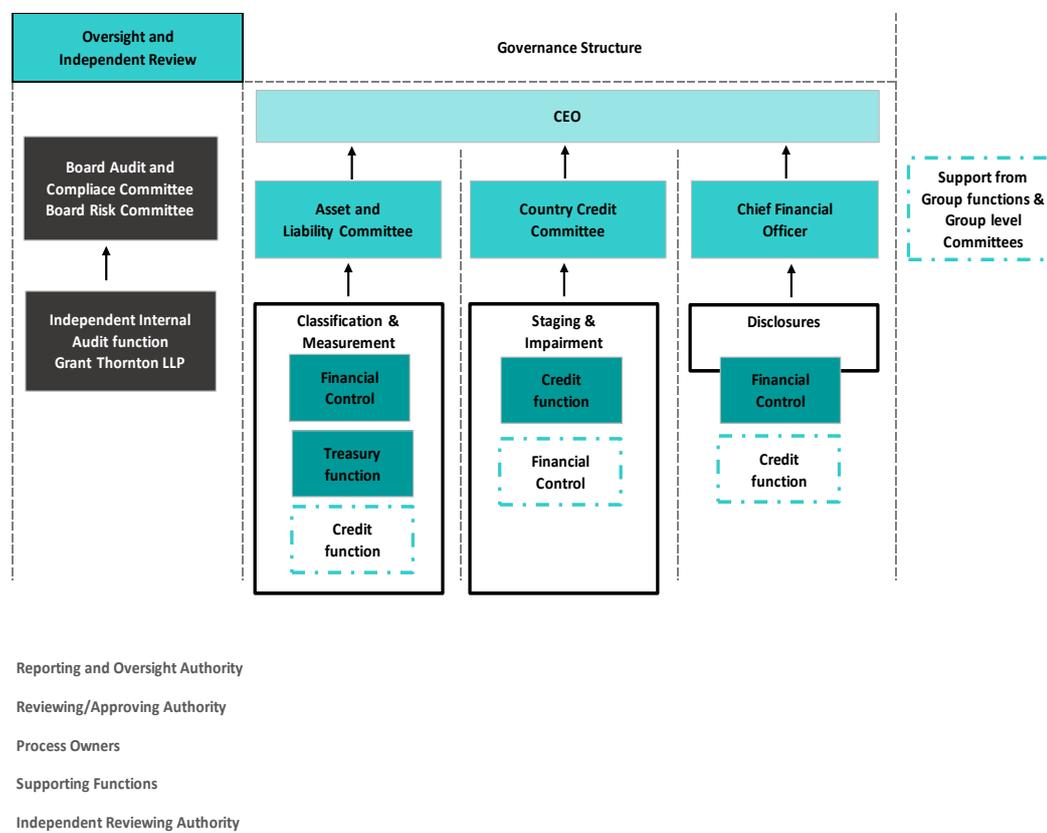
The Bank follows a general approach in designing ECL methodologies, duly aligned with its size, complexity, structure, economic significance and profile of exposure. The approach taken is considered consistent with the size of the Bank in relation to the UK financial market, its relative lack of complexity 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.

Post implementation of IFRS 9, the Bank established principles for ongoing IFRS 9 governance to ensure effective oversight of IFRS 9 processes. IFRS 9 governance structure incorporates Credit, Risk and Finance departments as central support functions for each component of IFRS 9, defines clear process owners and reviewing functions and utilises the three lines of defence to ensure an effective framework.

Governance Structure outlined below are the three lines of defence for the four key IFRS 9 processes, classification and measurement, staging, impairment and disclosures:

- The process owners i.e. Credit, Financial Control and Treasury form the first line of defence
- The reviewing/approving functions i.e. Chief Executive Officer, Country Credit Committee and Asset and Liability Committee form the second line of defence
- The independent review functions i.e. Internal Audit and the Audit and Compliance Committee of the BOD form the third line of defence



The Bank has also put in place appropriate control to cover credit risk model governance risk. The objective was to set out the governance for the development, validation / review, deployment and maintenance of the credit risk related models. The implemented controls put in place framework for governance along the different stages of the model lifecycle.

As per requirements set by the IFRS 9, the Bank is required to disclose information that explains the basis for its ECL calculations and the criteria it assesses and recommends changes in credit risk. Moreover, the Bank must also provide a reconciliation of the opening and closing ECL amounts and carrying values of the associated assets separately for different categories of ECL as well as by asset class. In order to comply with the requirements of IFRS 9, the ECL estimates need be adjusted against relevant updated macroeconomic variables to bring the Point in Time PD estimates for each segment to forward looking.

The Bank analysed the impact of change in PD by updating the macroeconomic variable against the behaviour of the portfolio during 2022. The underlying assumptions and estimates involved in subject calculations were critically examined and analysed by the Country Credit Committee (CCC) as well as by the Board of Directors for their relevance and appropriateness.

In addition, our independent Statutory Auditors, as part of their scope of assignment, duly assessed the design and implementation of the ECL model; while testing the operating effectiveness of key controls over the monitoring and reporting of credit exposures. In carrying out their aforesaid testing and assessment, they evaluated the appropriateness of the Bank's IFRS 9 impairment methodology, including

- i) testing and challenging the reasonableness of the assumptions, assessing the appropriateness of the model's design and independently recalculating the PD and LGD for a selection of loans;
- ii) ensuring the appropriateness of the Bank's macroeconomic variables, economic scenarios used and the probability weightings applied; and
- iii) determining the appropriateness and reasonableness of the post model adjustments and whether the post model adjustments are indicative of management bias.

The estimation made by the Bank was discussed by the Board and considered appropriate keeping in view the performance of the portfolio observed during pandemic and prospect of improvement in overall economic conditions in 2022.

5.11. 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 ensure 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.

5.12. Significant Risks

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

5.12.1 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 mitigation of credit risk is based on a combination of focused strategy, defined target market, secured lending, quality of underwriting standard, ongoing monitoring and pre-set thresholds for single party exposure, industry concentration and type of collateral.

The Bank has a well-defined and articulated credit risk management framework ("CRMF"), which comprises its credit risk appetite, credit policies, terms of reference of management and board level committees, target market analysis, collateral management, credit monitoring and other credit related policies. The Board Risk Committee ("BRC") has oversight responsibilities of the CRMF. The Country Credit Committee ("CCC") and Board Risk Committee review and approve credit exposures based on delegated authorities.

The Bank has put in place detailed policies and guidance for the business and credit team to deal with impact of IFRS 9. Regular monitoring of credit portfolio is carried out by analytics team which provides early warning to business team where customers start showing irregular repayments. Regular interaction between customers and relationship managers also helps in identifying any issues which might lead to significant increase in credit risk. Indicators, if any identified are closely monitored through a well-established watchlist process in place.

One of the key focus areas of the Bank during period of uncertainties such as pandemic or external conflicts remains effective credit risk management. The credit team carried out frequent rapid reviews of the portfolio covering industries and sectors more severely affected by such uncertainties. During the year 2022 more focus was given to customers' ability to repay through stress test at various interest rate levels. Frequency of CCC meetings also increases along with increase in number of BRC meetings where the members meet to discuss enhancement in risk management process.

Business teams remained at the forefront of managing customers expectation and providing them the required support in addressing concerns due to market uncertainties. This was clearly demonstrated through their various discussions with the customers to ensure impact on their repayment capacity as a result of increase in interest rate and ability to provide further cashflows or collateral to reduce the risk. As a responsible lender the Bank continues to support its customers to manage rising debt burden.

5.12.2 Counterparty credit risk (CCR)

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.

5.12.3 Credit value adjustment (CVA)

Credit Valuation Adjustment is an adjustment to the mid-market valuation accounting for the current market value of credit risk. Bank calculates a regulatory CVA capital charge. The purpose of this charge is to improve the resilience of banks to potential mark-to-market losses associated with deterioration in the creditworthiness of counterparties against non-cleared derivative trades.

5.12.4 Credit Quality Analysis

The following table set out information about the credit quality of financial assets measured at amortised cost and FVOCI debt investments. Unless specifically identified, for financial assets, the amounts in the table represent the gross carrying amounts.

	2022				2021
	Stage 1	Stage 2	Stage 3	Total	Total
Cash in hand and with central bank	96,506	-	-	96,506	88,689
Due from banks	157,250	-	-	157,250	101,336
Loans and advances to customers	560,008	26,132	20,029	606,169	518,514
Financial investments - amortised cost	97,827	-	-	97,827	89,931
Financial investments - FVOCI debt instruments	46,535	-	-	46,535	85,735
	144,362	-	-	144,362	175,666
Loss allowance	958,126 (145)	26,132 (326)	20,029 (4,656)	1,004,287 (5,127)	884,205 (4,484)
	957,981	25,806	15,373	999,160	879,721

The following table provide information about the credit quality of financial assets outstanding as at the balance sheet date in terms of regular, past due and impaired.

2022	Amount in £000					
	Cash and balances with central bank	Due from banks	Loans and advances to customers	Financial investments	Derivatives	Total
Current and past due up to 1 month	96,506	157,250	605,007	144,362	192	1,003,317
Past due 1 to 3 months	-	-	13	-	-	13
Past due over 3 months	-	-	1,149	-	-	1,149
Gross exposure	96,506	157,250	606,169	144,362	192	1,004,479
Less: impairment	-	(10)	(5,107)	(10)	-	(5,127)
Net exposure	96,506	157,240	601,062	144,352	192	999,352

5.12.5 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 £ 000

2022	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-	95,818	-	-	61,852	16	-	157,686
A+ to A- BBB+ to	-	70,897	-	46,488	15	-	117,400
B-	-	43,858	-	35,992	-	-	79,850
Unrated	688	42,485	601,062	20	162	34,820	679,237
	96,506	157,240	601,062	144,352	193	34,820	1,034,173

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.

5.12.6 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 £000

2022	Cash and balances with central bank	Due from banks	Loans and advances to customers	Financial investments	Derivatives	Contingent liabilities and commitments	Total
Supernational	95,818	-	-	55,672	-	-	151,490
Financial Institutions	-	157,240	-	72,656	31	8,557	238,484
Industrial & commercial	-	-	516,891	16,024	162	16,673	549,749
Individual	-	-	79,820	-	-	9,590	89,411
Other	688	-	4,351	-	-	-	5,039
	96,506	157,240	601,062	144,352	193	34,820	1,034,173

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 £000

2022	Cash and balances with central bank	Due from banks	Loans and advances to customers	Financial investments	Derivatives	Contingent liabilities and commitments	Total
United Kingdom	96,506	88,507	519,726	41,460	178	20,217	766,594
Europe excluding UK	-	27,337	36,986	80,094	15	1,820	146,252
Asia	-	22,859	28,301	11,895	-	5,658	68,713
North America	-	20	11,875	2,350	-	-	14,245
Africa	-	17,130	4,174	1,809	-	7,125	30,238
United States of America	-	1,264	-	6,744	-	-	8,008
Australia	-	123	-	-	-	-	123
	96,506	157,240	601,062	144,352	193	34,820	1,034,173

5.12.1. 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 Loan to Value (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	<ul style="list-style-type: none"> ▪ 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	<ul style="list-style-type: none"> ▪ 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	Amount in £000			
	2022		2021	
	Collateral Value	Advances	Collateral Value	Advances
Commercial real estate	908,901	440,097	798,044	382,240
Residential real estate	270,225	139,330	224,833	110,221
Cash collateral	37,224	21,175	36,574	18,119
Other collateral	-	-	-	-
Guarantees	-	-	-	-
Unsecured	-	-	-	7,934
Total	1,216,350	600,602	1,059,451	518,514

5.12.7 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 effective May 2020.

Following table provides the breakdown of credit risk weighted exposures post credit risk mitigation (CRM) and credit conversion factors (CCF) as at December 2021 segregated as per the sectors:

exposures as per Sectors	Amount in £000			
	On Balance Sheet	Off Balance Sheet	TOTAL	Total
	2022	2022	2022	2021
Retail	29	-	29	19
Secured by mortgages on immovable properties	381,353	-	381,353	327,243
Exposures in default	15,424	-	15,424	13,589
Contingencies and commitments	-	19,662	19,662	35,250
Institutions	62,091	-	62,091	88,749
Central governments or central banks	2,571	-	2,571	1,177
Corporates	41,178	-	41,178	25,537
Counterparty credit risk	-	269	269	180
Other	15,868	-	15,868	20,407
	518,514	19,931	538,445	512,151

Following table provides the breakdown of credit risk exposures post credit risk mitigation (CRM) and credit conversion factors (CCF) as at December 2022 as per geographical breakdown:

Country wise Exposures	Amount in £000	
	2022	2021
United Kingdom	421,940	377,525
Europe excluding UK	14,660	17,631
Asia	60,293	69,245
North America	8,299	10,253
Africa	32,975	28,176
United States of America	253	9,025
Australia	25	296
	538,445	512,151

5.12.8 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.

5.13. Interest Rate Risk in the Banking Book

Interest rate risk arises from changes in interest rates that could affect future profitability or the fair value of financial instruments. Interest rate risk at the Bank is managed and contained and the Bank has no significant long term or complex interest rate positions or products. The Bank seeks to minimise the negative impact on net interest income of adverse movement in interest rates.

Duration Risk

The Bank's main lending product is a 5 years variable rate loan. For client asset pricing, the Bank uses its own base rate, which can be changed with notice to the customers. Deposits are typically of 6 months to 1-year duration. Therefore, any significant fluctuation in interest rate is contained to a 6-month window and unlikely to have a material impact on the Bank as it can re-price its lending and customer deposit books.

Basis Risk

The Bank uses its own base rate (HBZ Base Rate) to price up Client loans. For deposits it aligns closely to the overall cost of funds and does a peer analysis. Therefore, basis risk is very limited.

Optionality Risk

The Bank currently does not use Interest Rate derivatives, whether embedded in loan agreements or for hedging purposes. As asset and liability products offered by the Bank are simple in nature, which mitigates optionality risk.

Risk Identification and Quantification

The Bank is exposed to interest rate risk on part of its HQLA Bond portfolio (Fixed Coupon) maintained to meet the LCR requirement. The Bank also has an investment Bond portfolio of investment grade (or higher). These are Floating Rate Notes (FRN) no longer than 3-year maturity and benefit in an interest rate rising environment (USD and GBP) as the rates are linked to 3 months LIBOR. The Bank monitors the economic landscape closely for any change in the interest rate environment.

5.14. 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.

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 ensures that it remains compliant with the latter but its approaches to the former will vary according to priority and need. In terms of customer services, the Bank will actively employ flexible approaches to maintaining and protecting delivery and to this end will incur reasonable costs as required.

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 manages operational risk through an articulated risk appetite and ongoing monitoring with oversight at management and board level committees. The Bank has a fully operational risk control function, which monitors various operational risks under supervision and guidance from the Chief Risk Officer.

To mitigate occurrence of loss as a result of operational risk, the management has implemented systems and controls some of which includes introduction of operation risk register, risk event reporting process and centralisation of process.

The Bank sets various tolerance trigger points in accordance with regulation and guidance from the UK Financial Conduct Authority ("FCA") and Prudential Regulation Authority ("PRA"). In the event of these tolerances being breached, reporting to the Operations and Technology Committee ("OTCO") is made. OTCO reviews the breaches and considers whether further escalation to Audit, Risk and Compliance Committee ("ARCC") and Executive Committee is required. Reporting is made together with confirmation of remediation plans. All key operational risks indicators and risk events are also reported to the BRC.

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.

5.15. 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
- Verified by Visa: HBZ UK successfully completed certification of VBV service to provide its customer secure online shopping experience
- Deployment of Security Incident Event Monitoring Solution
- Data Leakage Prevention Tools
- Secure VPN (Citrix) based work from home environment
- Scheduled based vulnerability scanning and penetration testing regime in place for critical applications
- Conducting change risk assessment when introducing new customer channels.

The Bank recognises risk associated with cyber threats and is constantly taking proactive measures to strengthen its operating environment to provide a secure banking experience to internal as well as external stakeholders. The Bank 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. Regular real time monitoring of all cyber alerts is monitored and analysed by Information Security function for corrective action and system updates

5.16. 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 regulator’s threshold conditions, Statements of Principle, rules, codes and guidance and any relevant directly applicable provisions of a European or group Directive or Regulation.

Regulations are constantly evolving and could adversely impact the Bank including capital, liquidity and funding requirements, enhanced data privacy requirements and the management of financial crime. The Bank implements new and updated regulatory requirements, where applicable, and incorporates the implications of related changes in its strategic and financial plans.

Compliance and Risk functions have responsibility for monitoring and oversight of new regulations, which are implemented by relevant functions such as finance, operations and IT. Where required the Bank also seek support and guidance from market experts to ensure best practices are adopted by the Bank. The Bank also receives regular update from different market sources such as Association of Foreign Banks on new regulatory requirements.

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.

6. 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 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 Board oversees liquidity risks. The risks identified in the Bank's risk profiles are all at a level, which are in line with the current business operations and the Business Plan. The Bank has a clearly defined liquidity risk appetite approved by the Board. This forms the basis of its liquidity risk policy as well as systems and controls around the management of liquidity adequacy. The Bank continues to review and update its liquidity risk management framework based on developments in market and industry best practices.

The Bank manages the maturities of its assets and liabilities and its cash flows on a daily basis. The Bank maintains substantial liquidity in the Bank of England Reserve account, high quality liquid assets and in short-term deposits. The Bank has early warning indicators in place, which are monitored at operational and management committee levels.

The Bank's customer deposit base is stable and considered sticky based on long-term relationships. The Bank's depositor base mainly comprises relationship-based retail and SME deposits. The Bank also offers 6 and 12 months fixed-rate web-based deposits, which are mainly a rate-driven source of funding.

To ensure the Bank has access to funding sources various measures were taken by the Bank including access to BoE facilities under Sterling Monetary Framework, which includes Indexed Long Term Repo facility, Discount Window facility and Term funding for SMEs. In addition, the Bank has also entered into bilateral repo arrangements with other counterparty to gain access to funding by utilising its stock of investments as collateral.

Amount in £000

2022	Cash and balances with central bank		Due from banks		Financial investments	
	2022	2021	2022	2021	2022	2021
Supnationals	95,818	88,166	-	-	55,672	90,964
Financial Institutions	-	-	157,240	101,317	72,656	54,595
Industrial & commercial	-	-	-	-	16,024	30,096
Other	688	523	-	-	-	-
	96,506	88,689	157,240	101,317	144,352	175,655

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

The Bank held cash and cash equivalents of £ 96.5 million as at 31 December 2022 (2021: £88.2 million) with central bank that is rated at least AA- to AA+ as per approved external credit rating agencies.

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 £000

2022	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	96,506	96,506	96,506	-	-	-	-
Due from banks	157,240	158,282	88,344	32,247	37,691	0	-
Loans & advances to customers	601,062	686,036	6,233	131,014	94,705	454,085	-
Financial investments							
- fair value through other comprehensive income	46,535	49,512	0	0	13,566	35,946	-
- Amortised cost	97,817	101,152	1,006	10,656	41,684	47,787	20
	999,160	1,091,488	192,089	173,917	187,646	537,817	20
Derivative assets							
Risk management							
Outflow	192	-	-	-	-	-	-
Inflow	-	192	54	76	62	-	-
	192	192	54	76	62	-	-
Financial liability by type							
Non-derivative liabilities							
Due to banks	129,266	(129,687)	(80,766)	(31,134)	(17,787)	-	-
Due to customers	672,008	(676,816)	328,932	(98,840)	(246,839)	(2,204)	-
Subordinated liabilities	20,273	(20,304)	-	-	(20,304)	20,288	-
Lease liability	2,373	(2,373)	-	-	-	-	-
	823,920	(829,180)	248,166	(129,974)	(284,930)	18,084	-
Derivative liabilities							
Risk management							
Outflow	229	-	-	-	-	-	-
Inflow	-	(229)	(47)	(59)	(123)	-	-
	-	229	(47)	(59)	(123)	-	-

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.

6.1. Liquidity risk management

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

6.2. 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 conducting 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.

6.3. Qualitative Information

6.3.1. Funding and liquidity sources

Bank has stable and diverse range of funding base including deposits from retail and non-retail customers with long length of relationship, deposits covered by Financial Service Compensated Scheme (FSCS) Tier1 and Tier2 Capital base and wholesale deposits.

6.3.2. Derivatives

The Bank transacts derivatives to manage and hedge its own risk and that of its customers. The Bank uses derivatives for hedging purposes for an economic perspective in the management of its own asset and liability portfolios. This enables the Bank to mitigate the market risk, which would otherwise arise from structural imbalances.

Forward foreign exchange currency contracts are Over the Counter agreements to deliver, or take delivery of, a specified amount of an asset or financial instrument based on a specific rate applied against the underlying asset or financial instrument, at a specific date.

Derivative transactions of the Bank are fully collateralised by the cash.

6.3.3. Liquid Assets

Bank held extremely high-quality liquid assets in the form of Bank of England Reserves and level 1 Securities.

The LCR disclosure template with liquidity risk limits are provided hereunder:

	Amount in £000	
Liquidity coverage ratio (LCR)	2022	2021
Total high-quality liquid assets (HQLA)	108,775	107,915
Total net cash outflow	26,883	70,335
LCR ratio (%)	405%	153%
Regulatory requirement (%)	100%	100%

6.4. Market Risk

Market risk refers to the risk to an institution resulting from movements in market prices, in particular, changes in interest rates, foreign exchange rates, and equity and commodity prices.

Market risk is the potential for loss of earnings or economic value due to adverse changes in financial markets. Banks involved in proprietary trading are exposed to market risk due to change in interest or foreign exchange rates.

6.4.1 Interest Rate Risk

Interest rate risk at the Bank is well managed and contained under oversight from ALCO and BRC. The Bank has no significant or complex long-term interest rate positions. The Bank's lending book is on variable interest rate, which allows re-pricing of all lending products within 90 to 120 days. Customer deposits have a longer behavioural rollover history as compared to contractual maturities, which stems from the strength of relationship-based business model.

The Bank Investments portfolio is well diversified with mix of HQLA and non HQLA bonds classified as held to collect and held to collect and sell. As at 31st December 2022 78% of the Bank portfolio was invested in fixed rate bonds with the remaining in floating rate note. As a result of significant increase in interest rates since the start of 2022 the Bank saw increase in mark to market loss on its overall investment portfolio, which at year end was 3% of the book value of Investments portfolio.

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 its fixed rate investment portfolio maintained to meet the Liquidity Coverage Ratio (LCR) requirement. However, this is only limited to a portion, which is monitored in ALCO.

6.4.2 Foreign Currency (FX) Risk Management

Foreign Exchange risk – is the risk that the Bank will suffer a loss as a result of an adverse movement in exchange rates.

The Bank has identified FX its risk component of its market risk that could lead to losses considering the nature of Bank's business. As the Bank is not running a trading book it is not exposed to FX risk to a large extent.

The Bank has developed various management reports to measure and manage foreign exchange risk. The Bank's open foreign exchange positions are monitored intraday. The foreign exchange exposures are managed by the treasury front office with a maximum allowable net open position ("NOP") of £1m with a maximum amount of £250,000 in a single currency. The Bank considers this an acceptable risk exposure. Client transactions are generally executed on a matched basis reducing the risk of losses. The Bank's does not engage in proprietary trading. This eliminates the likelihood of FX losses.

Key Risk Indicators exceeding tolerance are reviewed in the CCC & ALCO & reported to the Audit Risk and Compliance Committee (ARCC) together with remedial action plans.

The Bank's net open position (NOP) as at 31 December 2022 was (£0.07m) (2021: £0.114m)

Currency	2022 (£000)	2021 (£000)
USD	24	24
EUR	(33)	1
PKR	-	59
ZAR	(11)	-
CAD	-	(4)
INR	6.1	22
Others	6.2	12

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, entailing the Board's review and endorsement of underlying assumptions and anticipated scenarios. 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. 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 guards against crises that may emerge from internal / external factors, calling for immediate additional capital injection. The Bank maintains 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 injected / sponsored 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	£000
	2022	2021
Share capital	70,000	70,000
Retained earnings	20,525	16,301
Tier 1 capital	90,525	86,301
Fair value through OCI	(1,017)	(98)
Shareholders' equity	89,508	86,203
Subordinated liability	20,273	20,092
Own funds	109,781	106,295

8.1. 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) set by 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 2022 and actively managed capital base to cover the 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 2022:

Tier 1 Capital – Called up share capital includes 70 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 SONIA plus 150 bps per annum to be paid semi-annually. The term of the loan is five years, which complete in March 2026.

Reconciliation of statutory equity to regulatory capital resource

	31 December 2022	31 December 2021
Equity per statement of financial Position	89,508	86,203
Regulatory adjustments		
Less: Profit for the year	-5,700	-4,475
Less : Dividend paid	1,476	
Add: tier 2 issuance	20,000	20,000
Add: IFRS 9 Adjustment	579	481
Less: deferred tax assets	-2,399	
Less: additional value adjustment	-507	0
Less: Other Comprehensive Income	-1,017	
	12,431	16,006
Total Regulatory Capital Resource	101,940	102,209

8.2. 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:

Capital Adequacy Ratio of the Bank as at 31 December 2022 was as under:

Amount in £	Risk Weighted Assets	Capital Requirement
Credit Risk	538,880	43,110
Operational Risk	36,011	2,881
Market Risk including CVA	313	25
Pillar 1 Total (8% of RWAs)	575,204	46,016
Pillar 2A (4.24% of RWAs)	575,204	24,389
Total Pillar 1 and Pillar 2A (12.24%) – TCR	575,204	70,405
Capital Conservation Buffer (2.5% of RWAs)	575,204	14,380
PRA buffer (0.69%)	575,204	3,969
Countercyclical Buffer (1% of RWAs)	575,204	5,752
Total Capital Requirement - £ 000'	575,204	94,506
Total Capital Requirement - %		16.43%

- Risk Weighted Assets – Amount in £	575,204
- Regulatory Capital – Amount in £	101,940
- Capital Adequacy Ratio - %	17.72%

Capital Adequacy Ratio of the Bank as at 31 December 2021 was as under:

	2021
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Amount in £	Risk Weighted Assets	Capital Requirement
Credit Risk	512,151	40,381
Operational Risk	35,091	2,881
Market Risk including CVA	696	116
Pillar 1 Total (8% of RWAs)	547,938	43,835
Pillar 2A (4.19% of RWAs)	547,938	22,959
Total Pillar 1 and Pillar 2A (12.20%) – TCR	547,938	66,794
Capital Conservation Buffer (2.5% of RWAs)	547,938	13,698
Countercyclical Buffer (0% of RWAs)	547,938	0
PRA Buffer (0.48%)		2,630
Total Capital Requirement - £ 000'	547,938	83,122
Total Capital Requirement - %		15.17%

- Risk Weighted Assets – Amount in £	547,938
- Regulatory Capital – Amount in £	102,210
- Capital Adequacy Ratio - %	18.65%

9. 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 2022 Bank has a leverage ratio of 8.74% (2021: 10.7%).

The tables below summarised the information as per the formats prescribed by the European Banking Authority (EBA). Rows with Nil balances are not deleted.

Summary comparison of accounting assets vs leverage ratio exposure measure (LR1)

£ 000	2022	2021
Total assets as per published financial statements	1,019,038	892,077
Adjustments for derivative financial instruments	27,044	34,681
Adjustment for off-balance sheet items (i.e. conversion to credit equivalent amounts of off-balance sheet exposures)	15,824	14,263
Other adjustments- Including Central Bank Claims	(130,897)	(7,520)
Leverage ratio exposure measure	931,009	933,987

Leverage ratio common disclosure (LR2)

£ 000	2022	2021
On-balance sheet exposures (excluding derivatives and securities financing transactions (SFTs), but including collateral)	1,015,132	884,557
Deductions of cash variation margin provided in derivative transactions	-	-
Total On-balance sheet exposures (excluding derivatives and securities financing transactions (SFTs))	1,015,132	884,557
Replacement cost associated with all derivatives transactions (i.e. net of eligible cash variation margin)	5,212	34,681
Add-on amounts for PFE associated with all derivatives transactions (mark- to-market method)	397	486
Total derivatives exposures	5,609	35,167
Off-balance sheet exposures at gross notional amount	43,250	48,944
Adjustments for conversion to credit equivalent amounts	(27,426)	(34,681)
Total other off-balance sheet exposures	15,824	14,263
Capital and total exposure		
Tier 1 capital	81,360	81,824
Total exposure	931,009	948,055
Leverage ratio (%)	8.74%	8.63%

10. Impairment Provisions

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.

10.1. Measurement of ECL

In determining ECLs, the Bank has considered two economic scenarios for selected macroeconomic variables, (i) Debt service ratio and (ii) unemployment rate and weighted these according to their likely occurrence. The scenarios include a baseline scenario, based on the current economic environment, an upturn scenario and a downturn scenario. Scenario forecasts were weighted by the scenario's probability of occurrence in order to arrive at the probability-weighted macroeconomic impact over the 5-year forecast horizon.

The estimation and application of this forward-looking information will require significant judgement and be subject to appropriate internal governance and scrutiny.

Loss allowances for ECL are presented in the statement of financial position as follows:

- Financial assets measured at amortised cost: as a deduction from the gross carrying amount of the assets;
- Loan commitments, off balance sheet items and financial guarantees: generally, as a provision;

10.2. Significant increase in credit risk (SICR)

A critical element to the implementation of IFRS 9 for assessing Impairment is determining whether there has been a significant increase in risk of a credit exposure since origination to classify the assets into one of three stages as set out below.

The Bank considers days past due (DPD), marking the status of a loan as non-performing, a rating downgrade, restructure tag, or cross product defaults as being strong indicators of a significant increase in credit risk of an account. Hence, staging rules have been determined based on these criteria, as explained below:

Impairment is measured as either 12 months ECL, or Lifetime ECL depending on the change in credit risk associated with the financial instrument. The approach allocates financial instruments into three stages:

10.3. Staging Criteria

Stage 1 - 12-month ECL

The Bank assesses ECLs on exposures where there has not been a significant increase in credit risk since initial recognition and that were not credit impaired upon origination.

Stage2 - Lifetime ECL

The Bank assesses ECLs on exposures where there has been a significant increase in credit risk since initial recognition but are not credit impaired. Bank recognizes a lifetime ECL (i.e. reflecting the remaining lifetime of the financial asset).

Stage3 - Lifetime ECL

The Bank identifies ECLs on those exposures that are assessed as credit impaired based on whether one or more events that have a negative impact on the estimated future cash flows of that asset have occurred. For exposures that have become credit impaired, a lifetime ECL is recognized as a specific provision, and interest revenue is calculated by applying the effective interest rate to the amortised cost (net of provision) rather than the gross carrying amount.

The following tables show reconciliations from the opening to the closing balances of the loss allowance by class of financial instrument.

Amount in £ 000

Due from banks at amortised cost	2022				2021
	Stage 1	Stage 2	Stage 3	TOTAL	TOTAL
Balances at the beginning of the year	19	-	-	19	532
New provisions	2	-	-	2	14
Increased provisions	-	-	-	-	-
Uncollectable recovered / settled	(11)	-	-	(11)	(527)
Net measurement of loss allowance	(9)	-	-	(9)	(513)
Other movement	-	-	-	-	-
Balances at the closing of the year	10	-	-	10	19

Amount in £ 000

Loans and advances to customers at amortised cost	2022			2021	
	Stage 1	Stage 2	Stage 3	TOTAL	TOTAL
Balances at the beginning of the year	250	445	3,758	4,453	5,415
New provisions	27	-	-	27	55
Increased provisions	-	306	853	1,159	1,764
Recovered / settled / reduced	(140)	(168)	(196)	(504)	(1,342)
Net measurement of loss allowance	(113)	138	657	682	477
Transferred to 12 month's ECL Stage 1	-	-	-	-	-
Transferred to lifetime ECL stage 2 Credit not impaired	(11)	14	(3)	-	-
Transferred to lifetime ECL stage 3 Credit impaired	(1)	(271)	272	-	-
Uncollectable written off / other	-	-	(28)	(28)	(1,439)
Balances at the closing of the year	125	326	4,656	5,107	4,453

The contractual amounts outstanding on financial assets that were written off during the year ended 31 December 2022 is subject to enforcement activity.

Amount in £ 000

Financial investments	2022				2021
	Stage 1	Stage 2	Stage 3	TOTAL	TOTAL
Balances at the beginning of the year	12	-	-	12	1
New provisions	-	-	-	-	6
Increased provisions	-	-	-	-	(38)
Net measurement of loss allowance	-	-	-	-	(32)
Other movement	11	-	-	11	(1)
Impairment of FVOCI investment shown under OCI	(13)	-	-	(13)	44
Balances at the closing of the year	10	-	-	10	12

The following table provides reconciliation between:

- Amounts shown in above tables reconciling of opening and closing balances of loss allowance per class of financial instrument; and
- The impairment losses on financial instruments' line item in the statement of profit and loss.

	Amount in £000			
	Due from banks at amortised cost	Loans and advances to customers at amortised cost	Financial investments	Total
New provisions	2	27	-	29
Increased provisions	-	1,159	-	1,159
Uncollectable recovered / settled	(11)	(504)	11	(504)
Total – 2022	(9)	682	11	684
Total – 2021	(513)	477	(32)	(68)

IFRS 9 models are reviewed on a periodic basis with any material change being approved at the Board

11. 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.

In addition, borrowing is also made by pledging investment securities under Repo arrangement with counterparties. The Bank also availed financing under TFSME scheme by placing investment securities with Bank of England.

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:

Amount in £000

Collateral Type	2022		2021	
	Collateral Value	Advances	Collateral Value	Advances
Commercial real estate	908,901	440,097	798,044	382,240
Residential real estate	270,225	139,330	224,833	110,221
Cash collateral	37,224	21,175	36,574	18,119
Other collateral	-	-	-	-
Guarantees	-	-	-	-
Unsecured	-	-	-	7,934
Total	1,216,350	600,602	1,059,451	518,514

The Bank doesn’t hold collateral against any of the financial asset other than loans and advances to the customers.

The following table stratifies credit exposures from mortgage loans and advances to customers by ranges of loan-to-value (LTV) ratio. LTV is calculated as the ratio of gross amount of the loan – to the value of the collateral. The value of the collateral for mortgage loans is based on the collateral value at origination updated based on changes in valuation. For credit-impaired loans the value of collateral is based on the most recent appraisals and taking into account any reduction in values as a result of forced sales.

Loans and Advances

Amount in £ 000

LTV Bracket	2022				2021			
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total
Less than 50%	179,630	6,808	1,895	188,333	163,368	3,237	1,933	168,538
51-70%	374,043	16,543	10,593	401,179	317,832	6,911	5,903	330,646
71-90%	370	261	445	1,076	953	-	454	1,407
91-100%	49	-	3,345	3,394	90	-	-	90
More than 100%	618	2,273	3,729	6,620	11,111	2,042	4,680	17,833
Grand Total	554,710	25,885	20,007	600,602	493,354	12,190	12,970	518,514
Collateral	1,139,928	45,111	31,311	1,216,350	1,013,989	23,490	21,972	1,059,451

12. Employee Remuneration Policy

12.1. 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 ensures 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 including Material Risk Takers (MRTs).

12.2. Performance and reward

The Bank's remuneration policy is in line with market practice and is weighted towards a performance-based compensation plan. 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 focuses on the customer in order to implement the Bank's business strategy.

The Bank remuneration 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 their 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.

The Bank's Capital Adequacy Ratio will not be affected by the remuneration policy.

Appendix 1 Standardised approach – Credit risk exposure and CRM effects – CR4

2022 Asset classes	Exposures before CCF and CRM		Exposures post-CCF and post-CRM		RWA and RWA density	
	On-balance sheet	Off-balance sheet	On-balance sheet	Off-balance sheet	RWA	RWA density
Sovereigns and their central banks	115,926	0	115,926	0	2,571	2%
Multilateral development banks	69,096	0	69,096	0	0	0%
Financial institutions	164,085	2,899	164,085	2,899	64,884	40%
Corporates	87,329	32,507	87,329	32,507	53,467	61%
Retail	39	0	39	0	29	75%
Exposures secured against real estate	547,150	7,913	547,150	7,913	385,932	71%
Exposures at default	20,029	948	20,029	948	15,693	78%
Other assets	16,566	0	16,566	0	15,878	96%
	1,020,220	44,266	1,020,220	44,266	538,454	53%

Appendix 2 Standardised approach – Exposure by asset class and risk weights– CR5
Total credit exposure amount (post-CCF and post-CRM)

Asst classes	0%	20%	50%	100%	150%	Other	Total
Sovereigns and their central banks	108,571	3,684	3,669	-	-	-	115,924
Multilateral development banks	69,095	-	-	-	-	-	69,095
Financial institutions	-	98,813	46,065	22,108	-	-	166,986
Corporates	-	910	22,465	97,403	-	-	120,778
Retail	-	-	-	-	-	38	38
Exposures secured against real estate	-	-	-	402,669	-	152,393	555,062
Exposures at default	-	-	-	20,977	-	-	20,977
Other assets	688	-	-	14,938	-	-	15,626
Total	178,354	103,407	72,199	558,095	-	152,431	1,064,486

Appendix 3 – Composition of Regulatory Own funds

		2022	2021
	Common Equity Tier 1 (CET1) capital: instruments and reserves		
1	Capital instruments and the related share premium accounts of which called up share capital and share premium	70,000	70,000
		-	-
2	Retained earnings	14,822	11,824
3	Accumulated other comprehensive income (and other reserves)	(1,017)	0
4	Independently reviewed interim profits net of any foreseeable charge or dividend	-	-
		-	-
6	Common Equity Tier 1 (CET1) capital before regulatory adjustments	83,806	81,824
7	Additional value adjustments	(46)	-
8	Intangible assets	-	-
10	Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability where the conditions in Article 38 (3) CRR are met)	(2,399)	-
11	Fair value reserves related to gains or losses on cash flow hedges of financial instruments that are not valued at fair value		
12	Negative amounts resulting from the calculation of expected loss amounts		
14	Gains or losses on liabilities valued at fair value resulting from changes in own credit standing		
15	Defined-benefit pension fund assets		
19	Direct, indirect and synthetic holdings by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities (amount above 10% threshold and net of eligible short positions)		
22	Amount exceeding the 17,65% threshold		
23	of which: direct, indirect and synthetic holdings by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities		
25	of which: deferred tax assets arising from temporary differences	(2,399)	-
27a	Other regulatory adjustments to CET1 capital (including IFRS 9 transitional adjustments when relevant)		
28	Total regulatory adjustments to Common Equity Tier 1 (CET1)	81,361	81,824
29	Common Equity Tier 1 (CET1) capital		
	Additional Tier 1 (AT1) capital: instruments		
30	Capital instruments and the related share premium accounts		

31	of which: classified as equity under applicable accounting standards		
36	Additional Tier 1 (AT1) capital before regulatory adjustments		
40	Direct, indirect and synthetic holdings by the institution of the AT1 instruments of financial sector entities where the institution has a significant investment in those entities (net of eligible short positions)		
43	Total regulatory adjustments to Additional Tier 1 (AT1) capital		
44	Additional Tier 1 (AT1) capital		
45	Tier 1 capital (T1 = CET1 + AT1)		
	Tier 2 (T2) capital: instruments		
46	Capital instruments and the related share premium accounts	20,000	20,000
UK-47b	Amount of qualifying items referred to in Article 494b (2) CRR subject to phase out from T2		
50	Credit risk adjustments		
51	Tier 2 (T2) capital before regulatory adjustments	20,000	20,000
	Tier 2 (T2) capital: regulatory adjustments	-	-
52	Direct, indirect and synthetic holdings by an institution of own T2 instruments and subordinated loans		
55	Direct, indirect and synthetic holdings by the institution of the T2 instruments and subordinated loans of financial sector entities where the institution has a significant investment in those entities (net of eligible short positions)	579	386
57	Total regulatory adjustments to Tier 2 (T2) capital	20,579	20,386
58	Tier 2 (T2) capital		
59	Total capital (TC = T1 + T2)	101,940	102,209
60	Total Risk exposure amount	575,206	547,938