Habib Bank AG Zurich

Annual disclosures according to Basel III (Year 2014)

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(Incorporated in Switzerland 1967)

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1. Scope of consolidation

Scope of consolidation for capital adequacy purposes

The scope of consolidation for capital adequacy purposes consist of the following companies (hereafter referred to as "the Group"):

• Habib Bank AG Zurich	
• Habib Canadian Bank, Canada	(100% ownership)
• HBZ Bank Limited, South Africa	(100% ownership)
• Habib European Bank Ltd., Isle of Man	(100% ownership)
• Habib Metropolitan Bank Ltd., Pakistan	(51% ownership)
• HBZ Finance Limited, Hong Kong	(51% ownership)

Scope and method of consolidation according to FINMA Circular 2015/1 "Accounting - Banks"

The Group's method of capital consolidation follows the purchase method. The scope of consolidation according to FINMA Circular 2015/1 "Accounting - Banks" additionally includes the subsidiary HBZ Services FZ-LLC (100% ownership). This company acts as a service provider for the Group and does not operate in the financial sector. (please refer to the Annual Report 2014, page 35).

2. Group risk principles

Risk & Control Framework

The Risk & Control Framework of the Group is the cornerstone for risk management and control. The Risk & Control Framework provides the basis to effectively identify, assess and manage risks within the Group. Furthermore, it defines which body has the overall responsibility for a particular risk class, who manages it and who performs independent risk control.

Risk organisation

At the level of the Board of Directors, the responsibilities are the following:

- the Board of Directors is responsible for the strategic direction, supervision and control of the Group, and for defining the overall risk tolerance by means of a risk appetite statement and overall risk limits;
- the Risk & Control Committee is responsible for assisting the Board of Directors in fulfilling its oversight responsibilities by providing guidance regarding risk governance and the development of the risk profile, including the regular review of major risk exposures and overall risk limits; and
- the Audit Committee is responsible for assisting the Board of Directors in fulfilling its oversight responsibilities by monitoring General Management's approach with respect to financial reporting, internal controls and accounting. Additionally, the Audit Committee is responsible for monitoring the independence and performance of the Group Internal Audit and external auditors.

At the operational level, the Group operates with a three-line of defence model whereby business functions, risk management oversight and assurance roles are performed by functions independent of one another.

Furthermore, a clear distinction is made between "risk owners", "risk managers" and "risk controllers":

- Risk owners bear the overall supervision and responsibility for the management of specific risk classes or risk types;
- Risk managers focus on the monitoring and proactive management of risk. They initiate risk management measures and can change the risk profile;
- Risk controllers independently monitor and assess risk as well as highlight deviations from target risk parameters and non-compliance with policies.

Risk management principles

The following general principles support the Group's effort to maintain an appropriate balance between risk and return:

- We protect the financial strength of the Group by controlling our risk exposures and avoiding potential risk concentrations at individual exposure levels, at specific portfolio levels and at an aggregate Group-wide level across all risk types;

- We protect our reputation through a sound risk culture characterised by a holistic and integrated view of risk, performance and reward, and through full compliance with our standards and principles;
- We systematically identify, classify and measure risks applying best practice;
- We ensure management accountability, whereby Business Line Management owns all risks assumed throughout the Group and is responsible for the continuous and active management of all risk exposures to ensure that risk and return are balanced;
- We set up independent risk control functions or units, which monitor effectiveness of risk management and oversee risk-taking activities;
- We disclose risks to the Board of Directors, regulators and other stakeholders in a comprehensive and transparent manner.

Internal controls

Internal controls are a set of instruments used to monitor and control operational and other business risks. This process involves evaluating reports from the internal and external auditors on an ongoing basis, assessing risks and adjusting business processes and the internal control system. The organisational units responsible for internal controls therefore work closely with other organisational units within the Group. We see risk management as an on-going, multi-level and integral process within the Group.

Credit risk

Credit risk arises from the possibility that a counterparty, i.e. private clients, corporate clients, financial institution and issuer or sovereign does not fulfil its contractual obligations or the credit quality deteriorates. In order to manage potential default risk and other prevailing credit risks most effectively, it is divided into the following risk types: client credit risk, credit issuer risk, credit counterparty risk, country risk (including cross-border / transfer risk), settlement risk and credit concentration risk.

The Group manages its credit risk within a conservative framework by evaluating the creditworthiness of the borrowing counterparties, setting appropriate credit limits and obtaining collateral as deemed necessary. For each collateral type a minimum haircut is defined in order to account for the volatility in market values according to the nature and liquidity of the collateral. Around 35% of the Group's credit exposure is secured by property and only 18% is unsecured.

The Group's credit risk appetite is defined and monitored through a comprehensive system of credit limits.

The Group has its own rating system for corporate clients. Each credit is assessed as to the borrower's credit worthiness, collateral coverage and collateral quality requirements, as well as the underlying transaction rationale, business potential and any additional risk mitigations. Personal credits are usually only granted on a fully collateralised basis. Collateral coverage is monitored on a regular basis and according to the prevailing market conditions.

Adequate and clear segregation of duties is established among the various organisational units involved in the acquisition of credit business, the analysis and approval of a credit request, and the subsequent administration.

Bank counterparties, issuers and sovereigns are analysed according to their financial performance and their external rating. Over 75% of the credit exposure to financial institutions is of investment-grade quality and the remaining 25% consists mainly of trade finance exposure in emerging markets where the Group is closely related to and monitors the portfolio with a set of country limits.

As for non-performing loans, the Group is in a comfortable position. After taking the collateral at market value and the specific provisions into account, the net unsecured and unprovided position at the end of December 2014 was only CHF 10.5 million.

Country risks are monitored quarterly and are either guaranteed with the World Bank (MIGA) or provided for in accordance with the guidelines of the Swiss Bankers Association using international ratings.

For capital adequacy purposes, the Group uses the standardised approach under Basel III. External ratings (Moody’s, S&P, Fitch) are only used for Group counterparties and financial investments, as all corporates within the SME sector do not have external ratings from eligible rating agencies. Furthermore, the Group uses the simple approach for collateral recognition.

Market risk

The Group is exposed to interest rate risk, foreign exchange risk and, to a very limited extent, to equities and commodities risk.

The Group's market risk appetite is defined and monitored through a comprehensive system of market risk limits. Furthermore, the Group regularly performs scenarios and stress tests for interest rate and foreign exchange risks based on prevailing risk exposures.

The Group is exposed to interest rate risk due to interest periods set for advances made to clients exceeding the interest periods for client deposits taken. To limit interest rate risk, most client advances are agreed on a three or six month base rate plus a credit spread.

In addition, branches and subsidiaries have placed excess liquidity in bank placements or in financial investments with tenors usually up to three to five years. While the volume of financial investments is kept limited, the average duration of the fixed income portfolios creates interest rate risk exposure given the absence of long-term wholesale financing.

As for foreign exchange risks, the Group pursues a risk-averse approach and aims at keeping potential foreign exchange losses low. The Group neither speculates on foreign exchange movements nor pursues proprietary foreign exchange trading activities.

Profits earned in the Bank's branches are subject to exchange rate risk up to their remittance to Habib Bank AG Zurich, Zurich. These risks are monitored at the Head Office, and profits hedged as felt appropriate. Capital and reserves held in the branches are also subject to foreign exchange risk insofar as they are held in local currencies. Any foreign exchange translation gains or losses on these capital and reserves are taken to the income statement in the year in which they occur.

Operational risk

Operational risk is defined as the risk of direct or indirect loss, or damaged reputation, resulting from inadequate or failed internal processes, from people or systems, or from external events.

The Group makes use of six operational risk management processes, which consist of key risk indicators, change risk assessment, risk self-assessment, scenario analysis, risk event management and issue management and action tracking.

Furthermore, three types of risk mitigation are used and comprise control enhancement, business continuity management and other mitigation measures (risk avoidance, risk reduction, risk transfer).

To proactively address risks related to potential business disruptions, business impact analyses, crisis management teams and business continuity plans have been established for the Group as well as all branches and subsidiaries.

Table 1: Disclosure regulatory eligible capital according to FINMA Circular 2015/1 "Accounting - Banks"

In CHF 000's	**31.12.14**
Assets	
Liquid assets	941'017
Amounts due from banks	2'061'060
Amounts due from securities financing transactions	18'767
Amounts due from customers	2'972'811
Mortgage loans	435'420
Trading portfolio assets	707
Positive replacement values of derivative financial instruments	20'616
Other financial instruments at fair value	1'956'773
Financial investments	1'125'111
Accrued income and prepaid expenses	123'279
Non-consolidated participations	88
Tangible fixed assets	90'629
Intangible assets	5'140
Other assets	52'069
- of which for deferred tax assets	*29'341*
Total assets	**9'803'487**
Liabilities	
Amounts due to banks	370'241
Amounts due in respect of customer deposits	8'017'828
Negative replacement values of derivative financial instruments	21'638
Accrued expenses and deferred income	128'955
Other liabilities	35'115
Provisions	22'967
- of which for deferred taxes	*3'624*
Total liabilities	**8'596'744**

In CHF 000's	**31.12.14**
Equity	
Reserves for general banking risks	555'832
Bank's capital	150'000
Minority interest in equity	197'352
Retained earnings reserves	217'269
Currency translation reserves	8'675
Group profit / loss	77'615
Total equity	**1'206'743**

Table 2A: Eligible capital

In CHF 000's	**31.12.14**
Common equity Tier 1 capital (CET1)	
Reserves for general banking risks	555'832
Bank's capital	150'000
Minority interest in equity	197'352
Retained earnings reserves	217'269
Currency translation reserves	8'675
Group profit / loss	77'615
Common equity Tier 1 capital before deductions	**1'206'743**
Deductions from common equity Tier 1 capital	
Presumed dividend (incl. payments to minority interests)	-29'510
Non-consolidated participations	-88
Goodwill	-5'140
Deductions for minority interests	-81'787
Total deductions from common equity Tier 1 capital (CET1)	**-116'525**
Eligible adjusted common equity Tier 1 capital (CET1)	1'090'218
Eligible additional Tier 1 capital (AT1)	
Eligible Tier 2 capital (T2)	
Total eligible capital	**1'090'218**

Table 2B: Capital requirements

risk weighted at 11.2%

In CHF 000's		**31.12.14**
Credit risk	Standardised approach	495'317
Non-counterparty risks	Standardised approach	18'428
Market risk	Standardised approach	48'616
- of which currencies		*48'542*
Operational risks	Basic indicator approach	65'388
Total minimum capital requirements		**627'749**

Table 2C: Capital ratio

In CHF 000's	**31.12.14**
Solvency ratio (%) in respect of minimal capital requirements	19.5%
The minimal requirement is 11.2%	

Table 3: Credit risk allocation according to counterparty

In CHF 000's		Sovereigns	Banks	Other institutions	Corporates	Retail	Equity	Other exposure	Total
Liquid assets		910'410	3'600					27'007	**941'017**
Amounts due from banks			1'971'796	47'142	42'098			24	**2'061'060**
Amounts due from securities financing transactions			9'670		9'097				**18'767**
Amounts due from customers		39'744	145'882	112'102	2'104'795	840'435		2'342	**3'245'300**
Mortgage loans					76'754	358'666			**435'420**
Trading portfolio assets						50		657	**707**
Other financial instruments at fair value		1'905'477		7'546	13'661		10'456	19'633	**1'956'773**
Financial investments		427'881	310'050	42'875	236'602		107'703		**1'125'111**
Accrued income and prepaid expenses		55'590	223	1'314	14'594	5'750		41'819	**119'290**
Non-consolidated participations					88				**88**
Other assets		1'604			2'014	1'108		18'002	**22'728**
Total credit risk exposure	**31.12.14**	**3'340'706**	**2'441'221**	**210'979**	**2'499'703**	**1'206'009**	**118'159**	**109'484**	**9'926'261**
Total credit risk exposure	31.12.13	2'073'142	2'271'273	307'137	1'885'896	921'336	105'944	141'142	7'705'870

In CHF 000's		Sovereigns	Banks	Other institutions	Corporates	Retail	Equity	Other exposure	Total
Contingent liabilities		8'597	74'897	119'108	689'358	245'312		1'872	**1'139'144**
Irrevocable commitments					44'046			1'666	**45'712**
Credit commitments			44'924		150'415	25'932			**221'271**
Total off balance sheet transactions	**31.12.14**	**8'597**	**119'821**	**119'108**	**883'819**	**271'244**		**3'538**	**1'406'127**
Total off balance sheet transactions	31.12.13	8'824	153'532	121'358	794'892	258'477		4'124	1'341'207

Table 4: Credit risk mitigation (CRM)

In CHF 000's		Sovereigns	Banks	Other institutions	Corporates	Retail	Equity	Other exposure	Total
Exposure net of value adjustments and provisions, post application of credit conversion factors on off-balance sheet items		3'349'303	2'561'042	330'087	3'383'522	1'477'253	118'159	113'022	**11'332'388**
Exposure covered by guarantees					-2'592	-352			**-2'945**
Exposure covered by credit derivates									
Financial collateral: simple method			-7'840	-109'360	-273'184	-557'307			**-947'691**
Net exposure	**31.12.14**	**3'349'303**	**2'553'202**	**220'727**	**3'107'746**	**919'594**	**118'159**	**113'022**	**10'381'753**
Net exposure	31.12.13	2'081'966	2'423'999	428'495	2'486'259	798'388	105'944	145'266	8'470'317

Table 5: Segmentation by risk weights (On + Off balance)

In CHF 000's		Sovereigns	Banks	Other institutions	Corporates	Retail	Equity	Other exposure	Total
0%		3'247'702		76'002				27'664	**3'351'368**
	of which risk weighted based on external ratings	*3'247'702*		*76'002*					*3'323'704*
20%		3'000	1'962'599	33'028	59'168				**2'057'795**
	of which risk weighted based on external ratings	*3'000*	*1'350'487*	*33'028*	*59'168*				*1'445'683*
35%						13'831			**13'831**
50%		5'079	478'367	27'744	45'326			1'666	**558'182**
	of which risk weighted based on external ratings	*5'079*	*340'230*	*27'744*	*45'326*				*418'379*
75%						1'247'531			**1'247'531**
100%		93'522	103'099	193'313	3'205'679	206'154	20'222	83'692	**3'905'681**
	of which risk weighted based on external ratings	*92'532*	*74'183*	*2'848*	*367'346*				*536'909*
150%			16'977		73'349	9'737	97'937		**198'000**
	of which risk weighted based on external ratings		*10'368*						*10'368*
Total	**31.12.14**	**3'349'303**	**2'561'042**	**330'087**	**3'383'522**	**1'477'253**	**118'159**	**113'022**	**11'332'388**
Total	31.12.13	2'081'966	2'424'805	428'495	2'680'788	1'179'813	105'944	145'266	9'047'077

Table 6: Analysis of credit risk allocation by region

In CHF 000's		Europe	thereof Switzerland	Asia	Others	Total
Assets						
Liquid assets		126'903	124'037	803'910	10'204	**941'017**
Amounts due from banks		671'226	295'252	1'113'523	276'311	**2'061'060**
Amounts due from securities financiang transactions				18'767		**18'767**
Amounts due from customers		525'713	97'726	2'407'786	311'801	**3'245'300**
Mortgage loans		478		375'551	59'391	**435'420**
Trading portfolio assets		526	476	181		**707**
Other financial instruments at fair value				1'956'773		**1'956'773**
Financial investments		389'948	120'985	482'949	252'214	**1'125'111**
Accrued income and prepaid expenses		16'070	14'225	101'981	1'239	**119'290**
Non-consolidated participations		88				**88**
Other assets		6'393	4'939	12'400	3'935	**22'728**
Total	**31.12.14**	**1'737'345**	**657'640**	**7'273'821**	**915'095**	**9'926'261**
Total	31.12.13	1'493'583	503'715	5'272'724	939'563	7'705'870

In CHF 000's		Europe	thereof Switzerland	Asia	Others	Total
Off balance sheet						
Contingent liabilities		66'629	40'101	1'046'962	25'553	**1'139'144**
Irrevocable commitments		1'666	1'666	44'046	0	**45'712**
Credit commitments		16'731	14'869	199'144	5'396	**221'271**
Total	**31.12.14**	**85'026**	**56'636**	**1'290'152**	**30'949**	**1'406'127**
Total	31.12.13	27'433	9'711	1'218'320	95'454	1'341'207

Table 7: Impaired loans from customers by region

In CHF 000's		Impaired loans	Individual value adjustments
Europe		66'082	27'533
- of which Switzerland		*553*	*390*
Asia		296'884	197'195
Others		5'495	1'980
Total	**31.12.14**	**368'461**	**226'708**
Total	31.12.13	308'902	185'938

Table 8: Interest risk

In CHF 000's	**+ 100 basis points**	**- 100 basis points**
Change in total equity given a shift in the interest rate curve of:	-51'252	+53'724
in percent of total equity	-4.25%	+4.45%