

# Staying Ahead



YOUR PARTNER IN PROGRESS

Corporate Governance &  
Risk Management Report 2018



# About our Report

We continue our quest for excellence in corporate reporting with an even leaner collection of reports which comply with legal requirements and international best practice. Our objective is to communicate the relevant material information in a concise but comprehensive manner to provide shareholders with a balanced review of our performance during the year.

## CORPORATE GOVERNANCE, RISK & CAPITAL MANAGEMENT REPORT

This report is intended for providers of financial capital and regulators who require deeper insights into the Bank's approach to managing risk and financial capital.

### Frameworks Applied

- Code of Best Practice on Corporate Governance issued by the Institute of Chartered Accountants of Sri Lanka
- Banking Act Direction No.11 of 2007 and subsequent amendments thereto
- Directions issued by Central Bank of Sri Lanka on Risk Management including the Basel Capital Accord (II)
- Baseline Security Standards
- Sri Lanka Financial Reporting Standards issued by the Institute of Chartered Accountants of Sri Lanka
- Companies Act No.7 of 2007
- ISO 31000 – Enterprise Risk Management
- ISO 27001 – Information Security
- PCIDSS – Payment Card Industry Data Security Standards

Assurance has been provided by Ernst & Young to Central Bank of Sri Lanka on Compliance with the Banking Act Direction No.11 of 2007 and subsequent amendments.

## INTEGRATED ANNUAL REPORT 2018

This report is primarily for providers of financial capital and will be of interest to other stakeholders as it summarises information on all material issues impacting our performance.

### Frameworks Applied

- Companies Act No.7 of 2007
- Sri Lanka Financial Reporting Standards issued by the Institute of Chartered Accountants of Sri Lanka
- IR Framework issued by the International Integrated Reporting Council (*refer annexure page 327 for application of <IR> guiding principles*)
- GRI Standards
- Communicating Sustainability issued by the Colombo Stock Exchange

Assurance has been provided by Ernst & Young on the Financial Statements including the Notes to the Accounts.

DNV GL has provided assurance on the Sustainability Report.

**Scope & Boundary** - Whilst financial information presented is consolidated, the non-financial information presented is only for the Bank as we are in the process of further strengthening the process of data management systems within the group to ensure increased system reliability and completeness.

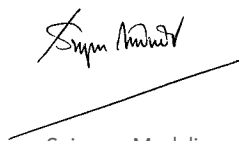
The Management of Hatton National Bank PLC has reviewed and approved the relevant content of all reports and recommended the report to the Board Audit Committee and Board for their approval as per delegation of authority.

The Board acknowledges its responsibility to ensure that the Annual Integrated Report provides a balanced view of its performance in 2018 and is of the opinion that it addresses all material issues that it believes may have a bearing on the Group's capacity to create value over the short term.

The reports were unanimously approved by the Board on 20th February 2019 and are signed on its behalf by



Dinesh Weerakkody  
Chairman



Sujeewa Mudalige  
Board Audit Committee



Jonathan Alles  
Managing Director/CEO

Colombo, Sri Lanka  
20th February 2019

## INNOVATIONS IN 2018

- Performance highlights have separate statements for Economic, Social and Environmental Performance
- Business line reviews highlight value to Group and value to external stakeholders facilitating a balanced assessment of performance
- Segregated digital capital from manufactured capital in recognition of its strategic significance and described how we nurtured this capital more fully
- Adopted and reported compliance with the new Code of Best Practice on Corporate Governance issued in December 2017
- Further refined the combined Corporate Governance and statutory report of the Board, eliminating repetition while conforming to regulatory requirements
- Streamlined the reporting suite to just two reports

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# Chairman's Message



“HNB is committed to the highest standards of corporate governance. We believe good governance is fundamental to the Bank’s success and the sustainable growth we seek for our stakeholders.”

It gives me pleasure to present the 2018 Corporate Governance Report on behalf of the HNB Board. This report provides us an opportunity to account for the work of the Board during 2018 and describes the Bank’s robust corporate governance principles and practices applied.

The HNB Board fully appreciates the importance of sound governance, where our approach extends beyond compliance. We believe corporate governance to be an enabler that creates competitive advantage in responding to a dynamic and challenging environment through enhanced accountability, prudent risk management, clear performance management, greater transparency, and effective leadership. Our leadership is underpinned by the Bank’s strong values, code of ethics and governance principles and practices designed to enhance public trust and confidence in the Bank.

As the Bank journeys through its digital transformation to become future ready by 2020, we continue to regularly review and benchmark the Bank’s governance structures and processes, to ensure compliance with all statutory and regulatory requirements and that they satisfy the evolving needs of the Bank. The two new appointments made to the Board to fill the vacancies arisen during the year, adds to the Board’s expertise and collective experience, enhancing the Board’s ability to provide effective leadership, guidance and oversight. Director training was enhanced to build on the Board’s range of relevant skills and competencies. Of critical importance is the threat of cybersecurity and we strengthened our cyber risk management system during the year, regularly reviewing its effectiveness at Board Meetings and through the BIRMC. The Bank has adopted all the principles included in the Code of Best Practice on Corporate Governance issued by the Institute

of Chartered Accountants of Sri Lanka in 2017 (the code) as disclosed on CG&RR pages 34 to 36. The compliance status with the Corporate Governance regulations made under the Banking Act Direction No 11 of 2007 and amendments thereof, issued by the Central Bank of Sri Lanka for Licensed Commercial Banks is given on CG&RR pages 20 to 33.

During the year, the Bank operated in an increasingly challenging environment, characterised by both volatility and uncertainty, with elevated Sri Lanka country risk. The Board and the Corporate Management, conscious of their responsibilities, spent a considerable amount of time reviewing the impact of these factors on the Bank and its stakeholders, and in averting any risks. The Board is satisfied that all decisions taken were fair, ethical and underpinned by the Bank’s values and were in the best interests of both the Bank and its stakeholders. The Board will continue to lead by example, ensuring the Bank upholds excellence in corporate governance, driving success and sustainable value.

As required by the above Code, I hereby confirm that, I am not aware of any material violations if any of the provisions embodied (i) in the Board Charter, by the Board of Directors of the Bank; or (ii) in the Bank’s Codes of Conduct and Ethics, by any member of the Corporate Management team of the Hattton National Bank PLC.

A handwritten signature in black ink, appearing to read 'Dinesh Weerakkody', written over a white background.

Dinesh Weerakkody  
*Chairman*

Colombo, Sri Lanka  
20th February 2019

# Corporate Governance

## BOARD OF DIRECTORS

THE Composition of the Board is the key to governance as it sets the tone at the top, shaping organization culture while driving strategy and performance.



### ROHAN KARUNARATNE (DR)

- Appointed - October 2011
- Expertise - Engineering



### SUJEEVA MUDALIGE

- Appointed - April 2012
- Expertise: Audit and Assurance



### AMAL CABRAAL

- Appointed - April 2014
- Expertise - Management and Marketing

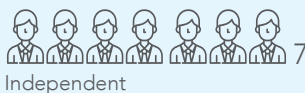


### DINESH WEERAKKODY

- Appointed Chairman - May 2018
- Appointed Director- June 2017
- Expertise - HRM, Strategy and Board Leadership



### COMPOSITION



### AGE DIVERSITY



### DULIKSHA SOOSAIPILLAI

- Appointed - April 2015
- Expertise - Finance, Enterprise Risk, Corporate Governance



### PALITHA PELPOLA

- Appointed - April 2015
- Expertise - Public Sector Leadership and Communication

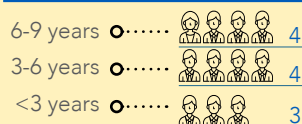


### NILANTH DE SILVA

- Appointed - April 2015
- Expertise - Banking



### NON-EXECUTIVE DIRECTOR TENURE



- ▼ Board Audit Committee
- ◆ HR & Remuneration Committee
- Nomination Committee
- \* Board Integrated Risk Management Committee
- Related Party Transactions Review Committee

- ▮ Strategy & Investment Review Committee
- ★ Procurement & Assets Disposal Committee
- ❖ Board Credit Committee
- Chairman/Chairperson



**DAMIEN FERNANDO**

- Appointed - October 2018
- Expertise - Management & Finance



**RUSI CAPTAIN**

- Appointed - April 2012
- Expertise - Strategy and Leadership



**PRAWIRA SALDIN**

- Appointed - July 2018
- Expertise - Management & Finance

(Alternate Director to Mr. Rusi Captain)

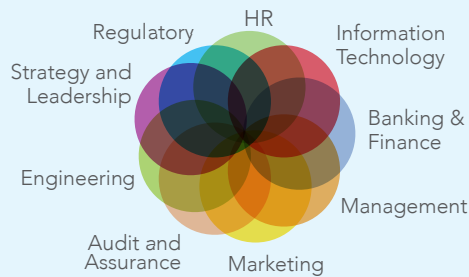


**JONATHAN ALLES**

- Appointed MD/CEO - July 2013
- Appointed Director - May 2013
- Expertise - Banking and Finance



**EXPERIENCE AND EXPERTISE**



**MADU RATNAYAKE**

- Appointed - October 2018
- Expertise - Information Technology



**ROSE COORAY (MS)**

- Appointed - February 2010
  - Expertise - Regulatory and Development Banking
- (Retired w.e.f. 15th February 2019)



**THUSHARI RANAWEERA (MS)**

- Company Secretary
- Appointed - January 2012
- Expertise - Legal

**Resignations in 2018**

**Rienzie Arseculeratne**

- Appointed Chairman - May 2015
- Appointed Director - April 2015
- Resigned - May 2018
- Expertise - Legal

**Sanjivani Jayawardena (Ms)**

- Appointed - April 2012
- Resigned - June 2018
- Expertise - Marketing & Management

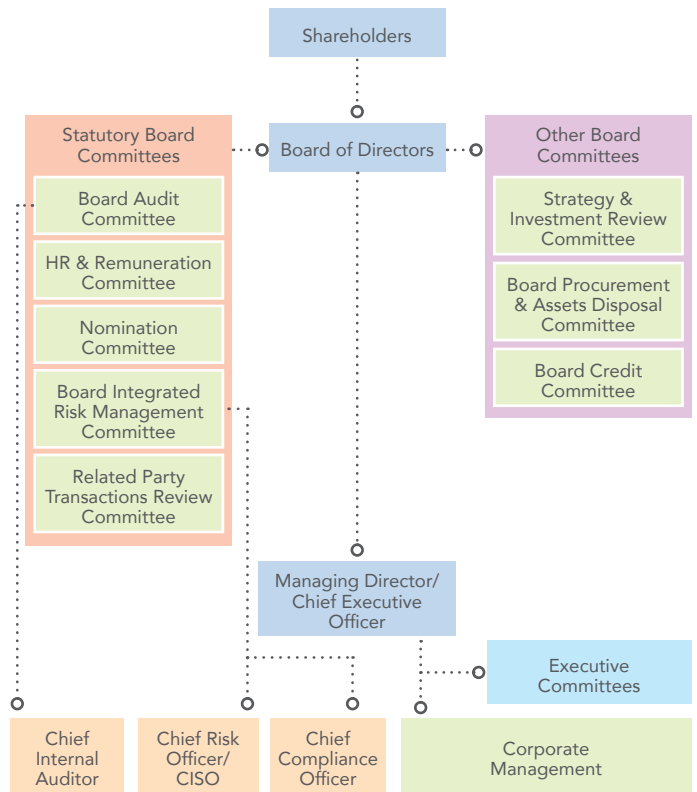
# Corporate Governance

We are committed to excellence in corporate governance because we believe it underpins our success and creates sustainable value. A sound governance structure together with a comprehensive policy framework founded on the Bank's values and code of ethics drives enhanced accountability, transparency, risk management and effective leadership. We regularly review and benchmark our practices to ensure they are applied in the best interests of HNB and our stakeholders.

## OUR APPROACH TO CORPORATE GOVERNANCE

The Board seeks to ensure that the Bank pursues its strategic goals in accordance with sound Corporate Governance principles, safeguarding its reputation, values and assets while balancing stakeholder interests. A defined strategic plan, fit-for-purpose governance structure and a comprehensive framework of policies facilitate accountability and transparency and drive the desired corporate behaviour, and long term, sustainable value. The framework and policies are reviewed at regular frequencies to maintain alignment with the Bank's strategy, regulatory requirements, enabling environment including technological advancements and international best practice. Policies are reinforced through training and an alignment of performance management systems to shape a culture of compliance while nurturing entrepreneurship and results orientation to realise our corporate goals.

Governance Structure



The Board delegates functions warranting greater attention, to eight (8) Board Sub-Committees with clear oversight responsibility to and on behalf of the Board. This enables the Board to allocate sufficient time to matters within its scope, particularly execution of strategy and forward-looking agenda items. Reports of the five (5) mandatory Sub-Committees are given on IR pages 102 to 115. The Board reviews and approves the delegation arrangements annually.

The Corporate Management led by the MD/CEO, is responsible for implementing the Bank's strategic plan within the policy framework, internal controls and risk appetite set in place by the Board. A clearly defined governance framework approved by the Board, provides for the delegation of authority to the MD/CEO, Executive Committees and Senior Management of the Bank with regular reporting to the Board on key matters. The Chief Internal Auditor reports directly to the BAC whilst the Chief Risk Officer/CISO and the Chief Compliance Officer report directly to BIRMC underscoring the independence of these key functions.



## Comprehensive Policy Framework

The policy framework of the Bank is key to sound Corporate Governance. Compliance with external regulations is facilitated through a Comprehensive Policy Framework. Collectively, they define how we do business and reflect our approach to compliance, managing stakeholders' expectations and risk. Policy documents are typically modelled on international best practice, ensuring compliance with regulatory requirements as appropriate to the Bank's size, systemic importance and the specific operational context.

Table 1 : Bank's Policy Framework

General	Talent Management	Risk Management
<ul style="list-style-type: none"> <li>Articles of Association</li> <li>Charters/Terms of Reference of Board, Board Sub-Committees and Management Committees</li> <li>Delegation of Authority</li> <li>Code of Conduct for Employees</li> <li>Charter for Management/Good Governance of Group Companies</li> </ul>	<ul style="list-style-type: none"> <li>Talent Acquisition Policy</li> <li>Talent Development Policy</li> <li>Talent Mobility Policy</li> <li>Overseas Training Policy</li> <li>Remuneration Policy</li> <li>Succession Planning Policy</li> <li>Promotion (Executive and Non-Executive) Policy</li> <li>Travel Policy</li> <li>Work Life Balance Policy</li> </ul>	<ul style="list-style-type: none"> <li>Overall Risk Management Framework</li> <li>Board Risk Appetite</li> <li>Compliance Policy</li> <li>Integrated Stress Testing Policy</li> </ul>
		Credit Risk
		<ul style="list-style-type: none"> <li>Credit Policy</li> <li>Credit Risk Policy</li> <li>Review of Personal Loan Policy</li> <li>Policy on Valuation of Immovable/ Movable Policy</li> <li>Policy on Provisioning for Facilities above 900 Days</li> <li>Recovery Policy</li> <li>Memorandum Transfer/ Write Off Policy</li> </ul>
External Relations	Conduct & Culture	Market Risk
<ul style="list-style-type: none"> <li>Customer Charter</li> <li>Corporate Communication Policy</li> <li>Related Party Policy</li> <li>Product and Delivery Channel Review Policy</li> <li>Social Media Policy</li> </ul>	<ul style="list-style-type: none"> <li>Ethics Policy</li> <li>Anti-Bribery and Corruption Policy</li> <li>Anti-Harassment Policy</li> <li>Employee Recognition and Rewards Policy</li> <li>Employee Share Trading Policy</li> <li>Equability and Diversity Policy</li> <li>Grievance Handling Policy</li> <li>Industrial Relations Policy</li> <li>Management and Resolution of Complaints Policy</li> <li>Human Rights Policy</li> <li>Whistle-blowing Policy</li> <li>Health &amp; Safety Policy</li> </ul>	<ul style="list-style-type: none"> <li>Treasury Policy</li> <li>Liquidity Policy</li> <li>Contingency Funding Plan</li> <li>Treasury Front Office Dispute Resolution Policy</li> <li>Assets and Liabilities Management Policy</li> </ul>
Procurement & Outsourcing		Operational Risk
<ul style="list-style-type: none"> <li>Outsourcing Policy</li> <li>Procurement Policy</li> </ul>		<ul style="list-style-type: none"> <li>Operational Risk Management Policy</li> <li>Information Security Policy</li> <li>Cyber Security Policy</li> <li>Anti-Money Laundering and Combating the Financing of Terrorism Policy</li> <li>Politically Exposed Persons Policy</li> <li>Investment Policy</li> <li>FATCA Policy</li> <li>Review of Environment and Social Risk Policy</li> <li>IT Recovery Policy</li> <li>IT Service Management Policy</li> </ul>

Table 2: External Compliance Framework

Key Regulatory Requirements	Voluntary Standards & Codes
<ul style="list-style-type: none"> <li>• Companies Act No.7 of 2007</li> <li>• Banking Act No. 30 of 1988 (as amended) and all Directions/ Guidelines issued thereunder</li> <li>• Continued Listing Rules of the Colombo Stock Exchange (CSE)</li> <li>• Code of Best Practice on Related Party Transactions issued by the Securities &amp; Exchange Commission</li> <li>• Foreign Exchange Act No. 12 of 2017</li> <li>• Securities and Exchange Commission of Sri Lanka Act No. 36 of 1987 (as amended)</li> <li>• Sri Lanka Accounting and Auditing Standards Act No.15 of 1995</li> <li>• Shop and Office Act, Industrial Disputes Act, Employees' Provident Fund Act, Employees' Trust Fund Act, Payment of Gratuity Act, Maternity Benefits Ordinance, etc</li> <li>• Inland Revenue Act No.24 of 2017</li> </ul>	<ul style="list-style-type: none"> <li>• Code of Best Practice on Corporate Governance issued by the Institute of Chartered Accountants of Sri Lanka in 2017</li> <li>• Integrated Reporting Framework</li> <li>• Global Reporting Initiative Standards</li> </ul>

Compliance with the requirements of the Banking Act Direction No.11 of 2007 and the Code of Best Practice on Corporate Governance issued by the Institute of Chartered Accountants of Sri Lanka in 2017 are given on CG&RR pages 20 to 33 and CG&RR pages 33 to 36 respectively. The External Auditors, Messrs. Ernst and Young, have performed procedures set out in Sri Lanka Standards on Related Service 4400 (SLSRS 4400) issued by Institute of Chartered Accountants of Sri Lanka to meet the compliance requirement of the Corporate Governance Directive. The Bank is exempted from disclosure of the CSE listing rules on Corporate Governance as the Bank complies with the Banking Act Direction No.11 of 2007 (as amended) on Corporate Governance for Licensed Commercial Banks in Sri Lanka.

## THE BOARD

The Board provides strategic guidance and maintains control of the affairs of the Bank through efficient resource allocation, risk management and performance management. These responsibilities are set out in the Board Charter, encompassing regulatory requirements and emerging trends in sound Corporate Governance. The Bank has obtained adequate insurance cover for the Board, Directors and Key Management Personnel in accordance with the recommendations of the Board. The Directors and Officers Liability Policy is renewed annually.

### KEY BOARD RESPONSIBILITIES

- Provide strategic direction
- Monitor implementation of strategy
- Set corporate values and promote ethical behaviours
- Determine the Bank's risk appetite and establish systems of risk management, internal control and compliance
- Be responsive to the needs of society
- Meet shareholders, employees and other stakeholders' obligations, balancing their interests in a fair manner
- Present a balanced and understandable assessment of the Bank's position and prospects
- Safeguard assets and ensure legitimate use
- Assess effectiveness of the Board and Sub-Committees through self-evaluation
- Ensure succession planning and the continued ability of the Bank to operate without any disruption

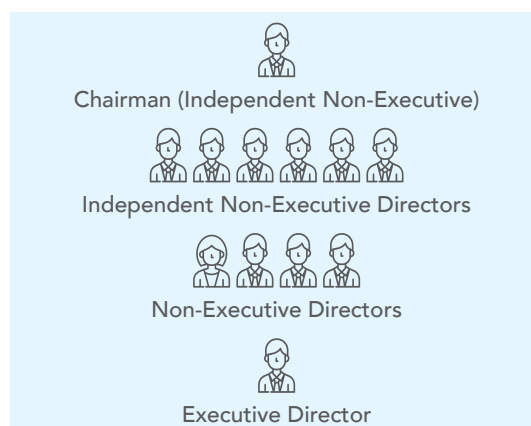
*Summarised extract of Board Charter*

“The fundamental role of the Board is to provide entrepreneurial and coherent leadership within a framework of prudent and efficient controls which enables risk to be identified, assessed and managed.”

### Board Charter

A well-balanced Board is critical to remain ahead of competition in an increasingly challenging operating environment. Accordingly, the HNB Board carefully reviews its composition for any gaps in skills and knowledge on retirement of a Director and at the annual performance review of the Board, to ensure the necessary expertise is retained to deliver on strategy and leverage opportunities.

Appointment of a Senior Independent Director has not been considered, as the Chairman is an Independent Director and the roles of the Chairman and Chief Executive Officer are clearly segregated.



## Board Composition

The Board comprises of twelve (12) Directors of whom seven (7) are independent including the Chairman. Independent Directors' tenure vary from less than one (1) year to eight (8) years ensuring there is sufficient knowledge of the Bank's operations among them on a collective basis facilitating their active participation. The sole Executive Director is the MD/CEO, who is an experienced Banker. Non-Executive Directors are eminent professionals in their respective fields.

The Board is balanced in age, experience, expertise and tenure and is of appropriate composition and size for the Bank. All Directors possess financial acumen and knowledge through experience gained from leading large private and public enterprises coupled with their academic and professional background.

## KEY AREAS OF BOARD FOCUS IN 2018

### STRATEGY & BUSINESS

- Review and approval of policy, key metrics and structural changes as per Strategic Plan 2016-2020
- Approval of significant investments
- Digitization and upgrade of IT systems per IT strategy
- Approval of 2019 budget
- Review of strategies of key Subsidiaries

### RISK & OVERSIGHT

- Performance review of the Bank and Subsidiaries
- Approval of Financial Statements and Annual Report
- Compliance reviews
- Review of impacts from operating environment
- Review of Cyber Security Risk

### GOVERNANCE

- Board Sub-Committee composition, resignations, nominations and appointments
- Board evaluations and action plan to implement recommendations
- Review of policy frameworks
- Succession planning

### STAKEHOLDER ENGAGEMENT

- Review of shareholder communications and Annual General Meeting
- Review of feedback from investor forums and quarterly analyst calls
- Review of regulatory reviews
- Engagement with CBSL

### FINANCIAL PERFORMANCE

- 2018 budget
- HNB's solvency, liquidity and going concern status and proposed dividend payments
- Financial impact of regulatory changes on capital bases and operational costs

## Role of Chairman and MD/CEO

The role of Chairman is separate from that of the MD/ CEO as detailed in the Board Charter and in line with best practices in Corporate Governance. The clear division of responsibilities ensures that no one Director has unfettered power in the decision-making process. The Chairman is an Independent Non-Executive Director and the MD/CEO, an Executive Director appointed by the Board.

Table 3 : Roles and Responsibilities of Chairman and MD/CEO

	Chairman	MD/CEO
Role	Leads the Board, preserving good Corporate Governance and ensuring that it works effectively, acting in the best interest of the Bank.	Accountable to the Board for exercise of authorities delegated and for the performance of the Bank
Responsibilities	<ul style="list-style-type: none"> <li>• Sets ethical tone for Board and Bank;</li> <li>• Sets Board's annual work plan and agendas in consultation with Company Secretary and MD/CEO;</li> <li>• Maintaining stakeholder trust and confidence;</li> <li>• Ensuring effective participation of all Board Members;</li> <li>• Ensuring balance of power between Executive and Non-Executive Directors;</li> <li>• Monitoring effectiveness of the Board;</li> <li>• Ensuring Board and Sub-Committee aware of duties and responsibilities and sufficient information supplied to Directors on time.</li> </ul>	<ul style="list-style-type: none"> <li>• Ensuring proper succession planning of the executive team and assessing their performance;</li> <li>• Developing the Bank's strategy for consideration and approval by the Board;</li> <li>• Developing and recommending budgets to the Board to support the Bank's strategy;</li> <li>• Monitoring and reporting to the Board on the performance and compliance with regulatory and policy framework;</li> <li>• Establishing an appropriate organisational structure for the Bank;</li> <li>• Setting the tone for ethical leadership and creating an ethical environment;</li> <li>• Ensuring a culture that is based on the Bank's values and</li> <li>• Ensuring that the Bank operates within the Board's risk appetite.</li> </ul>

### Appointment, Re-election and Resignation

The Board has a formal and transparent process in place for the succession and appointment of Directors. In the event of a vacancy of a Non-Executive Director, the Nomination Committee (NC) comprising of four (4) Non-Executive Directors including the Chairman, processes and shortlists candidates and makes recommendations to the Board for approval. The NC Report is given on IR pages 104 to 106.

Attributes and experience required from potential appointees are identified and agreed prior to the search process considering the combined knowledge, experience and diversity of the Board in relation to the Bank's strategic plans and any gaps thereof. The candidate's other directorships and commitments are also considered to ensure sufficient time to discharge their role effectively, as well as the level of participation, engagement and contribution of Directors proposed for re-election. The process for appointment of the Executive Director is similar with the exception being preference given to candidates and the Bank from among the Key Management Personnel.

Information on potential appointees is submitted to Central Bank of Sri Lanka (CBSL) for approval. Appointments are communicated to the CSE and shareholders through press releases together with a brief resume of the Director disclosing relevant expertise, key appointments, shareholding and Independent status. Appointments are limited to a maximum term of nine (9) years and an age limit of up to seventy (70) years, whichever comes first in line with the provisions of the Banking Act Direction No.11 of 2007.

Articles of Association of the Bank require 1/3 of the Non-Executive Directors to retire from office at each Annual General Meeting. These Directors are eligible to stand for re-election by the shareholders at the Annual General Meeting. The proposed re-election of Directors is subjected to prior recommendation by the Board Nomination Committee and approval by the full Board. Dr Rohan Karunaratne, Mr Rusi Captain and Mr Nilanth de Silva will retire by rotation at the AGM under the Articles of Association of the Bank. Dr Rohan Karunaratne, Mr Rusi Captain and Mr Nilanth de Silva have offered themselves for re-election, with the support of the Board. No Director has served on the Board for more than three (3) years from date of appointment, without being subject to re-election at an AGM of the Bank.

Directors appointed by the Board to fill casual vacancies arisen since the previous AGM, will offer themselves for re-election at the next AGM. Alternate Directors appointed by NEDs are not executives of the Bank. As such, Mr Prawira Saldin, who was appointed as the Alternate Director to Mr. Rusi Captain, is not an Executive of the Bank.

Resignations or removal, if any, of Directors and the reasons are promptly informed to the regulatory authorities and shareholders as per CSE requirements together with a statement confirming whether or not there are any matters that need to be brought to the attention of shareholders.

### RETIREMENTS, RESIGNATIONS & APPOINTMENTS - 2018

- Retirement of Mr Rienzie Arseculeratne as Chairman
- Appointment of Mr Dinesh Weerakkody as new Chairman
- Resignation of Ms Sanjivani Jayawardena
- Appointment of Mr Prawira Saldin as Alternate Director to Mr Rusi Captain
- Appointment of Mr Madu Ratnayake as an Independent Non-Executive Director and Mr Damien Fernando as a Non-Executive Director.
- Five (5) Directors including Mr Madu Ratnayake and Mr Damien Fernando will offer themselves for re-election at the AGM to be held on Friday 29th March, 2019.

### Company Secretary

All Directors have access to the services of the Company Secretary, Mrs Thushari Ranaweera, Attorney-at-Law. The Company Secretary guides the Board on discharging its duties and responsibilities, promoting best practices in Corporate Governance. Her responsibilities include ensuring the conduct of Board and General Meetings in accordance with the Articles of Association and relevant legislation, maintaining statutory registers, prompt communication to regulators and shareholders, filing statutory returns and facilitating access to legal advice in consultation with the Board, where necessary. She maintains the Minutes of Board Meetings, which are open for inspection by any Director at any time. Appointment and removal of the Company Secretary is a matter for the Board as a whole.

### Director Independence

Directors exercise their independent and unfettered judgment, promoting constructive Board deliberations and objective evaluation of the performance of the Bank. The Directors are deemed independent based on the criteria specified in the Banking Act Direction No.11 of 2007. All Directors submit annual declarations to this effect which are evaluated to ensure compliance with the criteria. Further, as an extension to the annual Board performance evaluation and following due process, the Board as a whole assesses Directors' demonstrated independence in judgment and character. Please refer Board Evaluation on CG&RR page 14. Overall, the Board was deemed to have demonstrated independence of view, in fulfilling their duties and responsibilities.

## Corporate Governance

### Board Meetings

The Board calendar with tentative dates for Board and Sub-Committee Meetings for the following year is sent to all Members approximately one month before the end of the current year. The agenda and Board Papers for Meetings are generally sent seven (7) days before the Meeting, allowing Members sufficient time to review the same. Urgent Board Papers are included on an exceptional basis.

The Chairman sets the Board agenda, assisted by the Company Secretary and MD/CEO. The agenda is prioritised and timed to ensure sufficient time for discussion.

During the year, the Board held fifteen (15) Meetings. Focus areas for 2018 are given on CG&RR page 10. Directors' concerns regarding matters which are not resolved unanimously are recorded in the Minutes. Board Minutes are circulated to Members and since the end of 2018, delivered within two (2) weeks of the Meeting being held, in compliance with the Code.

### ITEMS REGULARLY ON THE AGENDA

- CEO/MDs review
- Bank's financial and operational results
- Financial forecasts
- Board Committee Minutes and Feedback
- Risk Report including Dashboards
- Internal Control Report
- Compliance Report
- Directors' and Key Management Personnel's Declaration of Interest/Related Party Transactions
- Presentation by business units/support services

### Attendance at Meetings

Table 4 : Attendance at Meetings

Board Member	Date of Appointment to the Board	Board	Board Audit Committee	HR & Remuneration Committee	Nomination Committee	Board Integrated Risk Management Committee	Related Party Transactions Review Committee	Strategy & Investment Review Committee	Procurement and Assets Disposal Committee ***	Board Credit Committee
Total Meetings Held		15	8	7	8	9	4	8	12	7
Mr Dinesh Weerakkody (Chairman - Appointed w.e.f. 26th May 2018)	29th June 2017	■ 15/15		■ 5/6	■ 4/4					2/3
Mr Rienzie Arseculeratne, (Chairman - Resigned w.e.f. 25th May 2018)	30th April 2015	8/8		4/4	4/4					
Mr Jonathan Alles (MD/CEO)	01st May 2013	14/15	*7	*5	*2	6/9	2/4	*4		*5
Ms Rose Cooray	15th February 2010	15/15	*7	*2	8/8	■ 9/9	2/2	8/8	2/3	
Dr Rohan Karunaratne	06th October 2011	14/15	3/4	2/3			1/2		■ 10/12	7/7
Mr Sujeewa Mudalige	02nd April 2012	13/15	■ 8/8	7/7		*7		7/8		
Ms Sanjivani Jayawardena (Resigned w.e.f. 28th June 2018)	02nd April 2012	8/8				4/5			6/6	
Mr Rusi Captain	02nd April 2012	**14/15	**4/4	4/4	**8/8					
Mr Amal Cabraal	01st April 2014	**14/15	8/8	7/7				■ 8/8		3/3
Mr Palitha Pelpola	30th April 2015	**15/15			**8/8		**4/4			6/7
Mr Duliksha Soosaipillai	30th April 2015	15/15	*1	*1		9/9		8/8	12/12	
Mr Nilanth de Silva	30th April 2015	15/15	8/8				■ 4/4			■ 7/7
Mr Madu Ratnayake	25th October 2018	**2/2				0/1			1/2	
Mr Damien Fernando	25th October 2018	2/2	0/2					1/1		

\* Meetings attended by invitation

\*\* Includes Meetings attended by an alternative Director

\*\*\* The papers to the Procurement and Assets Disposal Committee are submitted via circular resolutions and physical Meetings are held only on need basis.

■ Chairman/Chairperson

Resolutions concerning business matters may be passed by circulation, within regulations. However, if a single Director deem it necessary that such resolution must be decided at a Board Meeting not by circulation, the Chairman shall put the resolution to be decided in a Meeting. This is in compliance with the Code, which requires at least 1/3rd of Directors to call for a resolution to be presented to the Board.

The Chairman met twice (2) with the Non-Executive Directors during the year and feedback was provided to the MD/CEO by the Chairman. To streamline and structure such Meetings better, a Non-Executive Directors Governance Committee was formed during the latter part of the year. The Terms of Reference include reporting procedures, scope of authority and responsibilities. Going forward the Committee is expected to meet at least twice a year.

#### Conflicts of interests and other Commitments /Related Party Transactions

Directors declare their business interests at appointment and quarterly thereafter. Details are maintained in a Register by the Company Secretary and tabled at the next Board Meeting. The

Register is available for inspection in terms of the Companies Act No.7 of 2007. Details of the business interests are submitted to the Finance Department for monitoring and statutory disclosure. Key appointments of the Directors are included in their profiles on IR pages 20 to 25. The total number of Board seats (excluding directorship in HNB) held by each Director as at 31st December 2018 is given below.

Directors do not participate in and excuse themselves from the Meeting when the Board considers any matters in which a conflict of interest is manifest and evident. The Board is aware of other commitments of its Directors and is satisfied that all Directors allocate sufficient time to enable them to discharge their responsibilities at HNB effectively.

The Related Party Transactions Review Committee reviews transactions, in line with the Bank's Related Party Transactions Policy and in compliance with regulations. Related party transactions are disclosed in Note 60 to the Financial Statements on pages 294 to 299 in the IR.

Table 5 : Directorships in Other Companies

Name of Director	Directorship Status	No of Board seats held in Listed Companies		No of Board seats held in Unlisted Companies	
		Executive Capacity	Non - Executive Capacity	Executive Capacity	Non - Executive Capacity
Mr Dinesh Weerakkody (Chairman w.e.f. 26th May 2018)	■	-	3	-	4
Mr Jonathan Alles (MD/CEO)	■	-	1	-	4
Ms Rose Cooray	■	-	4	-	3
Dr Rohan Karunaratne	■	-	1	1	6
Mr Sujeewa Mudalige	■	-	-	1	-
Mr Rusi Captain	■	-	1	18	-
Mr Amal Cabraal	■	-	4	-	8
Mr Palitha Pelpola	■	-	1	-	-
Mr Duliksha Soosaipillai	■	-	3	-	-
Mr Nilanth de Silva	■	-	1	-	1
Mr Madu Ratnayake (Appointed w.e.f 25th October 2018)	■	-	-	-	-
Mr Damien Fernando (Appointed w.e.f 25th October 2018)	■	-	-	-	2

■ Executive Director ■ Independent Non-Executive Director ■ Non-Executive Director



### Induction and Ongoing Director Training

On appointment, Directors are provided with a folder containing all relevant governance information, including the Bank's founding documents, charters, governance structures, significant reports, relevant legislation and policies. Meetings with Key Management Personnel are scheduled to introduce new Directors to the Bank and its operations as well as site visits to key branches.

The Board of Directors recognises the need for continuous training and expansion of knowledge and undertakes such professional development as they consider necessary in assisting them to carry out their duties as Directors. The Company Secretary coordinates the training needs analysis process where Directors identify their requirements, which are then collated and training facilitated as requested. In 2018, the Bank has made arrangements with the Sri Lanka Institute of Directors (SLID) to conduct Director induction programmes as well as training and Continuous Professional Development (CPD) programmes for the Board. Directors also undertake other CPD programmes in their personal capacity to update their knowledge on relevant and emerging topics.

### Supply of and Access to Information

The Board pack generally circulated seven (7) days in advance, provides comprehensive qualitative and quantitative information on issues to be raised at the Board Meeting. Further, Executive Management and external experts make regular presentations regarding the business environment and in relation to operations of the Bank. Directors also have unrestricted access to Bank Management, organisation information, and resources to facilitate discharge of their duties. They may seek independent professional advice, coordinated through the Company Secretary, at the Bank's expense and copies of such advice obtained are circulated to other Directors who request for it.

### Board Evaluation

The Board undertakes an annual self-assessment of its performance to ensure responsibilities are satisfactorily discharged. Overseen by the Chairman and coordinated by the Company Secretary, Directors assess their collective performance against pre-determined goals and targets. Collated results are made available to the Nomination Committee which makes recommendations to the Board on areas for improvement. Outcome of the assessment carried out in December 2018 will be tabled at a future Nomination Committee and the Board Meeting in 2019. Areas identified for improvement were communicated to the Board, including training needs, skills and knowledge gaps.

Following due process, the Board as a whole assessed the independence of Directors, in judgment and character. Directors provided insights and constructive feedback on the issues pertaining to their contribution as well as observations on the functioning of the Board and its Committees.

The Board Audit Committee is evaluated by its Chairman, with individual assessments from the Members of the Board Audit Committee, MD/CEO, COO, CFO, and the Chief Internal

*"The Directors of HNB shall at all times discharge their duties professionally with due diligence and efficiency and to the best of their abilities. All Directors shall have a sound understanding of the Bank."*

### Board Charter

#### DIRECTOR TRAINING FOCUS AREAS – 2018

- Governance
- New developments in Financial Reporting.
- New legislation and regulatory pronouncements
- Taxation
- Cybersecurity
- Industry developments

Auditor, in accordance with international best practices. Other Board Committees carry out self-assessments annually, in accordance with predetermined criteria.

### Appraisal of MD/CEO

The Board assesses the performance of the MD/CEO annually using criteria aligned to the short, medium and long-term objectives of the Bank which are agreed with the MD/CEO at the beginning of the year. Performance is reviewed at the end of the financial year against the backdrop of the operating environment. It is discussed by Chairman with MD/CEO and responses documented prior to approval by Board as a whole. HRRC assists in the evaluation process, recommending a revised remuneration based on performance.

### Board Sub-Committees

The Board has delegated certain functions warranting greater attention, to eight (8) Board Sub-Committees with oversight responsibility for same. This enables the Board to allocate sufficient time to matters within its scope, particularly execution of strategy and forward-looking agenda items, enhancing effectiveness. Five (5) Committees are constituted under regulatory requirements and the others established considering the business, governance and risk management needs of the Bank. The Committees consist largely of Independent Non-Executive Directors. The Committee Chairmen/Chairperson are accountable for the effective functioning of the Committees and report to the Board on the activities of their respective Committee, highlighting matters for Board attention. Committee mandates are reviewed regularly.



Table 6 : Board Sub-Committees & Areas of Oversight as at 31st December 2018

	Composition of Directors	Areas of oversight	Report Reference (Page No.)
Mandatory Committees	<b>Board Audit Committee (BAC)</b>		
	<ul style="list-style-type: none"> <li>Mr Sujeewa Mudalige - Chairman</li> <li>Mr Amal Cabraal</li> <li>Mr Nilanth de Silva</li> <li>Mr Rusi Captain</li> <li>Mr Duliksha Soosaipillai</li> <li>Mr Damien Fernando</li> </ul>	<ul style="list-style-type: none"> <li>Integrity of Financial Reporting and disclosures</li> <li>Internal controls and audit</li> <li>External audit</li> <li>Compliance</li> </ul>	IR 111-113
	<b>HR &amp; Remuneration Committee (HRRC)</b>		
	<ul style="list-style-type: none"> <li>Mr Dinesh Weerakkody - Chairman</li> <li>Mr Sujeewa Mudalige</li> <li>Mr Amal Cabraal</li> <li>Dr Rohan Karunaratne</li> </ul>	<ul style="list-style-type: none"> <li>HR Policies including remuneration</li> <li>Organisation values and Code of Conduct</li> <li>Compliance with labour laws</li> <li>HR Systems including performance evaluation, talent management, succession</li> </ul>	IR 102-103
	<b>Nomination Committee (NC)</b>		
	<ul style="list-style-type: none"> <li>Mr Dinesh Weerakkody - Chairman</li> <li>Ms Rose Cooray</li> <li>Mr Rusi Captain</li> <li>Mr Palitha Pelpola</li> </ul>	<ul style="list-style-type: none"> <li>Selection and appointment of Directors, MD/CEO and Key Management Personnel</li> <li>Expertise gaps, succession, and re-election</li> <li>Board Corporate Governance</li> </ul>	IR 104-106
Mandatory Committees	<b>Board Integrated Risk Management Committee (BIRMC)</b>		
	<ul style="list-style-type: none"> <li>Ms Rose Cooray - Chairperson</li> <li>Mr Duliksha Soosaipillai</li> <li>Mr Jonathan Alles - MD/CEO</li> <li>Mr Madu Ratnayake</li> </ul>	<ul style="list-style-type: none"> <li>Comprehensive Risk Management Framework</li> <li>Risk measurement, monitoring and management</li> <li>Compliance with regulatory and internal prudential requirements</li> <li>Review Basel III implementation</li> </ul>	IR 107-110
	<b>Related Party Transactions Review Committee (RPTRC)</b>		
	<ul style="list-style-type: none"> <li>Mr Nilanth de Silva - Chairman</li> <li>Mr Jonathan Alles - MD/CEO</li> <li>Mr Palitha Pelpola</li> <li>Ms Rose Cooray</li> </ul>	<ul style="list-style-type: none"> <li>Related Party Transaction Policy</li> <li>Scrutiny all Related Party Transactions</li> <li>Market Disclosures on Related Party Transactions</li> <li>Quarterly and annual disclosures of Related Party Transactions</li> <li>Avoidance of conflict of interest</li> </ul>	IR 114-115
Discretionary Committees	<b>Strategy &amp; Investment Review Committee (SIRC)</b>		
	<ul style="list-style-type: none"> <li>Mr Amal Cabraal - Chairman</li> <li>Ms Rose Cooray</li> <li>Mr Sujeewa Mudalige</li> <li>Mr Duliksha Soosaipillai</li> <li>Mr Damien Fernando</li> </ul>	<ul style="list-style-type: none"> <li>Review of economic climate, capital markets activity economic and monetary policy direction, emerging trends and their potential/impact</li> <li>Investment Policy</li> <li>Review Bank's investment portfolios and their performance</li> </ul>	-
	<b>Procurement &amp; Assets Disposal Committee (PADC)</b>		
	<ul style="list-style-type: none"> <li>Dr Rohan Karunaratne - Chairman</li> <li>Mr Duliksha Soosaipillai</li> <li>Ms Rose Cooray</li> <li>Mr Madu Ratnayake</li> </ul>	<ul style="list-style-type: none"> <li>Procurement and Disposal Policy</li> <li>Approve procurements and disposal in line with delegation</li> </ul>	-
Discretionary Committees	<b>Board Credit Committee (BCC)</b>		
	<ul style="list-style-type: none"> <li>Mr Nilanth de Silva - Chairman</li> <li>Mr Palitha Pelpola</li> <li>Dr Rohan Karunaratne</li> <li>Mr Amal Cabraal</li> </ul>	<ul style="list-style-type: none"> <li>Credit Policy and Lending Guidelines</li> <li>Credit risk control measures including pricing of credit risk</li> <li>Performance of credit risk indicators</li> <li>Formulate and periodically review the credit policy</li> <li>Authorise credit facilities over and above the delegated limits of specified categories</li> </ul>	-

## Corporate Governance

### Corporate Management

The MD/CEO and other Key Management Personnel are accountable to the Board for the Bank's operational and financial performance. Regular reports and presentations by Key Management Personnel facilitate Board review in addition to explanations given to enumerate and clarify matters referred to the Board. All appointments of designated Key Management Personnel are recommended by the Nomination Committee and approved by the Board. Succession planning for Key Management Personnel is carried out by the Nomination Committee.

Several Executive Committees have been established to facilitate co-operation across department and healthy debate on matters considered critical for the Bank's operations.

### Succession Planning

The Board is assisted by the Nomination Committee in developing succession plans for the Board to ensure the Board has a mix of skills and experience to support delivery of the Bank's strategy. The Nomination Committee reviews succession planning for Key Management Personnel, focusing on developing employees to assume the current and future responsibilities in key positions. A list of competencies necessary for each key position is reviewed and revised annually by the Nomination Committee based on the Bank's strategic plan and existing competitive and regulatory challenges. Skills, education and knowledge gaps of the Key Management Personnel are assessed against the expected competencies and addressed.

## DIRECTORS' AND EXECUTIVE REMUNERATION

### Policy and Procedure

The Remuneration Policy for the Board of Directors and Key Management Personnel seek to motivate and reward performance while meeting regulatory requirements, stakeholder expectations and corporate values. The Board as a whole determines the remuneration of the NED's who receive a fee for being the Chairman/ a Director of the Board and additional fee for being a Member of a Committee.

The HRRC is responsible for making recommendations to the Board regarding remuneration of the Executive Director and Corporate Management team within agreed terms of reference and in accordance with the remuneration policies of the Bank. The Report of the HRRC is given on IR pages 102 to 103. The MD/CEO participates at Meetings when deciding the remuneration of the Corporate Management team. Services of HR professionals are sought when required, by the Board and HRRC in discharging their responsibilities.

### Level and Make Up of Remuneration

The Remuneration of the Executive and Non-Executive Directors' is designed to attract persons of high repute with the requisite skills and experience. Accordingly, remuneration reflects market expectations considering time required, standard of performance and associated risks and set to attract and retain them as Directors. The remuneration framework for the MD/CEO aligns

**"The Board would maintain a sound relationship with the Executive Management which would in turn assist the Board to develop structures, processes and practices that fit the Bank and its business needs."**

### Board Charter

short term and long-term interests of the Bank, linking rewards to corporate and individual performance.

Remuneration of the Executive Director and Key Management Personnel are compliant with the provisions of Schedule E of the Code of Best Practice on Corporate Governance issued by the Institute of Chartered Accountants of Sri Lanka in 2017 and comprises two components, fixed remuneration and variable remuneration comprising of an annual performance bonus. No special early termination clauses are included in the contract of employment of Executive Directors that would entitle them to extra compensation. However, such compensation, if any, would be determined by the Board of Directors.

All rights under the ESOP scheme have expired during 2018.

Non-Executive Directors do not receive any performance related/incentive payments. Considering the commitment and responsibilities of their role, a review of NEDs' remuneration was carried out in 2017 and changes effected from April 2018.

Please refer IR page 201 for the total Directors' Remuneration.

## RISK MANAGEMENT AND INTERNAL CONTROL

The Board is responsible for formulating and implementing effective risk management and internal control systems to safeguard shareholder interests and the assets of the Bank, in meeting strategic objectives. These systems cover all controls, including financial, operational and compliance and are monitored and regularly reviewed for effectiveness by the Board. The BIRMC assists the Board in the discharge of duties in relation to risk management while the Board Audit Committee assists in the discharge of its duties with regards to internal controls. Their roles and responsibilities have been formulated with reference to the requirements of the Banking Act Direction No.11 of 2007 on Corporate Governance, the Code and the Bank's business needs and are set out in the Committee reports on IR pages 102 to 115.

The Risk Department supports the BIRMC in execution of responsibilities as set out in the Risk & Capital Management Report on CG&RR pages 37 to 88 The Internal Audit Department supports the Board Audit Committee, reviewing the adequacy and effectiveness of the Bank's internal control systems and reporting to the Board Audit Committee on a regular basis. The Board is satisfied with the integrity of financial information and the robustness of the financial controls and systems of risk management of the Bank.

## CODE OF CONDUCT & ETHICS

- Act ethically, responsibly, honestly and with integrity, in the best interest of the Bank
- Safeguard the Bank from fraud, corruption, collusion and coercion
- Compliance with Laws, Rules and Regulations
- Conflicts of Interest
- Discrimination and Harassment
- Bribery & Corruption
- Confidentiality
- Fair dealing
- Entertainment and gifts
- Accurate accounting and record keeping
- Fair and transparent procurement practices
- Protection and proper use of Bank assets including information assets
- Encourage whistleblowing
- Corporate opportunities

## CODE OF CONDUCT AND ETHICS

The Bank's Code of Conduct & Ethics provides guidelines on the conduct of the Bank's businesses and operations and is aligned to HNB's values, standards, policies and procedures. It ensures the Bank do the right business in the right way, complying with relevant laws and legislation and retaining the trust of our stakeholders. Available in all three (3) languages, the Code applies to all employees, Key Management Personnel and Directors and covers all banking operations. Every employee is responsible for the implementation of and compliance with the Code in his/her environment.

The Board leads by example setting the ethical tone for the Bank. Bound further by a 'Standard of Conduct' embodied in the Board Charter, they promote a corporate culture of integrity, responsibility and ethics. The Board is not aware of any material violations of any of the provisions of the Code of Conduct and Ethics/Standard of Conduct by any Director or Key Management Personnel of the Bank.

## WHISTLEBLOWING

The Whistleblowing Policy facilitates anonymous reporting of unethical or unlawful behaviour in relation to possible inappropriate financial reporting, internal controls or other matters by employees. Information on accessibility, anonymity, processes and the policy relating to the whistleblowing service is communicated to all employees. Ms Rose Cooray, Independent Non-Executive Director was appointed as the Officer to whose office the staff could report any irregularities.

## CORPORATE COMMUNICATION

At HNB, the Board is conscious of their responsibility towards stakeholders and is committed to fair disclosure, with emphasis on the integrity, timeliness and relevance of the information

provided. Information is communicated accurately and in such a manner as to avoid the creation of a false market.

The Bank's Corporate Communication Policy provides guidelines to ensure effective and timely communication of material matters to key stakeholders as an integral part of good business practice, fostering sustainable relationships founded on trust and integrity. Covering internal and external communication, the policy has been communicated to all staff members and sets out formal areas of responsibility. A Communications Council headed by the MD/CEO and consisting of five (5) other members of the Corporate Management team, ensures all HNB communications are coherent and cohesive.

A formal customer communication management process is in place including a centralized dedicated unit set up to manage and resolve customer complaints. The Unit is headed by the Customer Experience Officer and facilitates objective engagement with customers. A 24x7 trilingual customer hotline is also available for handling customer complaints.

An open-door policy for employees is actively pursued by the Bank Management and encouraged by the Board. The appointment of a Chief Employee Experience Officer in 2016 has been a very successful initiative in grievance handling, offering employees quick access to Corporate Management to raise their concerns. The Chief Employee Experience Officer has worked together with HR to address a number of these issues. During 2018, 88% of the grievances referred were resolved.

## Communication with Shareholders

Shareholders are engaged through multiple channels of communication, including the Annual General Meeting (AGM) (detailed on the next page), Annual Report, Interim Financial Statements, a dedicated investor relations page on the Bank's website, press releases in three (3) languages in the main newspapers and notification of key events through announcements in the CSE. The Annual Report presents a fair and balanced review of the Bank's financial position, performance and prospects combining narrative and visual elements to facilitate readability and comprehension. All statutory requirements have been complied within the Annual Report and the Interim Financials have been reviewed and recommended by the Board Audit Committee and finally approved by the Board of Directors, prior to publication.

Regular structured Meetings involving the Chairman, MD/CEO and relevant Key Management Personnel, are held with equity analysts who provide research to large institutional investors. They also conduct roadshows to potential investors overseas to attract foreign interest, supporting capital planning. Directors ensure the protection of share price sensitive information at the Meetings. Views of the shareholders are communicated to the Board as a whole by the Chairman. Investors are encouraged to give due weight to all relevant matters relating to the Board structure and composition and to participate in General Meetings of the Bank and exercise their voting rights.

Shareholders may, at any time, direct questions, request for publicly available information and provide comments and suggestions to Directors or Management of the Bank. Such

## Corporate Governance

questions, requests and comments should be addressed to the Company Secretary. The Company Secretary maintains a record of all correspondence received and delivers as soon as practicable such correspondence to the Board or individual Director/s as applicable. The Board or individual Director/s, as applicable, will generate an appropriate response to all validly received shareholder correspondence, if it deemed appropriate, and will direct the Company Secretary to send the response to the particular shareholder.

A Board approved Shareholder Complains Resolution Procedure is also in place.

### Constructive use of Annual General Meeting (AGM)

The AGM is the main mechanism for the Board to interact with shareholders and report the performance of the Bank. It provides opportunity for shareholders' views to be heard and be fully considered. The Board encourages informed participation by shareholders. Notice of the AGM, the Annual Report and Accounts, any resolution together with the corresponding information that may be set before the shareholders at the AGM, together with a summary of the procedures governing voting at the AGM are circulated to shareholders a minimum fifteen (15) days prior to the AGM in compliance with statutory requirements. HNB proposes a separate resolution for each item of business, giving shareholders the opportunity to consider and vote on each issue, separately.

At the AGM, the Board provides an update to shareholders on the Bank's performance. Shareholders are then offered an opportunity to ask questions and vote on resolutions. It is the key forum for shareholders to engage in decision making matters reserved for the shareholders which typically include proposals to adopt the Annual Report and Accounts, appointment of Directors and Auditors and other matters requiring special resolutions. The Chairman, Board Members including the Chairmen/Chairperson of the Sub-Committees and External Auditors are present and available to answer any queries raised. All Shareholders are encouraged to participate at the AGMs and exercise their voting rights. HNB has a history of well attended AGMs and 207 shareholders attended or were represented by proxy at the 2018 AGM.

The Bank has a mechanism to record and count all proxy votes lodged for each resolution. The following information is made available at the AGM and posted on the Bank's website ([www.hnb.net](http://www.hnb.net)).

- Number of shares in respect of which proxy appointments have been validly made
- Number of votes for and against the resolution
- Number of shares in respect of which the vote was directed to be withheld

In the event, there is a significant proportion of the votes cast against a resolution, the Board will take steps to understand the reasons behind the vote results and determine if any actions are required.

### MAJOR AND MATERIAL TRANSACTIONS

Transactions which materially affect HNB's and/or the Group's consolidated net asset base, will be disclosed in the Quarterly/ Annual Financial Statements. During the year, there were no such major transactions.

### GOOD GOVERNANCE FOR GROUP COMPANIES

The Board seeks to ensure adequate Corporate Governance across the Group and that there are governance policies and mechanisms appropriate to the structure, business and risks of the Bank and its entities. The Board is guided by the Board approved Charter for Management/Good Governance for Group Companies. Through the alignment of governance practices and processes, the framework improves efficiencies and transparency within the Group and ensures business is carried out based on the highest professional standards, integrity and ethics. All Group Companies have a Charter at Board level and abide by all other specific regulatory requirements and governance codes applicable to industry it operates in.

Adherence to the Charter is reinforced by the appointment of Directors and/or Key Management Personnel including the MD/ CEO, COO, CFO, CRO and Chief Strategy Officer, to the Boards of subsidiaries.

### CYBERSECURITY

A Cybersecurity Policy and Information Security Policy were adopted in 2017, providing Management direction and support to ensure protection of HNB's information assets from cyber threats. The policies cover all cyber facing information assets and apply to every employee and service provider engaged with cyber facing information assets.

An information and cyber risk vertical have been established within the Risk Management Department, under the purview of the Chief Risk Officer (CRO), to introduce and implement the policies. The Risk Management Framework has been improved to strengthen the information and cyber risk management capability. The CRO has been appointed Chief Information Security Officer (CISO) and is responsible for the management of cyber/information security threats.

During the year, the Bank has carried out an independent review of the Bank's cyber risk strategies and capabilities. Presentations were made to the Board based on the findings and suggestions provided for improvement.

IT and cybersecurity is an agenda of the monthly Board Risk Committee Meeting and reviewed by Board through the BIRMC Minutes. Prudent and reasonable steps are taken to govern technology and information and matters escalated to the Board where deemed necessary, considering risk, impact and other measures. Management of information and cyber risk is described in detail on CG&RR pages 56 to 57 of the Risk & Capital Management Report.

## CYBER SECURITY AND INFORMATION ASSETS - POLICY STATEMENT

It is the Policy of HNB that its information assets shall be protected from all cyber threats identified, whether internal or external, deliberate or accidental, such that the brand is protected; confidentiality of information is maintained; integrity of information can be relied upon; availability of information is ensured; and all legal, regulatory, statutory and contractual obligations are met.

## COMPLIANCE

Directors are conscious of their duty to comply with the laws, regulations, regulatory guidelines, internal controls and approved policies on all areas of business of the Bank. HNB is compliant with all relevant legal and statutory requirements. The Bank has implemented controls to provide reasonable assurance of its compliance, including establishment of a compliance function. This function is headed by a dedicated Compliance Officer who reports to the Board Integrated Risk Management Committee.

The Compliance Officer submits a report on mandatory banking and statutory requirements on a quarterly basis to the Board Audit Committee and the Board Integrated Risk Management Committee.

## EXTERNAL AUDITOR

The Bank is guided by the Policy for the Engagement of the External Auditor for audit and non-audit services. The External Auditor is appointed following the procedures set out in Article 53 (iv) of the Articles of Association. The Board Audit Committee (BAC) makes recommendations to the Board for the appointment, re-appointment or removal of the External Auditor in-line with professional & ethical standards and regulatory requirements. The BAC monitors and reviews the External Auditor's independence, objectivity and the effectiveness of the audit process taking into account relevant professional and regulatory requirements.

In assignment of non-audit services to External Auditors by the Bank, the Board/BAC ensures that the External Auditor has the necessary skills and experience for the assignment and ascertains that independence and/or objectivity of the External Auditor in carrying out his duties and responsibilities will not be impaired.

On the recommendation of the Board, the shareholders approved the reappointment of Messrs. Ernst & Young (Chartered Accountants) as the External Auditor of the Bank for 2018, at the last AGM. In compliance with Section 163 (3) of the Companies Act No. 07 of 2007, the External Auditors submit a statement annually confirming their independence in relation to the external audit.

## GOING CONCERN

The Board considers and assesses the Bank's status as a going concern in the preparation of the Annual and Interim Financial Statements of the Bank. In addition, the Board considers the solvency and liquidity requirements in line with the provisions of the Companies Act.

In the unlikely event the Bank is about to become insolvent, a procedure is in place to inform the Director of Banking Supervision of same.

## SUSTAINABILITY

HNB is committed to understanding and being responsive to the interests and expectations of stakeholders in creating a sustainable business. Sustainability principles are embedded in the Bank's business strategy and endorsed in its operations. As such, opportunities and risks having a material impact on the Bank's economic, social and environmental performance, its value creation process and its key stakeholders are consistently managed and monitored for business growth.

Sustainability initiatives of the Bank are reported in a holistic manner in the Integrated Report. The report provides a balanced review of the Bank's economic, environment and social impact and the governance mechanisms in place to measure, monitor and manage same. The Annual Integrated Report summarises information on all material issues impacting performance.

Reporting is as follows:

- Reporting of Economic Sustainability (Financial Capital) - IR pages 46 to 49
- Reporting on the Environment (Natural Capital) - IR pages 70 to 71
- Reporting on Labour Practices (Human Capital) - IR pages 56 to 62
- Reporting on Society (Social and Network Capital) - IR pages 63 to 67
- Reporting on Stakeholder identification, engagement and effective communication (Engaging Stakeholders) - IR page 38
- Reporting on Governance (Corporate Governance and Risk Report) - CG&RR pages 3 to 36
- Sustainable Reporting to be formalised as part of the reporting process and to take place regularly (Overview of our Business) - IR page 33

These reports have been prepared in line with GRI Standards of the Global Reporting Initiative and the IR Framework issued by the International Integrated Reporting Council, among other frameworks.

### APPENDIX I: COMPLIANCE WITH BANKING DIRECTION NO.11 OF 2007 ON CORPORATE GOVERNANCE

Section	Principle, Compliance & Implementation
3 (1)	<b>Responsibilities of the Board</b>
3 (1) (i)	<p><b>Strengthening the Safety and Soundness of the Bank</b></p> <p>The Board's responsibilities are set out in the Board Charter summarised on CG&amp;RR page 9. The Board is accountable for the management of the affairs of the Bank and the safety and soundness of the Bank.</p> <p><b>a. Setting Strategic Objectives and Corporate Values - Complied <input checked="" type="checkbox"/></b></p> <p>The Bank's strategic objectives derived from the Vision and Mission Statements and its corporate values, have been determined and approved by the Board of Directors and communicated to all levels of staff. The corporate values are included in the Code of Conduct &amp; Business Ethics which is provided in hard copy to all new employees, available on the intranet, explained at orientation programmes and reinforced at Meetings.</p> <p><b>b. Approving overall Business Strategy including Risk Policy and Management - Complied <input checked="" type="checkbox"/></b></p> <p>The 2016-2020, five year business strategy (Corporate Strategic Plan) was approved by the Board in 2015, and subsequently reviewed in 2018 incorporating internal and external developments. The strategy and execution thereof, is usually reviewed by the Board on a quarterly basis. The Annual budget, derived from the business strategy is approved, and monitored monthly, by the Board.</p> <p>The Board also approved the overall risk strategy of the Bank, determining the Risk Appetite, Policies and Risk Management Framework &amp; Mechanisms. The Corporate Strategy Plan is aligned to the overall risk strategy of the Bank, where risk appetite is considered in areas such as capital allocation and in the adoption of risk matrix to measure the risk levels. Governance and Compliance which are embedded in the Risk Management Policy Framework have also been included in the strategic plan. Further, the risk management procedures and mechanisms with time bound implementation milestones were approved and monitored by the Board Integrated Risk Management Committee (BIRMC) on a regular basis.</p> <p><b>c. Risk Management - Complied <input checked="" type="checkbox"/></b></p> <p>The Board takes overall responsibility for risk management of the Bank. The BIRMC, is tasked with assisting the Board in structuring Bank's Risk Policy, defining the risk appetite, identifying principal risks, setting governance structures and implementing systems to measure, monitor and manage the principal risks. The following reports provide further insights in this regard:</p> <ul style="list-style-type: none"> <li>• Risk &amp; Capital Management Report on CG&amp;RR pages 37 to 88.</li> <li>• Board Integrated Risk Management Committee Report on IR pages 107 to 110.</li> </ul> <p><b>d. Communication with all Stakeholders - Complied <input checked="" type="checkbox"/></b></p> <p>The Board has approved a Corporate Communication Policy to ensure effective and timely communication with all stakeholders including depositors, creditors, share-holders and borrowers. Corporate Communication Policy, which was reformulated in August 2016 (revised in 2017), is guided by the principles of efficiency, transparency, proactivity, clarity and feedback.</p> <p>The Bank substantially implemented the provisions of Banking Act Directions No 8 of 2011 "Customer Charter of Licensed Banks", which became effective in 2012.</p> <p>The Charter seeks to improve the quality and content in dispensing of customer service by enhancing customer protection and instilling trust and confidence in the Bank while incorporating a set of customer obligations generated in the interest of Bank stability.</p> <p><b>e. Internal Control System and Management Information Systems - Complied <input checked="" type="checkbox"/></b></p> <p>The Board reviews the adequacy and the integrity of the Bank's Internal Control Systems and Management Information Systems and is satisfied with same. It is assisted in this regard by the Board Audit Committee (BAC). The BAC has reviewed reports from the Internal Audit Department in carrying out this function, together with the Management responses on the same. The findings have been reported to the Board.</p>



Section	Principle, Compliance & Implementation
	<p><b>f. Key Management Personnel - Complied</b> <input checked="" type="checkbox"/></p> <p>Key Management Personnel comprise the Corporate Management (MD/ CEO, COO, DGMs and AGMs), Head of Compliance, Head of Custody &amp; Trustee Services and Digital Transformation Consultant as per the guideline on “ Key Management Personnel in Banking Act Direction for Corporate Governance” issued by the Banking Supervision Department of CBSL. All appointments of Key Management Personnel are recommended by the Nomination Committee and approved by the Board.</p>
	<p><b>g. Define areas of authority and Key Responsibilities for Directors and Key Management Personnel - Complied</b> <input checked="" type="checkbox"/></p> <p>Areas of authority and key responsibilities for the Board of Directors are set out in the Board Charter. Areas of authority and key responsibilities for Key Management Personnel are stated in their Job Descriptions as recommended by the Nomination Committee and approved by the Board. The delegated authority limits for Key Management Personnel have been approved by the Board.</p>
	<p><b>h. Oversight of affairs of the Bank by Key Management Personnel - Complied</b> <input checked="" type="checkbox"/></p> <p>The MD/CEO and other Key Management Personnel are accountable to the Board for the Bank’s operational and financial performance, in accordance with the policies set by the Board. The Board reviews the performance of the Bank against the strategic plan and receives reports from its Sub-Committees on matters delegated to them, through which the Board exercises oversight over the affairs of the Bank and the Key Management Personnel. Further, Key Management Personnel make regular presentations to the Board on matters under their purview and are also called in by the Board to explain matters relating to their areas.</p>
	<p><b>i. Assess effectiveness of own Governance Practices - Complied</b> <input checked="" type="checkbox"/></p> <p>The effectiveness of the Board’s own governance practices, including the process for selection, nomination and election of Directors (which is explained in detail under Rule 3 (2) (ix)) and the process for management of conflict of interest (which is explained in detail under Rule 3 (1) (xii)) are reviewed by Board on a periodic basis. Implementation of changes required are being discussed and determined by the Board at the year-end through the submission of the summary of annual self-evaluations.</p>
	<p><b>j. Succession Plan for Key Management Personnel - Complied</b> <input checked="" type="checkbox"/></p> <p>The Bank has an appropriate succession plan for Key Management Personnel aligned to the Bank’s strategic objectives and Talent Management Programme. The plan is guided by the policy on Succession Planning for Key Management Personnel and Directors, last reviewed in March and September 2018. The Nomination Committee is responsible for the formulation, review and rollout of the plan.</p>
	<p><b>k. Regular Meetings with Key Management Personnel - Complied</b> <input checked="" type="checkbox"/></p> <p>The Board maintains a sound relationship with the Corporate/Senior Management led by the MD/CEO, who in turn assists the Board to formulate policies, strategies, processes and practices that fit the Bank and its business needs in achieving corporate objectives. The Management is open and transparent with the Board, bringing all significant matters to its attention. Key Management Personnel are regularly invited to attend Board and Sub-Committee Meetings for discussion on matters concerning their areas of responsibility, or make presentations on key agenda items.</p>
	<p><b>l. Regulatory environment and maintaining an effective relationship with regulator - Complied</b> <input checked="" type="checkbox"/></p> <p>On appointment, Directors are provided with a folder containing all relevant governance information, including regulatory laws, directions and guidelines. Directors are briefed about regulatory developments at Board and Sub-Committee Meetings by Key Management Personnel including the Heads of Internal Audit, Risk and Compliance and by attending Director Forums arranged by the Central Bank of Sri Lanka (CBSL). Further, Board Members regularly meet with CBSL officials to discuss strategic matters specific to the Bank, maintaining an effective relationship with the regulator.</p>
	<p><b>m. Hiring and oversight of External Auditors - Complied</b> <input checked="" type="checkbox"/></p> <p>The External Auditor is appointed following the procedures set out in Article 53 (iv) of the Articles of Association. The Board Audit Committee makes recommendations to the Board for the appointment, re-appointment or removal of the External Auditor in-line with professional &amp; ethical standards and regulatory requirements. A policy for Engagement of the External Auditor to provide Non-Audit Services is in place, as reviewed and recommended by the Board Audit Committee. On the recommendation of the Board, the shareholders approved the reappointment of Messrs. Ernst &amp; Young (Chartered Accountants) as the External Auditor of the Bank, at the last AGM. In compliance with Section 163 (3) of the Companies Act No. 07 of 2007, the External Auditors submit a statement annually confirming their independence in relation to the external audit.</p>

## Corporate Governance

Section	Principle, Compliance & Implementation
3 (1) (ii)	<p><b>Appointment of Chairman and CEO and defining and approving their functions and responsibilities - Complied <input checked="" type="checkbox"/></b></p> <p>The Board has appointed the Chairman and the MD/CEO. Their roles and responsibilities are separate and set out clearly in the Board Charter, ensuring a balance of power and authority and preventing unfettered power being vested with an individual. These functions and responsibilities are in line with Direction 3(5) of the said Direction.</p>
3 (1) (iii)	<p><b>Regular Board Meetings - Complied <input checked="" type="checkbox"/></b></p> <p>Monthly Board Meetings are held regularly and Special Meetings are scheduled based on need. Fifteen (15) Board Meetings were held in 2018. Directors actively participate in the Meetings deliberating on matters set before the Board. Attendance at Board Meetings is given on CG&amp;RR page 12. Urgent Board Papers are approved via circular resolution only on an exceptional basis, where such resolutions are ratified by the Board at the next Meeting. Six hundred and thirteen (613) credit papers were approved in 2018, via circulation.</p>
3 (1) (iv)	<p><b>Arrangements for Directors to include proposals in the agenda - Complied <input checked="" type="checkbox"/></b></p> <p>The Board Calendar with tentative dates for Board and Sub-Committee Meetings for the following year is sent to all Members approximately one month before the end of the current year. The Chairman sets the Board agenda assisted by the Company Secretary. Directors may submit proposals for inclusion in the agenda on discussion with the Chairman.</p>
3 (1) (v)	<p><b>Notice of Meetings - Complied <input checked="" type="checkbox"/></b></p> <p>Notice of Meetings, Agenda and Board Papers for the Meetings are sent generally seven (7) days before the Meeting, giving the Members sufficient time to attend the Meeting and study the documents. Urgent Board Papers are included on an exceptional basis, with the consent from the Chairman.</p>
3 (1) (vi)	<p><b>Directors Attendance - Complied <input checked="" type="checkbox"/></b></p> <p>At appointment, all Directors are apprised of the regulations on attendance. Attendance at Board Meetings is given on CG&amp;RR page 12. All Directors have attended at least two thirds (2/3) of Board Meetings held during 2018, the lowest attendance being nine (9) Directors at a Meeting (including attendance of an Alternate Director). No Director has been absent from three consecutive Meetings during 2018.</p>
3 (1) (vii)	<p><b>Appointment and setting responsibilities of the Company Secretary - Complied <input checked="" type="checkbox"/></b></p> <p>The Board has appointed a Company Secretary, an Attorney at Law, who satisfies the provisions of Section 43 of the Banking Act No.30 of 1988. The Company Secretary guides the Board on discharging its duties and responsibilities, facilitates adherence to best practices in Corporate Governance and apprises the Board of relevant legislative and regulatory changes.</p>
3 (1) (viii)	<p><b>Directors access to advice and services of Company Secretary - Complied <input checked="" type="checkbox"/></b></p> <p>All Board Members have full access, to the advice and services of the Company Secretary to ensure that proper Board procedures are followed and all applicable rules and regulations are complied with.</p>
3 (1) (ix)	<p><b>Maintenance of Board Minutes - Complied <input checked="" type="checkbox"/></b></p> <p>Company Secretary maintains the Minutes of the Board Meetings. The Minutes are circulated to all Board Members and approved at the next Board Meeting upon incorporating any amendments proposed by other Directors. Board Minutes are circulated to members and since the end of 2018, delivered within two weeks of the Meeting being held. The Minute book is maintained by the Company Secretary and opens for inspection by any Director, at any time.</p>
3 (1) (x)	<p><b>Minutes to be of sufficient detail and serve as a reference for regulators and supervisory authorities - Complied <input checked="" type="checkbox"/></b></p> <p>Minutes of Board Meetings are recorded in sufficient detail to reflect that the Board acted with due care and prudence in performing its duties and to serve as a reference for regulatory and supervisory authorities to assess the depth of deliberations at the Board Meetings.</p>
3 (1) (xi)	<p><b>Directors ability to seek independent professional advice - Complied <input checked="" type="checkbox"/></b></p> <p>Procedures are in place to allow Directors to seek independent professional advice, as and when necessary and at the Bank's expense, in discharging their duties and responsibilities. This facility is coordinated through the Company Secretary.</p>



Section	Principle, Compliance & Implementation
3 (1) (xii)	<p><b>Dealing with Conflicts of Interest - Complied <input checked="" type="checkbox"/></b></p> <p>Article 40 of Articles of Association addresses the provision with regard to this requirement. The Board is conscious of its obligations to ensure that Directors avoid conflicts of interest (both real and apparent) between their duty to HNB and their other interests. The Board has taken steps to ensure that conflicts and potential conflicts of interest of Directors are disclosed to the Board. Any Director with a material personal interest in a matter being considered by the Board declares his/her interest and unless the Board resolves otherwise, he/she does not participate in discussions or vote on that specific matter. The Directors declare their interests at appointment and thereafter on a quarterly basis.</p>
3 (1) (xiii)	<p><b>Formal schedule of matters - Complied <input checked="" type="checkbox"/></b></p> <p>The Board reserves for itself a formal schedule of matters on which it takes the ultimate decision.</p>
3 (1) (xiv)	<p><b>Inform Central Bank if there are solvency issues - Complied <input checked="" type="checkbox"/></b></p> <p>The Bank is solvent.</p> <p>In the unlikely event, the Bank is about to become insolvent, a procedure is however in place to inform the Director of Banking Supervision of same, prior to taking any decision or action to suspend payments due to depositors and other creditors.</p>
3 (1) (xv)	<p><b>Capital Adequacy - Complied <input checked="" type="checkbox"/></b></p> <p>The Board monitors capital adequacy and other prudential measures to manage risk and to ensure compliance with regulatory requirements. The Bank is in compliance with the minimum capital requirements of the Monetary Board.</p>
3 (1) (xvi)	<p><b>Publish Corporate Governance Report in Annual Report - Complied <input checked="" type="checkbox"/></b></p> <p>This report forms part of the Corporate Governance Report of the Bank which is set out on pages 3 to 36 in CG&amp;RR.</p>
3 (1) (xvii)	<p><b>Self-assessment of Directors - Complied <input checked="" type="checkbox"/></b></p> <p>Each Director undertakes annually, a self-assessment of the Board, to ensure responsibilities are satisfactorily discharged. The last appraisal was carried out in December 2018 and the outcome of the assessment and areas for improvement tabled at a future Board Meeting.</p>
<b>3 (2)</b>	<b>The Board's Composition</b>
3 (2) (i)	<p><b>Number of Directors - Complied <input checked="" type="checkbox"/></b></p> <p>The Board consists of twelve (12) Directors, compliant with CBSL direction which requires the number of Directors to be not less than seven (7) and not more than thirteen (13).</p>
3 (2) (ii)	<p><b>Period of service of a Director - Complied <input checked="" type="checkbox"/></b></p> <p>The total period of service of all Non-Executive Directors does not exceed nine (9) years as required by the CBSL Direction. Tenures of service of Directors are given on CG&amp;RR page 4.</p>
3 (2) (iii)	<p><b>Director Appointment of an Employee as a Director- Complied <input checked="" type="checkbox"/></b></p> <p>The single Executive Director is the MD/CEO. Board balance is compliant with the CBSL Direction which limits the number of Executive Directors to 1/3 of the Board</p>
3 (2) (iv)	<p><b>Independent Non-Executive Directors - Complied <input checked="" type="checkbox"/></b></p> <p>The Board comprises seven (7) Independent Non-Executive Directors, in excess of the regulatory requirement. The Directors satisfy the criteria for determining independence, which is reviewed annually by the Board based on self-declaration forms submitted by the Directors.</p>
3 (2) (v)	<p><b>Alternate Independent Directors - Complied <input checked="" type="checkbox"/></b></p> <p>There were no alternate Directors appointed to Independent Directors during the year.</p>
3 (2) (vi)	<p><b>Criteria for Non-Executive Directors - Complied <input checked="" type="checkbox"/></b></p> <p>All Non-Executive Directors are eminent professionals in their respective fields, with credible track records and necessary skills and experience. They contribute diverse perspective to matters set before the Board, bringing independent judgment to bear on issues of strategy, performance and resources.</p>

## Corporate Governance

Section	Principle, Compliance & Implementation
3 (2) (vii)	<p><b>More than half the quorum to comprise non-executive Directors - Complied <input checked="" type="checkbox"/></b></p> <p>Complied with majority of the Board are Non-Executive Directors.</p>
3 (2) (viii)	<p><b>Identify Independent Non-Executive Directors in communications and disclose categories of Directors in Annual Report - Complied <input checked="" type="checkbox"/></b></p> <p>The Independent Non-Executive Directors are expressly identified in all corporate communications that disclose the names of Directors of the Bank. Composition and details of the Board are given on CG&amp;RR page 9.</p>
3 (2) (ix)	<p><b>Formal and transparent procedure for appointments to the Board - Complied <input checked="" type="checkbox"/></b></p> <p>The Board has a formal and transparent process in place for the succession and appointment of Directors. The Nomination Committee processes and shortlists candidates and makes recommendations to the Board for approval. The attributes and experience required from potential appointees are identified and agreed prior to the search process considering the combined knowledge, experience and diversity of the Board in relation to the Bank's Strategic Plans and any gaps thereof. The candidate's other directorships and commitments are also considered to ensure sufficient time to discharge their role at HNB, effectively. Upon completion of this process, names are referred to the Director of the Bank Supervision Department of the Central Bank of Sri Lanka for approval as a "fit and proper" person, prior to the appointment.</p> <p>Mr Madu Ratnayake and Mr Damien Fernando were appointed to the Board in 2018.</p>
3 (2) (x)	<p><b>Re-election of Directors filling casual vacancies - Complied <input checked="" type="checkbox"/></b></p> <p>All Directors appointed to the Board are subjected to re-election by shareholders at the first Annual General Meeting after their appointment.</p> <p>Mr Madu Ratnayake and Mr Damien Fernando who were appointed to the Board in October 2018 to fill the casual vacancy created by the retirement of Mr Rienzie Arseculeratne and the resignation of Ms Sanjivani Jayawardena, will offer themselves for re-election at the AGM to be held in March 2019.</p>
3 (2) (xi)	<p><b>Communication of reasons for removal or resignation of Director - Complied <input checked="" type="checkbox"/></b></p> <p>Resignations of Directors and the reasons thereof, are promptly informed to the regulatory authorities and shareholders in compliance with the CSE regulations together with a statement confirming whether or not there are any matters that need to be brought to the attention of shareholders.</p>
3 (2) (xii)	<p><b>Prohibition of Directors or Employees of a Bank becoming a Director at another Bank - Complied <input checked="" type="checkbox"/></b></p> <p>None of the Directors are Directors or employees at any other Bank. This is a requirement when seeking appointments of Directors.</p>
<b>3 (3)</b>	<b>Criteria to assess fitness and propriety of Directors</b>
3 (3) (i)	<p><b>Age of Director should not exceed 70 years- Complied <input checked="" type="checkbox"/></b></p> <p>There are no Directors who are over 70 years of age as at 31st December 2018.</p>
3 (3) (ii)	<p><b>Directors should not be Directors of more than 20 companies and not more than 10 companies classified as Specified Business Entities - Complied <input checked="" type="checkbox"/></b></p> <p>The Directors do not hold directorships of more than twenty (20) companies/entities/institutions inclusive of Subsidiaries or Associate Companies of the Bank.</p>
<b>3 (4)</b>	<b>Management Functions delegated by the Board</b>
3 (4) (i)	<b>Understand and study delegation arrangements - Complied <input checked="" type="checkbox"/></b>
3 (4) (ii)	<b>Extent of delegation should not hinder Board ability to discharge its functions - Complied <input checked="" type="checkbox"/></b>
3 (4) (iii)	<p><b>Review delegation arrangements periodically to ensure relevance to operations of the Bank - Complied <input checked="" type="checkbox"/></b></p> <p>The Board has a clear understanding of the delegation arrangements, studying, reviewing and approving the extent of delegation annually to ensure it meets the business needs of the Bank whilst enabling the Board to effectively discharge their duties.</p>

Section	Principle, Compliance & Implementation
<b>3 (5)</b>	<b>The Chairman and Chief Executive Officer</b>
3 (5) (i)	<b>Separation of roles - Complied <input checked="" type="checkbox"/></b> There is a clear separation of roles of the Chairman and the CEO, ensuring a balance of power for decision-making.
3 (5) (ii)	<b>Non-Executive Chairman and appointment of a Senior Independent Directors- Complied <input checked="" type="checkbox"/></b> The Chairman is an Independent Non-Executive Director; as such there is no requirement to appoint a Senior Independent Director.
3 (5) (iii)	<b>Disclosure of identity of Chairman and CEO and any relationships with the Board members - Complied <input checked="" type="checkbox"/></b> The profiles of the Chairman and CEO are disclosed on IR page 22.  As declared by the Directors, no relationships including financial, business, family, or any other, prevail between the Chairman, MD/CEO or among other Board Members.
3 (5) (iv)	<b>Chairman to provide leadership to the Board - Complied <input checked="" type="checkbox"/></b> The Chairman leads the Board ensuring that it works effectively, and acts in the best interest of the Bank in a timely basis. The effectiveness of the Chairman in the discharge of the Board functions is assessed annually by Board and in his/her self-assessment.
3 (5) (v)	<b>Responsibility for agenda lies with Chairman but may be delegated to Company Secretary - Complied <input checked="" type="checkbox"/></b> The Chairman sets the Board agenda, assisted by the Company Secretary and MD/CEO.
3 (5) (vi)	<b>Ensure that Directors are properly briefed and provided adequate information - Complied <input checked="" type="checkbox"/></b> The Chairman ensures that the Board is sufficiently briefed and informed regarding the matters arising at Board.  Board papers are generally circulated seven (7) days prior to Meeting, giving the Members adequate time to study the documents. Directors have access to Key Management Personnel to clarify matters and to external specialists for independent advice, when required.
3 (5) (vii)	<b>Encourage active participation by all Directors and lead in acting in the interests of the Bank - Complied <input checked="" type="checkbox"/></b> The Chairman has encouraged all Directors to actively contribute towards the best interests of the Bank.
3 (5) (viii)	<b>Encourage participation of Non-Executive Directors and relationships between Non-Executive and Executive Directors - Complied <input checked="" type="checkbox"/></b> The Chairman has encouraged effective participation of all Directors and has encouraged constructive relations between the MD/CEO and the Non-Executive Directors. This function is assessed annually by the Board and by the Chairman in his self-assessment.
3 (5) (ix)	<b>Refrain from direct supervision of Key Management Personnel and executive duties - Complied <input checked="" type="checkbox"/></b> The Chairman does not get involved in the supervision of Key Management Personnel or any other executive duties.
3 (5) (x)	<b>Ensure effective communication with shareholders - Complied <input checked="" type="checkbox"/></b> The Annual General Meeting (AGM) is the main mechanism for shareholders' views to be heard and where the Board interacts with and clarifies matter for the shareholders. The Board formulated a formal policy to handle shareholders complaints.
3 (5) (xi)	<b>CEO functions as the apex executive in charge of the day to day operations and Business - Complied <input checked="" type="checkbox"/></b> As set out in the Board Charter, the responsibility for the day to day operations and business of the Bank has been delegated to the MD/CEO in his capacity as the apex executive-in-charge.

Section	Principle, Compliance & Implementation
<b>3 (6)</b>	<b>Board Sub- Committees</b>
3 (6) (i)	<p><b>Establishing Board Committees, their functions and reporting - Complied <input checked="" type="checkbox"/></b></p> <p>The Board has appointed eight (8) Sub-Committees, to ensure its oversight and control over the affairs of the Bank. The details of Board Sub-Committees are disclosed on CG&amp;RR page 15.</p> <p>Each Sub-Committee is governed by its own Terms of Reference and has a Secretary who arranges the Meetings and maintains Minutes and records under the supervision of the Chairman/Chairperson of the Sub-Committee. The Sub-Committee Chairmen/Chairpersons are accountable for the effective functioning of the Committees and reports on a periodic basis to the Board on the activities of their respective Sub-Committees, highlighting matters for Board attention. Committee mandates are reviewed regularly.</p>
<b>3 (6) (ii)</b>	<b>Board Audit Committee</b>
	<p><b>a. Chairman to be an Independent Non-Executive Director with qualifications and experience in accountancy and/or audit - Complied <input checked="" type="checkbox"/></b></p> <p>Mr Sujeewa Mudalige is an Independent Non-Executive Director. A senior practicing Chartered Accountant, he is a Fellow of the Institute of Chartered Accountants of Sri Lanka, Fellow of the Chartered Institute of Management Accountants (UK), Fellow of the Association of Chartered Certified Accountants (UK) and Fellow of the Certified Public Accountants (Australia).</p> <p>He holds over twenty six (26) years extensive experience in public accounting practice and has the required skills and experience to function effectively in the capacity of Chairman.</p>
	<p><b>b. Committee to comprise solely of Non-Executive Directors - Complied <input checked="" type="checkbox"/></b></p> <p>All Members are Non-Executive Directors.</p>
	<p><b>c. Board Audit Committee functions - Complied <input checked="" type="checkbox"/></b></p> <p>In terms of its mandate, the Board Audit Committee is responsible for the following key recommendations:</p> <ol style="list-style-type: none"> <li>i. The appointment of the External Auditor for audit services in line with professional and ethical standards and in compliance with regulatory requirements. On the recommendation of the Board Audit Committee/Board, the shareholders have approved the reappointment of Messrs. Ernst &amp; Young (Chartered Accountants) as the External Auditor of the Bank for the year 2018;</li> <li>ii. The service period, audit fee and any resignation or dismissal of the auditor. The Board Audit Committee ensures that the service period of the engagement of the External Audit partner shall not exceed five (5) years, and that the particular audit partner is not re-engaged for the audit before the expiry of three (3) years from the date of the completion of the previous term;</li> <li>iii. The implementation of the Central Bank guidelines issued to auditors from time to time and</li> <li>iv. Monitoring and review of the adequacy and effectiveness of accounting policies and the application of relevant accounting.</li> </ol>
	<p><b>d. Review and monitor External Auditor's Independence and objectivity and the effectiveness of the audit processes - Complied <input checked="" type="checkbox"/></b></p> <p>The Board Audit Committee monitors and reviews the External Auditor's independence, objectivity and the effectiveness of the audit process taking into account relevant professional and regulatory requirements.</p>
	<p><b>e. Provision of Non-Audit Services by External Auditor - Complied <input checked="" type="checkbox"/></b></p> <p>The Board is guided by the policy for Engagement of the External Auditor to provide non-audit services, as reviewed and recommended by the Board Audit Committee.</p> <p>In assignment of non-audit services to External Auditors by the Bank, the Board/Board Audit Committee ensures that the external auditor has the necessary skills and experience for the assignment and ascertains that independence and/or objectivity of the External Auditor in carrying out his duties and responsibilities will not be impaired. Assigning such non-audit services to External Auditors is discussed at BAC Meetings and prior approval obtained. Please refer Board Audit Committee Report on IR pages 111 to 113 for further details.</p>

Section	Principle, Compliance & Implementation
	<p><b>f. Determine scope of audit - Complied <input checked="" type="checkbox"/></b></p> <p>The Committee met with the External Auditor five (5) times during the year to discuss the audit approach and procedures, including nature and scope of the audit and auditor's independence.</p>
	<p><b>g. Review financial information of the Bank - Complied <input checked="" type="checkbox"/></b></p> <p>The Committee reviews the financial information of the Bank, in order to monitor the integrity of the Bank's Financial Statements, Annual Report, accounts and quarterly reports prepared for disclosure, and the significant financial reporting judgments contained therein. The review focuses particularly on the following:</p> <ul style="list-style-type: none"> <li>(i) Major judgemental areas,</li> <li>(ii) Any changes in accounting policies and practices,</li> <li>(iii) Significant adjustments arising from the audit,</li> <li>(iv) The going concern assumption and</li> <li>(v) Compliance with relevant accounting standards and other legal requirements.</li> </ul>
	<p><b>h. Discussions with External Auditor on interim and final audits - Complied <input checked="" type="checkbox"/></b></p> <p>The Board Audit Committee discusses issues, problems and reservations arising from the interim and final audits with the External Auditor. The Committee met the External Auditor on two (2) occasions in 2018, in the absence of the MD/CEO and Key Management Personnel.</p>
	<p><b>i. Review of Management Letter and Bank's response - Complied <input checked="" type="checkbox"/></b></p> <p>The Board Audit Committee reviewed the External Auditor's management letter and the Management's response thereto, during 2018.</p>
	<p><b>j. Review of Internal Audit Function - Complied <input checked="" type="checkbox"/></b></p> <p>During the year, the Board Audit Committee reviewed the independence, objectivity and performance of the Internal Audit Function, ensuring the function acts with impartiality, proficiency and due professional care.</p> <p>It reviewed the adequacy of coverage of the internal audit plan and approved the same. It also assessed the Department's resource requirements including succession planning, and is satisfied that the Internal Audit Department has the necessary authority to carry out its work.</p> <p>The findings of the internal audits completed during the year, the Management's responses thereto and the Internal Audit Department's evaluation of the Bank's internal controls were reviewed by the Board Audit Committee. Results of the follow up action taken on the recommendations of the Internal Audit Department were reviewed at subsequent Meetings.</p> <p>The Committee reviewed the performance appraisal of the Chief Internal Auditor and other senior staff members of the Internal Audit Department. The Committee is kept apprised of resignations of senior staff of the Internal Audit Department together with the reasons for resigning.</p> <p>The Chief Internal Auditor directly reports to the Board Audit Committee thus ensuring the independence of the Internal Audit Department.</p>
	<p><b>k. Internal Investigations- Complied <input checked="" type="checkbox"/></b></p> <p>Major findings of internal investigations and Management's responses thereto are reviewed by the Board Audit Committee and recommendations implemented.</p>
	<p><b>l. Attendees at Board Audit Committee Meetings - Complied <input checked="" type="checkbox"/></b></p> <p>MD/CEO, COO, Chief Risk Officer, Chief Financial Officer, Chief Internal Auditor, Head of Compliance and a representative of the External Auditor are typically invited to attend Meetings. Other Board Members may also attend Meetings upon invitation.</p>

Section	Principle, Compliance & Implementation
	<p><b>m. Explicit authority, resources and access to information - Complied</b> <input checked="" type="checkbox"/></p> <p>The Board Audit Committee is guided by the Committee Charter which sets out authority and responsibility of the said Committee. The Charter was reviewed in November 2018. The Board Audit Committee is authorised to obtain external professional advice and to invite outsiders with relevant experience to attend as and when necessary. The Committee also has full access to information in order to investigate into matters relating its Terms of Reference.</p> <p><b>n. Regular Meetings - Complied</b> <input checked="" type="checkbox"/></p> <p>The Board Audit Committee met eight (8) times during the year. Conclusions in discharging its duties and responsibilities are recorded in the Minutes of the Meetings.</p> <p><b>o. Disclosure in Annual Report- Complied</b> <input checked="" type="checkbox"/></p> <p>Details of the activities of the Board Audit Committee are included in the Report of the Board Audit Committee on pages 111 to 113 in the IR.</p> <p>Number of Meetings held and attendance at Board Audit Committee Meetings held in 2018 are set out on CG&amp;RR page 12.</p> <p><b>p. Maintain Minutes of Meetings- Complied</b> <input checked="" type="checkbox"/></p> <p>Minutes of Board Audit Committee Meetings are recorded and maintained by the Secretary to the Committee. The Board Secretary served as the Secretary until 1st July 2018 and the Chief Internal Auditor assumed duties thereafter.</p> <p><b>q. Whistleblowing policy and relationship with External Auditor- Complied</b> <input checked="" type="checkbox"/></p> <p>A Board approved whistleblowing policy is in place. The whistleblowing policy and the mechanism had been communicated to all staff members.</p> <p>The Board Audit Committee reviews issues relating to breach of ethics if any and the arrangements by which the staff of the Bank may in confidence raise concerns about possible improprieties. The Committee also ensured that the procedures for the independent investigations of such matters are appropriate and are in place.</p> <p>The Board Charter addresses the Board's responsibility to encourage any communication regarding non-compliances and unethical behaviour within the Bank.</p>
3 (6) (iii)	<p><b>Human Resources &amp; Remuneration Committee</b></p> <p><b>a. Remuneration Policy- Complied</b> <input checked="" type="checkbox"/></p> <p>The Committee reviews all significant human resource policies and initiatives, salary structures, promotions and terms and conditions relating to staff at Senior Management level with information and recommendations from the MD/CEO and the Chief Human Resource Officer.</p> <p>Separate Remuneration Policies for the Board of Directors, MD/CEO and all employees of the Bank including Key Management Personnel are in place.</p> <p><b>b. Goals and Targets- Complied</b> <input checked="" type="checkbox"/></p> <p>The goals and targets of the Board of Directors have been clearly set out and evaluated at the end of the year. The goals and targets for the MD/CEO and the senior leadership team are documented under the Balance Score Card system.</p> <p><b>c. Performance Evaluation- Complied</b> <input checked="" type="checkbox"/></p> <p>The Directors are evaluated at the end of the year based on the goals and targets set out.</p> <p>The Committee deliberates upon and recommends to the Board of Directors the remuneration packages, annual increments and bonuses of the MD/CEO, COO, members of the Corporate Management and Senior Management staff, having evaluated their performance against the set goals and targets.</p> <p><b>d. Meetings - Complied</b> <input checked="" type="checkbox"/></p> <p>The HRRC Committee met seven (7) times during the year.</p> <p>The MD/CEO attends Human Resources &amp; Remuneration Committee by invitation. The MD/CEO is not present at the time his performance is being discussed.</p>

Section	Principle, Compliance & Implementation
3 (6) (iv)	<p><b>Nomination Committee</b></p> <p><i>a. Appointment of Directors, CEO and Key Management Personnel - Complied</i> <input checked="" type="checkbox"/> A formal procedure is in place to appoint new Directors, MD/CEO and Key Management Personnel.</p> <p><i>b. Re-election of Directors - Complied</i> <input checked="" type="checkbox"/> The Committee considers and recommends the re-election of the Directors to the Board. The Committee also sets criteria of the succession of the MD/CEO.</p> <p><i>c. Eligibility criteria for appointments to key managerial positions including CEO - Complied</i> <input checked="" type="checkbox"/> The Committee sets the eligibility criteria, including qualifications, experience and key attributes, for appointment or promotion to key managerial positions including the position of the MD/CEO. A Board approved procedure to appoint Directors, MD/CEO and Key Management Personnel is in place.</p> <p><i>d. Fit &amp; Proper persons - Complied</i> <input checked="" type="checkbox"/> Each Director including the MD/CEO carries out an assessment of "fitness and propriety" to serve as a Director of the Bank. These declarations are reviewed by the Nomination Committee prior to submission to the Director Bank Supervision of the Central Bank of Sri Lanka.</p> <p><i>e. Succession Plan and new expertise - Complied</i> <input checked="" type="checkbox"/> A Succession Planning Policy is in place for Key Management Personnel and Directors. Each year, the Nomination Committee reviews the additional/new expertise requirements and succession arrangements for Directors and Key Management Personnel of the Bank, in line with the strategic plan.</p> <p><i>f. Composition of Nomination Committee - Complied</i> <input checked="" type="checkbox"/> The following Non-Executive Directors served on the Nomination Committee during 2018. Mr Rienzie Arseculeratne - Independent Non-Executive Director (Chairman - Resigned w.e.f 25th May 2018) Mr Dinesh Weerakkody - Independent Non-Executive Director (Chairman - Appointed w.e.f 26th May 2018) Ms Rose Cooray - Non- Executive Director Mr Rusi Captain - Non- Executive Director Mr Palitha Pelpola - Independent Non-Executive Director</p>
3 (6) (v)	<p><b>Board Integrated Risk Management Committee</b></p> <p><i>a. Composition of Risk Management Committee - Complied</i> <input checked="" type="checkbox"/> The following personnel served on the Board Integrated Risk Management Committee during 2018. Ms Rose Cooray - Non-Executive Director (Chairperson) Mr Jonathan Alles - Managing Director / CEO Ms Sanjivani Jayawardena - Non-Executive Director (Resigned w.e.f. 28th June 2018) Mr Madu Ratnayake - Independent Non-Executive Director (Appointed w.e.f. 25th October 2018) Mr Duliksha Soosaipillai - Independent Non-Executive Director Mr Damith Pallewatte - Chief Risk Officer/AGM - Risk /CISO Ms Mohini Seneviratne - Head of Compliance The COO, CFO, Chief Information Officer and Chief Internal Auditor attend Meetings on invitation. The Committee makes decisions on behalf of the Board within the framework of the authority and responsibility assigned to it. Terms of Reference of the Committee are described in the Committee Report on pages 107 to 110 in the IR.</p>

Section	Principle, Compliance & Implementation
	<p><b>b. Risk Assessment - Complied <input checked="" type="checkbox"/></b></p> <p>Policies on Credit Risk Management, Market Risk Management and Operational Risk Management have been approved by the Committee, providing a framework for management and assessment of risks. In discharging its responsibilities further as per the mandate, periodic reports on pre-established risk indicators prepared by the Risk Department is submitted to the Committee for review.</p>
	<p><b>c. Review of management level Committees on risk - Complied <input checked="" type="checkbox"/></b></p> <p>The Committee reviews the reports of the Management Committees including the Asset and Liability Committee (ALCO) and the Executive Risk Management and Credit Policy Committee to assess their adequacy and effectiveness in addressing specific risks and managing the same within the quantitative and qualitative risk limits set in the Risk Appetite Statement approved by the Board.</p>
	<p><b>d. Corrective action to mitigate risks exceeding prudential levels - Complied <input checked="" type="checkbox"/></b></p> <p>The Risk Dashboards, prepared on a periodic basis, reflects the actual exposure levels under each risk category against the tolerance levels, decided by the Committee on the basis of the Bank's policies and regulatory and supervisory requirements. The Committee has taken prompt corrective actions to mitigate the effects of risk indicators which have gone beyond the tolerance levels.</p>
	<p><b>e. Frequency of Meetings - Complied <input checked="" type="checkbox"/></b></p> <p>The Committee has met nine (9) times during the year. The agenda covers matters assessing all aspects of risk management including the updated business continuity plans.</p>
	<p><b>f. Actions against officers responsible for failure to identify specific risks or implement corrective action - Complied <input checked="" type="checkbox"/></b></p> <p>Such matters, if any, are referred to the Human Resources Division for necessary action.</p>
	<p><b>g. Risk assessment report to Board - Complied <input checked="" type="checkbox"/></b></p> <p>Detailed reports of the BIRMC Meetings are submitted to the Board at the subsequent Board Meeting.</p>
	<p><b>h. Compliance Function- Complied <input checked="" type="checkbox"/></b></p> <p>The Bank has established a compliance function to assess and ensure the Bank's compliance with laws, regulations, regulatory guidelines, internal controls and approved policies on all areas of business operations, headed by a dedicated Compliance Officer who reports to the BIRMC.</p>
<b>3 (7)</b>	<b>Related Party Transactions</b>
3 (7) (i)	<p><b>Avoid conflict of interest - Complied <input checked="" type="checkbox"/></b></p> <p>A Board approved policy to enhance the transparency of Related Party Transactions is in place.</p> <p>Steps have been taken by the Board to avoid any conflicts of interest, that may arise, in transacting with related parties as per the definition of this Direction. The Directors provide declarations to the Board of their outside business interests at appointment and quarterly thereafter. The Directors do not participate in, and excuse themselves from, the Meeting when the Board considers any matters in which lending to related entities are discussed and where a conflict in interest may arise.</p> <p>Transactions carried out with related parties as defined by LKAS 24 on 'Related Party Disclosures' in the normal course of business are disclosed in Note 60 to the Financial Statements on 'Related Party Disclosures' on IR pages 294 to 299. Directors' interest in contracts which do not fall into the definition of Related Party Transactions as per LKAS 24 are reported separately in the Annual Report, outside the Financial Statements. The net accommodation granted to each category of related parties as a percentage of the Bank's regulatory capital is given under Rule 3 (8) (ii) (e).</p>



Section	Principle, Compliance & Implementation
3 (7) (ii)	<p><b>Related Party Transactions covered by direction - Complied <input checked="" type="checkbox"/></b></p> <p>The Related Party Transactions Policy approved by the Board covers the following transactions:</p> <ul style="list-style-type: none"> <li>a) The grant of any type of accommodation, as defined in the Monetary Board's Directions on maximum amount of accommodation;</li> <li>b) The creation of any liabilities of the Bank in the form of deposits, borrowings and investments;</li> <li>c) The provision of any services of a financial or non-financial nature provided to the Bank or received from the Bank and</li> <li>d) The creation or maintenance of reporting lines and information flows between the Bank and any related parties which may lead to the sharing of potentially proprietary, confidential or otherwise sensitive information that may give benefits to such related parties.</li> </ul>
3 (7) (iii)	<p><b>Prohibited transactions - Complied <input checked="" type="checkbox"/></b></p> <p>The Bank's Related Party Transactions Policy prohibits transactions which would grant related parties more favourable treatment than that accorded to other customers. These include the following:</p> <ul style="list-style-type: none"> <li>a) Granting of "Total Net Accommodation" to related parties, exceeding a prudent percentage of the Bank's regulatory capital. Please refer Rule 3 (8) (ii) (e) on CG&amp;RR page 32;</li> <li>b) Charging of a lower rate of interest than the Bank's best lending rate or paying more than the Bank's deposit rate for a comparable transaction with an unrelated comparable counterparty;</li> <li>c) Providing of preferential treatment, such as favourable terms, covering trade losses and/or waiving fees/commissions, that extend beyond the terms granted in the normal course of business undertaken with unrelated parties;</li> <li>d) Providing services to or receiving services from a related-party without an evaluation procedure and</li> <li>e) Maintaining reporting lines and information flows that may lead to sharing potentially proprietary, confidential or otherwise sensitive information with related parties, except as required for the performance of legitimate duties and functions.</li> </ul>
3 (7) (iv)	<p><b>Granting accommodation to a Director or close relation of a Director - Complied <input checked="" type="checkbox"/></b></p> <p>A formal procedure is in place for granting accommodation to Directors or to close relatives of Directors. Such accommodation must be sanctioned at Board Meetings, by not less than 2/3 of the number of Directors excluding Director concerned, voting in favour of such accommodation or through circulation of papers which requires approval by all. The terms and conditions of the facility include a provision that it will be secured by such security as may from time to time be determined by the Monetary Board.</p>
3 (7) (v)	<p><b>Accommodations granted to persons, or concerns of persons, or close relations of persons, who subsequently are appointed as Directors of the Bank - Complied <input checked="" type="checkbox"/></b></p> <p>Accommodations granted to the newly appointed Director is in line with the prescribed regulation.</p>
3 (7) (vi)	<p><b>Favourable treatment or accommodation to Bank employees or their close relations - Complied <input checked="" type="checkbox"/></b></p> <p>No favourable treatment or accommodation is provided to Bank employees or their relatives, other than staff benefits.</p>
3 (7) (vii)	<p><b>Remittance of accommodations subject to Monetary Board approval - Complied <input checked="" type="checkbox"/></b></p> <p>No such situation has arisen during the year.</p>
<b>3 (8)</b>	<b>Disclosures</b>
3 (8) (i)	<p><b>Publish annual and quarterly Financial Statements - Complied <input checked="" type="checkbox"/></b></p> <p>Annual Audited Financial Statements and Interim Financial Statements of the Bank were prepared in accordance with the formats prescribed by the Supervisory and Regulatory Authorities and applicable accounting standards and have been published in the newspapers in all three languages.</p>

Section	Principle, Compliance & Implementation																															
3 (8) (ii)	<p><b>Disclosures in Annual Report</b></p> <p><b>a. A statement to the effect that the Annual Audited Financial Statements has been prepared in line with applicable accounting standards and regulatory requirements, inclusive of specific disclosures. - Complied <input checked="" type="checkbox"/></b></p> <p>Disclosures on the compliance with the applicable accounting standards and regulatory requirements in preparation of the Annual Audited Financial Statements have been made in the 'Statement of Directors' Responsibility for Financial Reporting' on IR page 132, 'Chief Executive Officer's and Chief Financial Officer's Statement of Responsibility' on IR page 131 and Note 2.1.1 (Statement of Compliance) to the Financial Statements on IR page 145.</p> <p><b>b. Report by the Board on the Bank's internal control mechanism - Complied <input checked="" type="checkbox"/></b></p> <p>A confirmation by the Directors on the effectiveness of the internal control system over financial reporting is given under the Directors' Statement on Internal Control on pages 116 to 117 in the IR.</p> <p><b>c. External Auditor's certification on the effectiveness of the internal control mechanism - Complied <input checked="" type="checkbox"/></b></p> <p>The Assurance Report issued by the External Auditor on the Internal Control over Financial Reporting based on "SLSAE 3050 - Assurance Reports for Banks on Directors' Statement on Internal Controls" issued by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) is given on IR page 118. The recommendations made by the Auditors where relevant, will be dealt with in 2019.</p> <p><b>d. Details of Directors, including names, fitness and propriety, transactions with the Bank and the total of fees/remuneration paid by the Bank - Complied <input checked="" type="checkbox"/></b></p> <p>Profiles of Directors are given on pages 20 to 25 in the IR.</p> <p>Directors' transactions with the Bank are disclosed in Note 60 to the Financial Statements on pages 294 to 299 in the IR.</p> <p>Remuneration paid by the Bank to the Board of Directors (which includes the remuneration of the Executive Director) is disclosed in Note 18 to the Financial Statements on IR page 201.</p> <p><b>e. Total accommodations granted to each category of related parties and as a percentage of the Bank's regulatory capital - Complied <input checked="" type="checkbox"/></b></p> <p>The net accommodation granted to each category of related parties is given below as a percentage of the Bank's regulatory capital.</p> <table border="1"> <thead> <tr> <th>Category of Related Party Transactions</th> <th>Rs Mn</th> <th>%</th> </tr> </thead> <tbody> <tr> <td>Non-Executive Directors and their close family members</td> <td>13.2</td> <td>0.01</td> </tr> <tr> <td>Key Management Personnel* and their close family members</td> <td>100.8</td> <td>0.08</td> </tr> <tr> <td>Subsidiaries</td> <td>3,330.6</td> <td>2.49</td> </tr> <tr> <td>Joint Venture</td> <td>3,877.1</td> <td>2.89</td> </tr> <tr> <td>Entities which Directors and their close family members have a substantial interest</td> <td>678.4</td> <td>0.51</td> </tr> <tr> <td>Government of Sri Lanka/Entities Controlled, Jointly Controlled, Significantly Influenced by the Government of Sri Lanka</td> <td>36,816.6</td> <td>27.47</td> </tr> </tbody> </table> <p>*includes the Executive Director</p> <p><b>f. Aggregate values of remuneration to, and transactions with Key Management Personnel - Complied <input checked="" type="checkbox"/></b></p> <p>The aggregate amount of remuneration paid during 2018 to Key Management Personnel and the transactions with Key Management Personnel are given below</p> <table border="1"> <thead> <tr> <th>Remuneration &amp; Transactions with Key Management Personnel</th> <th>Rs Mn</th> </tr> </thead> <tbody> <tr> <td>Remuneration Paid</td> <td>343.8</td> </tr> <tr> <td>Loans and Advances</td> <td>376.7</td> </tr> <tr> <td>Deposits</td> <td>287.0</td> </tr> <tr> <td>Investments</td> <td>124.2</td> </tr> </tbody> </table>	Category of Related Party Transactions	Rs Mn	%	Non-Executive Directors and their close family members	13.2	0.01	Key Management Personnel* and their close family members	100.8	0.08	Subsidiaries	3,330.6	2.49	Joint Venture	3,877.1	2.89	Entities which Directors and their close family members have a substantial interest	678.4	0.51	Government of Sri Lanka/Entities Controlled, Jointly Controlled, Significantly Influenced by the Government of Sri Lanka	36,816.6	27.47	Remuneration & Transactions with Key Management Personnel	Rs Mn	Remuneration Paid	343.8	Loans and Advances	376.7	Deposits	287.0	Investments	124.2
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Section	Principle, Compliance & Implementation
	<p><i>g. External Auditors certification of compliance - Complied</i> <input checked="" type="checkbox"/></p> <p>The External Auditors have performed procedures set out in Sri Lanka Standards on Related Service 4400 issued by the Institute of Chartered Accountants of Sri Lanka (SLSRS 4400), to meet the compliance requirement of the Corporate Governance Directive. Their findings presented in their report addressed to the Board are consistent with the matters disclosed above and did not identify any inconsistencies to those reported above by the Board. The recommendations made by the Auditors where relevant will be dealt with in 2019.</p> <p><i>h. Report confirming compliance with prudential requirements, regulations, laws and internal controls - Complied</i> <input checked="" type="checkbox"/></p> <p>There were no material non - compliance to prudential requirements, regulations, laws and internal controls affecting the Bank.</p> <p><i>i. Non-compliance Report - Complied</i> <input checked="" type="checkbox"/></p> <p>There were no supervisory concern lapses in the Bank's Risk Management Systems or non-compliance with the said Direction that have been pointed out by the Director of the Banks Supervision Department of the CBSL, which has been directed to be disclosed to the public. Hence, there are no disclosures in this regard.</p>
3 (9)	<b>Transitional and other general provisions</b>
	<p><b>Transitional and other general provisions - Complied</b> <input checked="" type="checkbox"/></p> <p>Transitional provisions have been complied with.</p>

## Corporate Governance

### APPENDIX II: COMPLIANCE WITH THE CODE OF BEST PRACTICE ON CORPORATE GOVERNANCE ISSUED BY THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA IN 2017

This table summarises compliance with the revised Code, providing details where it has not been explained in the Corporate Governance Report or Appendix I: Compliance with Banking Direction No.11 of 2007 on Corporate Governance. Responses are summarised to provide a high level view of the subject.

Code Ref.	Requirement	Reference	Complied	Page No.
<b>A</b>	<b>Directors</b>			
A.1	The Board	The Board	<input checked="" type="checkbox"/>	CG&RR 9
A.1.1	Board Meetings	Board Meetings Attendance at Meetings	<input checked="" type="checkbox"/>	CG&RR 12 CG&RR 12
A.1.2	Role & Responsibilities of the Board	Key Board Responsibilities The Board Governance Structure	<input checked="" type="checkbox"/>	CG&RR 9 CG&RR 9 CG&RR 6
A.1.3	Compliance Independent professional advice	Compliance Supply of and access to information	<input checked="" type="checkbox"/>	CG&RR 19 CG&RR 14
A.1.4	Access to advise and services of Company Secretary and Insurance Cover	Company Secretary The Board	<input checked="" type="checkbox"/>	CG&RR 11 CG&RR 9
A.1.5	Independent judgment	Director Independence	<input checked="" type="checkbox"/>	CG&RR 11
A.1.6	Dedicate adequate time and effort	Board Meetings Conflicts of Interests and Other Commitments	<input checked="" type="checkbox"/>	CG&RR 12 CG&RR 13
A.1.7	Calls for resolutions	Attendance at Meetings	<input checked="" type="checkbox"/>	CG&RR 12
A.1.8	Board induction and training	Induction and on-going Director training Board Evaluation	<input checked="" type="checkbox"/>	CG&RR 14 CG&RR 14
A.2	Chairman & Chief Executive Officer	Role of Chairman and MD/CEO	<input checked="" type="checkbox"/>	CG&RR 10
A.3	Chairman's role in preserving good Corporate Governance	Roles and Responsibilities of Chairman and MD/ CEO	<input checked="" type="checkbox"/>	CG&RR 10
A.4	Availability of financial acumen	Board Composition	<input checked="" type="checkbox"/>	CG&RR 9
A.5	Board Balance	Board Composition Director Independence Board Meetings	<input checked="" type="checkbox"/>	CG&RR 9 CG&RR 11 CG&RR 12
A.6	Provision of appropriate and timely information	Supply of and Access to Information Role of Chairman and MD/CEO Board Meetings	* <input checked="" type="checkbox"/>	CG&RR 14 CG&RR 10 CG&RR 12
A.7	Appointments to the Board	Appointment, Re-election and Resignation	<input checked="" type="checkbox"/>	CG&RR 11
A.8	Re-election of Directors	Appointment, Re-election and Resignation	<input checked="" type="checkbox"/>	CG&RR 11
A.9	Appraisal of Board & Sub-Committees	Board Evaluation		CG&RR 14
A.10	Annual Report to disclose specified information regarding Directors	Profiles Directorships in Other Companies Board Composition Board Sub-Committees Attendance at Meetings	<input checked="" type="checkbox"/>	IR 20-25 CG&RR 13 CG&RR 9 CG&RR 14 CG&RR 12
A.11	Annual appraisal of the CEO	Appraisal of MD/CEO	<input checked="" type="checkbox"/>	CG&RR 14

Code Ref.	Requirement	Reference	Complied	Page No.
<b>B</b>	<b>Directors' Remuneration</b>			
B.1	Directors' & Executive Remuneration	Directors' & Executive Remuneration - Policy and Procedure	<input checked="" type="checkbox"/>	CG&RR 16
B.2	Level & Make Up of Remuneration	Level and Make Up of Remuneration	<input checked="" type="checkbox"/>	CG&RR 16
B.3	Disclosures related to remuneration in Annual Report	Policy and Procedure Financial Statements HRRC Report	<input checked="" type="checkbox"/>	CG&RR 16 IR 201 IR 102-103
<b>C</b>	<b>Relations with Shareholders</b>			
C.1	Constructive use of the AGM & Other General Meetings	Corporate Communication - Constructive use of Annual General Meeting (AGM)	** <input checked="" type="checkbox"/>	CG&RR 18
C.2	Communication with Shareholders	Corporate Communication - Communication with Shareholders	<input checked="" type="checkbox"/>	CG&RR 17
C.3	Disclosure of Major and Material Transactions	Major and Material Transactions	<input checked="" type="checkbox"/>	CG&RR 18
<b>D</b>	<b>Accountability &amp; Audit</b>			
D.1	Present a balanced and understandable assessment of the Company's financial position, performance and prospects	<p>The Board has taken every effort to ensure that the Annual Report presents a fair and balanced review of the Bank's financial position, performance and prospects combining narrative and visual elements to facilitate readability and comprehension. All statutory requirements have been complied within the Annual Report and the interim financials have been reviewed and approved by the Board Audit Committee, prior to publication. The following disclosures as required by the Code are included in the Integrated Report:</p> <ul style="list-style-type: none"> <li>• Chief Executive Officer's and Chief Financial Officer's Responsibility Statement</li> <li>• Annual report of the Board of Directors on the affairs of the Bank</li> <li>• Directors Responsibility for Financial Reporting Directors' Statement on Internal Control Management Discussion and Analysis Capital Reports/Business Line Reports</li> <li>• Statement of going concern of the Bank on note 2.3.1, to the Financial Statements</li> <li>• Related Party Transactions <ul style="list-style-type: none"> <li>(i) Note 60 in the Financial Statements</li> <li>(ii) Report of the RPTRC</li> </ul> </li> </ul> <p>In the unlikely event of the net assets of the company falling below 50% of Shareholders Funds, the Board will summon an Extraordinary General Meeting (EGM) to notify the shareholders of the position and to explain the remedial action being taken.</p>	<input checked="" type="checkbox"/>	IR 131 IR 93-101 IR 132 IR 147 IR 294-299 IR 114-115
D.2	Process of risk management and a sound system of internal control to safeguard shareholders' investments and the Company's assets	Risk Management and Internal Control Risk & Capital Management Report Directors' Statement on Internal Control over Financial Reporting	<input checked="" type="checkbox"/>	CG&RR 16 CG&RR 37-88 IR 116-117

## Corporate Governance

Code Ref.	Requirement	Reference	Complied	Page No.
D.3	Board Audit Committee	Board Audit Committee Report	*** <input checked="" type="checkbox"/>	IR 111-113
D.4	Related Party Transactions Review Committee	Related Party Transactions Review Committee Report	<input checked="" type="checkbox"/>	IR 114-115
D.5	Code of Business Conduct and Ethics	Code of Conduct and Ethics Communication with Shareholders Conflicts of Interests and Other Commitments Chairman's Message	<input checked="" type="checkbox"/>	CG&RR 17 CG&RR 17 CG&RR 13 CG&RR 3
D.6	Corporate Governance Disclosures	Corporate Governance Report	<input checked="" type="checkbox"/>	CG&RR 3-36
<b>E &amp; F</b>	<b>Institutional and other Investors</b>			
	Encourage voting at AGM - institutional and other investors	Communication with Shareholders	<input checked="" type="checkbox"/>	CG&RR 17
<b>G</b>	<b>Internet of Things &amp; Cybersecurity</b>			
G.1	Identify connectivity and related cyber risks	Cybersecurity	<input checked="" type="checkbox"/>	CG&RR 18
G.2	Appoint a CISO and allocate budget to implement a cyber security policy	Cybersecurity	<input checked="" type="checkbox"/>	CG&RR 18
G.3	Include cybersecurity in Board agenda	Cybersecurity	<input checked="" type="checkbox"/>	CG&RR 18
G.4	Obtain periodic assurance to review effectiveness of cybersecurity risk management	Cybersecurity	<input checked="" type="checkbox"/>	CG&RR 18
G.5	Disclosures in Annual Report	Cybersecurity	<input checked="" type="checkbox"/>	CG&RR 18
<b>H</b>	<b>Environment, Society &amp; Governance</b>			
H.1	ESG Reporting	Sustainability	<input checked="" type="checkbox"/>	CG&RR 18

\* Since the end of 2018, circulation of Minutes has been expedited to within two weeks of the Meeting being held.

\*\* The disclosure in respect of number of shares in respect of which proxy appointments have been validly made, Number of votes for and against the resolution and the number of shares in respect of which the vote was directed to be withheld relating to the 2018 AGM has been and posted on the Bank's website as 31.12.2018.

\*\*\* The Board Audit Committee (BAC) was constituted with an equal number of Independent and Non-Independent Directors w.e.f 29th November 2018. The BAC was reconstituted with three (3) Independent and two (2) Non-Independent (Non-Executive) Directors w.e.f 25th January 2019.

# Risk & Capital Management Report

## ENTERPRISE RISK MANAGEMENT

Risk is an inherent part of the business of a bank as we consciously accept risk in our lending and investing activities and also need to manage risks arising from events beyond our control in managing our business portfolios. We understand that we need to take risks to create value to our stakeholders and that risk and opportunity are two sides of the same coin. Consequently, we seek to manage our portfolios, businesses and associated risks in a manner that balances interests of our customers, investors and other stakeholders while ensuring the financial stability, profitability and growth of the Bank. We invest in developing competencies in managing risk and ensure that all members of our team understand the role they play in managing risks and that they do so within the Board approved risk management framework.

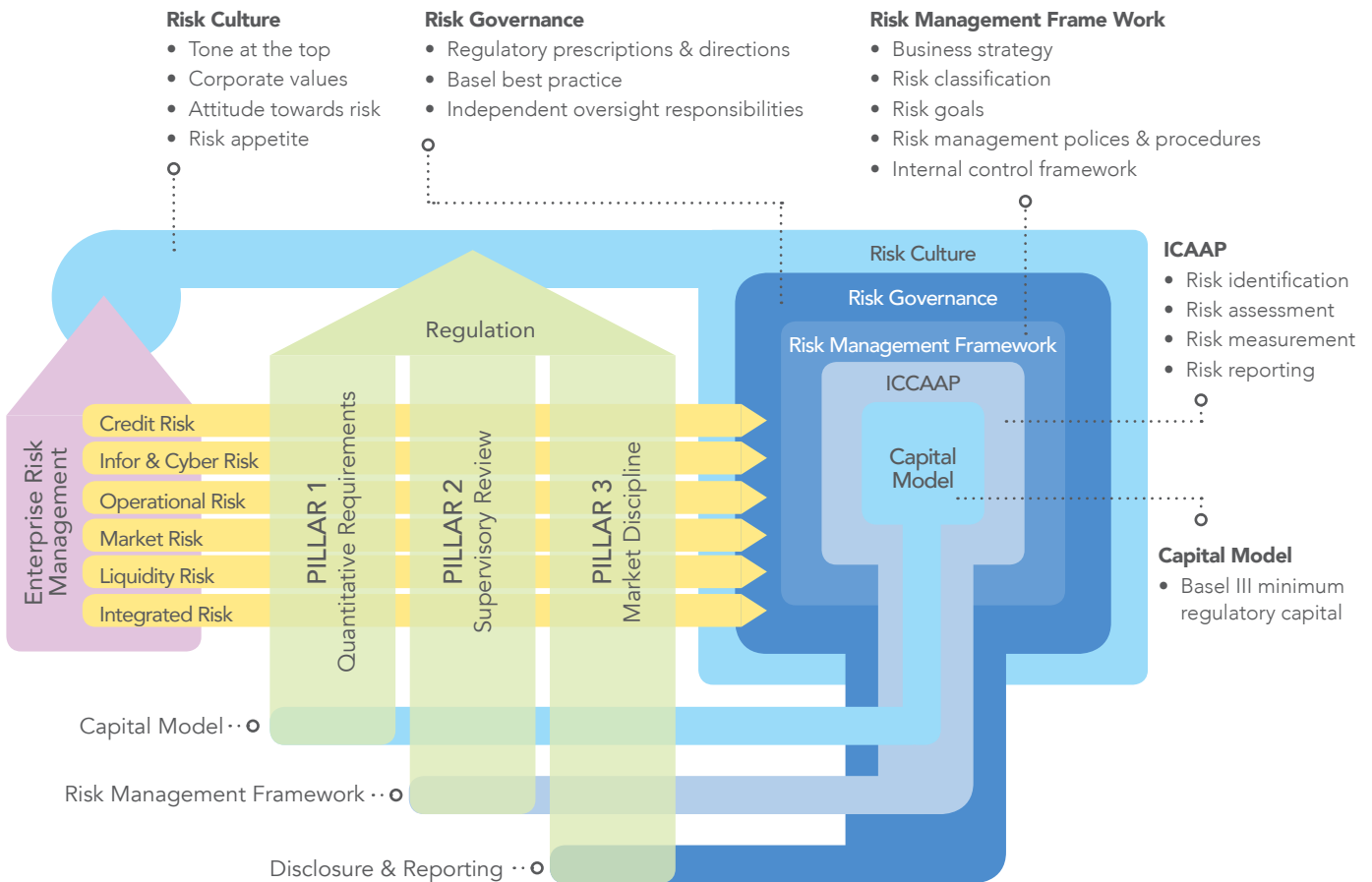
## RISK ENVIRONMENT 2018

The global regulatory environment for risk management continues to evolve at a rapid pace, with key areas of reform focusing on open banking, cyber security, data protection and

anti-money laundering. While many territories including the EU are strengthening regulation, the US repealed the Dodd-Frank Act easing regulations imposed in the immediate aftermath of the global financial crisis and enabling mobile banking and e-signatures. Many of these changes will shape the digital transformation of banks around the world and support inclusive growth of the financial services globally.

Payment related fraud and identity theft continue to be key concerns for all businesses, typically affecting a bank or other payment solutions providers. EU's revised Directive on Payment Services (PSD2) which came in to force in January 2018 is expected to level the playing field between banks and other payment solution providers but skeptics point to potential for increased risk of fraud and difficulties in proving liability as payments move through open APIs (Application Programming Interface). Encouragingly, advancements in technology and Artificial Intelligence (AI) enable integration of fraud-prevention systems that are preventive and adaptive to effectively counter threats.

Figure 01: HNB Philosophy in Managing Risk









# Risk & Capital Management Report

## OUR MATERIAL RISKS

Our material risks are summarized below in figure 02: Material Risks and signposted to the respective detailed discussion for those who require more detailed information.

Figure 02: Material Risks

	 <b>Credit Risk</b>	 <b>Information &amp; Cyber Risk</b>	 <b>Operational Risk</b>
<b>Definition</b>	The risk of losses due to one or more counterparties failing to meet all or part of their contractual obligations towards the Bank in accordance with agreed terms.	Risk of financial loss, disruption or damage to the reputation of the Bank from some sort of compromise of information to unintended parties and unauthorised access to our systems or data/information. It also arises from failure of the Bank's information technology systems.	The risk of loss due to inadequate or failed internal processes, people and systems or from external events. This definition includes legal risk but excludes strategic and reputational risk
<b>Drivers</b>	Concentration of portfolio by product, business sector, geography etc.; macroeconomic conditions, rigour of credit evaluation and monitoring processes, Bank's credit risk appetite, internal risk goals and tolerance level	Arises from the integration of information technology in to all aspects of banking operations which facilitate convenience, scalability and capability but also makes the Bank vulnerable to unauthorized access to systems and information assets	Arises from day to day operations and external events
<b>Measured</b>	Based on credit exposure, Probability of Default (PD), expected losses, Loss Given Default (LGD) and recovery rates. NPA ratios, stress testing on concentration, large borrower default, increase in provision etc... Additional capital under Pillar 2 risk is assessed by ICAAP as per Basel III	Reference to cyber risk loss limits and cyber risk matrix , hacking attempts for a month	Measured using operational losses, loss events/near misses, key risk indicators, overall risk grid matrix, risk ranking and prioritizing, risk heat map, capital allocation under CAR as per Basel III
<b>Monitored</b>	By BIRMC, BCC and executive committees using the credit risk dashboard which provides metrics on a number of parameters including analysis of arrears, collateral, concentration etc.	By cyber risk monitoring unit through a cyber risk dashboard presented to BIRMC monthly	Monitored and overseen by operational risk management vertical under the guidance of ORSC with input from business units through Risk and Control Self Assessments (RCSA). Operational risk monthly dashboards are submitted to ERMCP, BIRMC and Board
<b>Managed</b>	In accordance with credit risk management policy suite supported by dedicated resources for monitoring of arrears, strong documentation and a proactive approach to resolving issues.	Through the Bank's action plan for digital resilience, awareness programs for staff, business continuity plans, use of physical controls, technical and logical access and administrative controls.	Managed through a sound operational risk management framework by the ORSC with the participation of all business/support units
<b>Key Information</b>	Assessment: Moderate Trend:  Pages 48-52 in CG&RR	Assessment: Moderate Trend:  Pages 56-57 in CG&RR	Assessment: Moderate Trend:  Pages 53-55 in CG&RR



 <b>Liquidity Risk</b>	 <b>Market Risk</b>	 <b>Strategic Risk</b>	 <b>Reputation Risk</b>
<p>The risk that the Bank is unable to meet its debt obligations associated due to lack of funds or having to meet these obligations at excessive cost.</p>	<p>The risk that movements in market factors could reduce our income or value of portfolios.</p>	<p>Refers to uncertainties and untapped opportunities embedded in our strategic intent and how well they are executed.</p>	<p>The loss resulting from damages to a firm's reputation, in lost revenue; increased operating, capital or regulatory costs; or destruction of shareholder value,</p>
<p>Arises from mismatches in cash flow due to potential short-term cash demands placed upon the Bank, by depositors, borrowers, the Bank's own borrowing activity, trading activities and counterparty interactions.</p>	<p>Arises from movement in market factors such as foreign exchange rates, interest rates, credit spreads, equity prices and commodity prices.</p>	<p>Arises from external developments in technology, products, business models</p>	<p>Arises from events that could adversely impact public perception of the Bank as a responsible corporate citizen</p>
<p>Measured using a range of metrics including regulatory limits such as the LCR, internal model and balance sheet based measures and stress testing on interest rate sensitivity, probabilistic analysis, NII analysis,</p>	<p>Measured using Value at Risk, sensitivity analysis and stress testing on open positions, mark to market on daily basis to identify the trading book position capital is allocated under CAR as per Basel III</p>	<p>Measured using a scorecard approach to quantify strategic risk under the Basel III Pillar 2 calculation</p>	<p>Measured using a scorecard approach by assessing underlying risk drivers of reputational risk due to qualitative nature of the risk</p>
<p>Monitored by ALCO and Treasury Middle Office (TMO) using a matrix of regulatory and prudential limits and gaps using both stock and flow approaches, dashboards submitted to ALCO and BIRMC and Board</p>	<p>Monitored by ALCO using market risk dashboards supported by an independent Treasury Middle Office (TMO) which reports to CRO. Internal and regulatory limits and exceptions are immediately reported to CRO, MD/CEO</p>	<p>Monitored by the risk management function who report to Board annually via ICAAP submission</p>	<p>Monitored by the risk management function who report to the Board annually via ICAAP submission</p>
<p>Managed through a strong liquidity risk management framework which includes contingency plans with both contracted and un-contracted liquidity positions, liquidity buffers, liquidity ladders</p>	<p>Managed by treasury within a robust market risk management framework, market risk limits, through diversification and hedging strategies,</p>	<p>Managed at corporate management and Board level with reference to market developments and potential disruptions to current business model Assessments.</p>	<p>Managed by setting the tone at the top and reinforcing its core values and purpose. A Reputation Risk Task Force was established as a sub-committee of ORSC to manage risk in case of trigger events.</p>
<p>Assessment: Moderate Trend:  Pages 63-64 in CG&amp;RR</p>	<p>Assessment: Moderate Trend:  Pages 58-63 in CG&amp;RR</p>	<p>Assessment: Moderate Trend:  Pages 66-67 in CG&amp;RR</p>	<p>Assessment: Moderate Trend:  Page 66 in CG&amp;RR</p>

# Risk & Capital Management Report

## ENTERPRISE RISK GOVERNANCE

The Board of Directors bear ultimate responsibility for oversight of the risk management in the Bank. A governance structure, a comprehensive policy framework and robust processes have been put in place to facilitate discharge of this key function as described below.

Figure 03: Risk Governance Structure

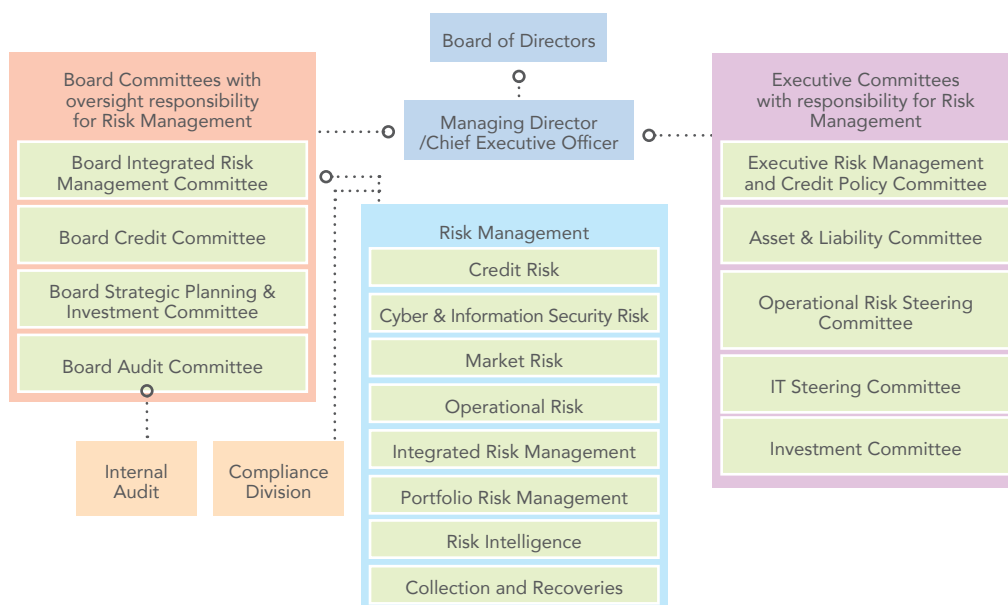


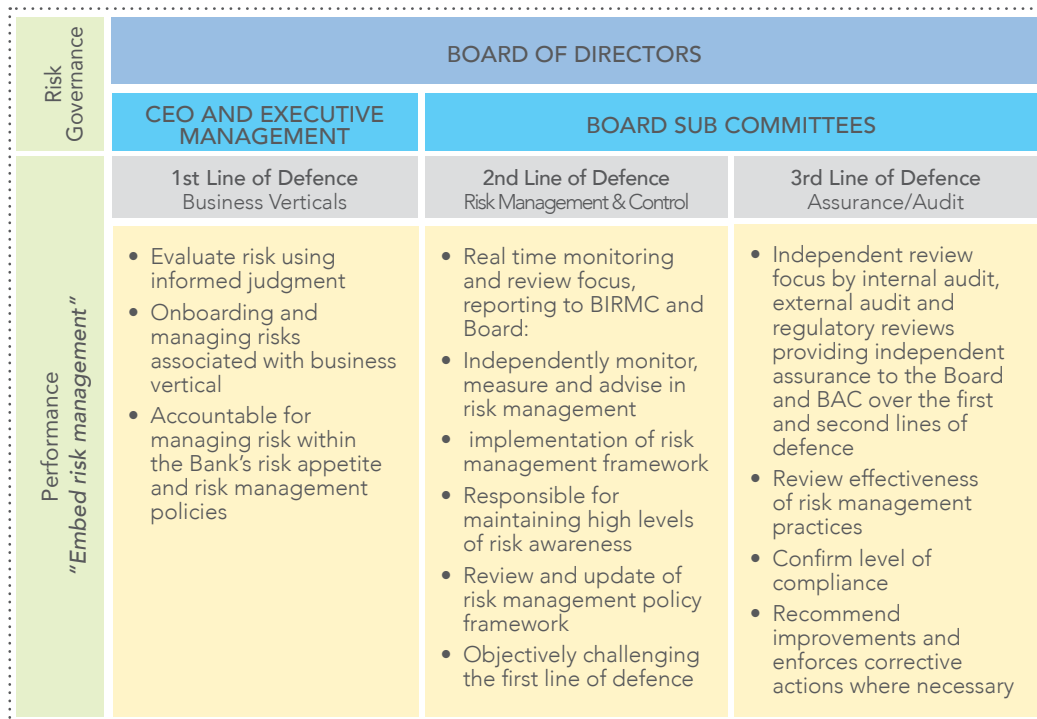
Figure 04: Roles & Responsibilities of Committees in Relation to Risk Management

Board Committees	Role of Committee in Relation to Risk Management
Board Integrated Risk Management Committee (BIRMC)	This committee has oversight responsibility for risk management and makes recommendations to Board on risk management policy, setting the Bank's risk appetite and monitoring the material risks of the Bank through risk dashboards. The risk management and compliance departments of the Bank report to BIRMC who also provide inputs on hiring of key management personnel for this department and their performance.
Board Credit Committee (BCC)	BCC has an oversight responsibility for management of credit appetite of the Bank, supporting BIRMC in discharging their duties. BCC reviews the credit risk dashboards and makes recommendation on credit risk management policies and processes to BIRMC and Board.
Board Audit Committee (BAC)	BAC has oversight responsibility for financial statements and effective operation of internal controls which plays a key role in risk management and compliance.
Board Strategic Planning & Investment Committee (BSPIC)	As this committee sets strategy for the Bank, there is a significant congruence between BIRMC and BSPIC in determining strategic direction, goals and KPIs.

Executive Committees	Role of Committee in Relation to Risk Management
Executive Risk Management and Credit Policy Committee (ERMPCPC)	ERMPCPC is the apex executive committee for risk management and supports BIRMC in effective implementation of the policy framework in monitoring and managing risk. This key committee is chaired by MD/CEO and comprises heads of key business lines and operating units of the Bank ensuring shared ownership of responsibility for managing risk, a common understanding of the Bank's risk philosophy and awareness of current challenges.
Asset & Liability Committee (ALCO)	ALCO plays a key role in managing liquidity risk and financial stability of the Bank. It reviews liquidity forecasts to manage gaps, adequacy of contingency funding plans and stress testing results in achieving its objectives.
Operational Risk Steering Committee	Focused on managing operational risk, this committee is chaired by CRO and comprises DGM-operations, CIA, CIO, Head of Talent Management and AGM-Network Management,
IT Steering Committee	This committee drives the IT strategy of the Bank and supports management of information and cyber security risk. It is chaired by MD/CEO and comprises COO, CRO, CFO, DGM Operations DGM –HR , CIA, CSO, CIO, DGM –Corporate Banking and DGM-Retail
Investment Committee	This committee ensures that return on investments is commensurate with the risk and in alignment with the Bank's strategic goals and is chaired by MD/CEO and comprise of COO and CSO.

Responsibility for risk management is shared across the Bank in line with the three lines of defence model given below. This facilitates risk awareness throughout the organization as risk acceptance and management activities initiated by business lines are monitored, measured and constructively challenged by an independent and specialized risk management function with assurance on the effective functioning of these defence lines. The risk management and compliance functions report- directly to BIRMC while internal audit reports directly to BAC, ensuring independence of the 2nd and 3rd lines of defence.

Figure 05: Three Lines of Defence



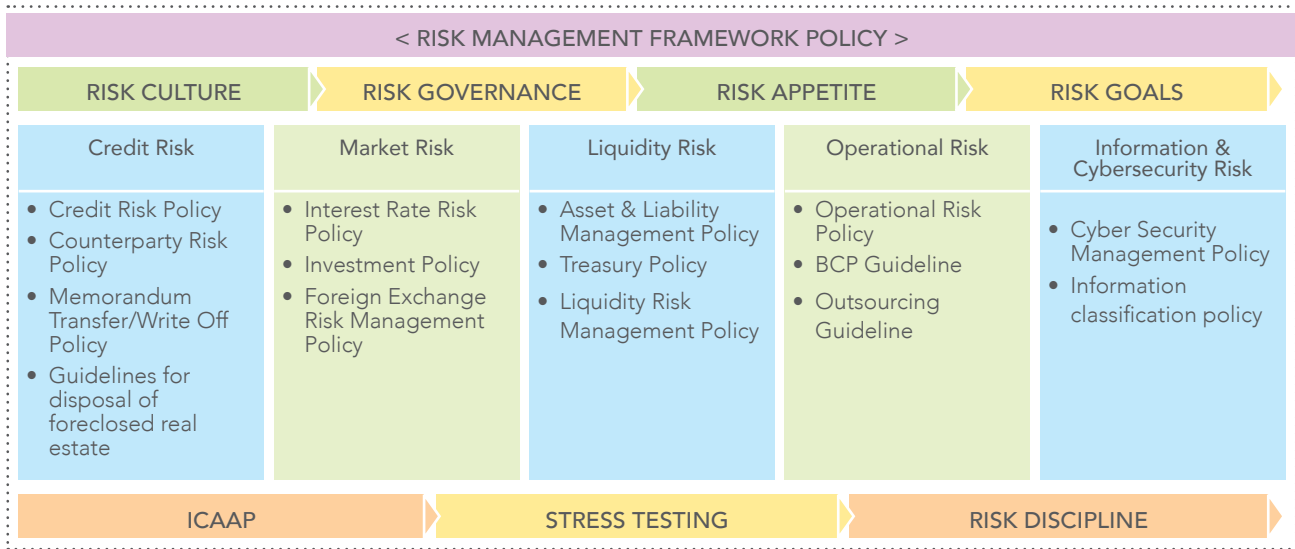
# Risk & Capital Management Report

## A COMPREHENSIVE POLICY FRAMEWORK

The Bank’s enterprise risk management framework is based on the COSO framework for enterprise risk management, Basel III regulatory framework and CBSL directive on IRM framework. It aims to establish a process to effectively identify, measure, manage, control and monitor risks faced by the Bank within its risk appetite while facilitating achievement of strategic goals in the long term, preserving and safeguarding the capital of the Bank.

These Board approved policies provide guidance to the management on the processes in place within the Bank to ensure compliance with the legal requirements and the Bank’s own requirements which may be more stringent in many areas.

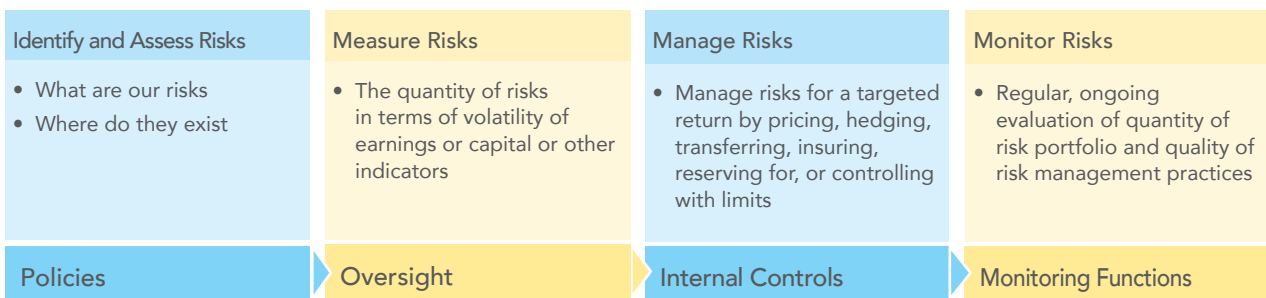
Figure 06: Risk Management Framework



## A ROBUST PROCESS

The Bank’s risk management processes follow the stages outlined below and are strongly supported by a comprehensive framework of policies, oversight and monitoring at multiple stages throughout a multi layered governance structure and robust internal controls.

Figure 07: Risk Management Process



## STRENGTHENING RISK MANAGEMENT

The Board shapes the Bank's risk management agenda, continuously refining policy frameworks, structures and processes, adapting to a changing risk landscape. The following schematic reflects our journey in 2018.

Figure 08: Key Initiatives to Strengthen Risk Management in 2018

	Project	Impact
Risk Governance	Introduction and Update of Risk Management Policies	<ul style="list-style-type: none"> <li>• Introduced information classification and electronic labelling of information according to new policy</li> <li>• Commencement of a project to enhance coverage of stress testing policy</li> </ul>
	Establishing Risk Intelligence Unit	<ul style="list-style-type: none"> <li>• Forward looking view of risk assessment based on credit portfolio behaviours</li> <li>• Better information for decision making</li> <li>• Alignment of policies taking cognizant of historical risk events</li> </ul>
Credit Risk	Development of Loan Origination System	<ul style="list-style-type: none"> <li>• Streamlined credit approval process</li> <li>• 360° assessment of customer for informed credit evaluations</li> <li>• Reduced turnaround times</li> <li>• Enhanced compliance and risk culture</li> <li>• Paperless processes in credit approvals</li> </ul>
	Strengthening Portfolio Risk Management	<ul style="list-style-type: none"> <li>• Streamlined process to identify and monitor under performing credit through a tiered approach i.e. management review list and watch list</li> <li>• Improved information dissemination and engagement of business verticals to manage stressed credits early</li> <li>• Strengthened loan review mechanism</li> <li>• Enhanced credit risk dashboards to management and Board/Board sub committees</li> </ul>
	Implementation of SLFRS 9	<ul style="list-style-type: none"> <li>• Implementation of Expected Credit Loss (ECL) models is in progress</li> <li>• Compliance with SLFRS 9 framework to assess forward looking credit risks</li> </ul>
	Recalibration and enhancements to Internal Risk Rating Models	<ul style="list-style-type: none"> <li>• Expanding coverage to SME, microfinance, project finance and individuals</li> <li>• Umbrella retail model for all PFS products</li> <li>• Recalibration of existing rating models</li> <li>• Upgrading the existing rating software platform to the latest version</li> </ul>
Integrated Risk	Development of Risk Models	<ul style="list-style-type: none"> <li>• Refinement of ICAAP methodology adopted by the Bank</li> <li>• Development of conduct and model risk policies along with further refined disclosure policy for the Bank</li> <li>• Improved integrated stress testing mechanism</li> </ul>
Market Risk	Treasury Systems Upgrade	<ul style="list-style-type: none"> <li>• Enhanced treasury limit management</li> <li>• Improved online real time limit monitoring</li> <li>• Increased automation of market risk controls</li> <li>• Improved processing times in MI and reporting</li> </ul>
Operational Risk	Risk & Control Self-Assessment Process Enhancement	<ul style="list-style-type: none"> <li>• Enhanced risk awareness across the Bank and risk culture</li> <li>• Reviewed and constructively challenge root causes to avoid repeat mistakes</li> </ul>
	Streamlined Root Cause Analysis of Operational Loss Event Including Near Misses	<ul style="list-style-type: none"> <li>• Improved internal controls</li> <li>• Enhanced efficiency and effectiveness of established operational controls through continuous assessment of control design and performance</li> </ul>
	Established specialized Business Continuity Management Function	<ul style="list-style-type: none"> <li>• Improved disaster recovery capability</li> <li>• Clear benchmarks set for recovery times and recovery points</li> <li>• Improved business impact assessment process</li> </ul>
	Strengthened Monitoring of Outsourced Activities	<ul style="list-style-type: none"> <li>• Improved alignment to the Bank's goals and objectives</li> <li>• Improved management of operational risk associated</li> </ul>
Information & Cyber Risk	Strengthening Data Management	<ul style="list-style-type: none"> <li>• Engaged in external consultancy to institutionalize global best practices</li> <li>• Introduced clear classification and electronic labelling of information using a new software tool in accordance with policy</li> <li>• Improved Data Loss Prevention (DLP) capability using DLP tools</li> <li>• Introduced comprehensive Digital Right Management (DRM) through a DRM solution</li> <li>• Upgraded firewalls</li> <li>• Introduced two factor authentication for internet banking application</li> </ul>

## Risk & Capital Management Report

### PLANNED ACTIVITIES IN 2019

Work on the following projects have commenced and will be rolled out in 2019.

Figure 09: Planned Initiatives to Strengthen Risk Management in 2019

Risk	Planned Initiatives
Credit Risk	<ul style="list-style-type: none"> <li>• Implement a credit risk score cards for approval of credit cards, personal loans, housing loans, leasing and micro finance facilities.</li> <li>• Implement a state-of-the-art LOS</li> <li>• Implement a revised/ recalibrated internal risk rating system</li> <li>• Incorporate impact of SLFRS 9 to credit underwriting.</li> <li>• Strengthen portfolio based risk return management.</li> </ul>
Integrated Risk Management	<ul style="list-style-type: none"> <li>• Implement a revised and improved ICAAP of the Bank.</li> <li>• Improve stress-testing framework.</li> <li>• Introduce of a model risk management framework.</li> <li>• Rollout conduct risk management initiatives.</li> </ul>
Loan Review Mechanism	<ul style="list-style-type: none"> <li>• Enhance the scope and coverage to intensify the LRM assessment.</li> <li>• Use learning to influence credit policy revisions.</li> </ul>
Operational Risk Management	<ul style="list-style-type: none"> <li>• Strengthen fraud risk management framework</li> <li>• Improve RCSA process in terms of comprehensiveness and coverage together with establishment of clear framework for timely review.</li> <li>• Strengthen BCM plan across the Bank and establish oversight responsibilities under operational risk.</li> <li>• Moving into an operational risk management solution.</li> <li>• Establish risk register and control registry to be the basis for process improvement</li> </ul>
Market Risk	<ul style="list-style-type: none"> <li>• Improve market risk management limit structure to have a better control over losses; i.e. introduction of take – profit limits.</li> </ul>
Information & Cyber Security Risk	<ul style="list-style-type: none"> <li>• Complete rollout of data classification tool.</li> <li>• Implement Data Loss Prevention (DLP) &amp; Digital right management (DRM) tool, to ensure minimal data losses.</li> <li>• Implement Identity &amp; Access Management (IAM) tool with special emphasize on Privilege Access Management (PAM)</li> <li>• Strengthen Information security governance framework through Information Security Steering Committee (ISSC)</li> <li>• Partner with industry experts to garner knowledge and experience in managing system related vulnerabilities by subscribing to “Security As A Management Service”.</li> <li>• Introduce a cyber-crisis management plan.</li> <li>• Introduce IT-GRCM (Governance Risk Compliance Management) framework.</li> <li>• Introduce governance framework to implement industry standard such as Payment Card Industry Data Security Standard (PCIDSS), ISO 27001, General Data Protection Regulation (GDPR) etc.</li> <li>• Establish security operations centre</li> <li>• Carry out cyber security current state assessment with milestone tracking</li> </ul>
Risk Intelligence & Portfolio Management Unit	<ul style="list-style-type: none"> <li>• Increase the involvement of risk department in implementing SLFRS 9 in the areas of stage assessment criteria and factors assessment, development of provisioning framework, model development, driving loss estimation computation, portfolio data review and review of provisioning output</li> </ul>
Collection and Recoveries	<ul style="list-style-type: none"> <li>• Improve the efficiency on the collection process by introducing auto-dialer capability.</li> <li>• Rationalize collection effort by differentiating customers who needs closer follow up from the rest by introducing a collection scorecard.</li> </ul>

## RISK CULTURE

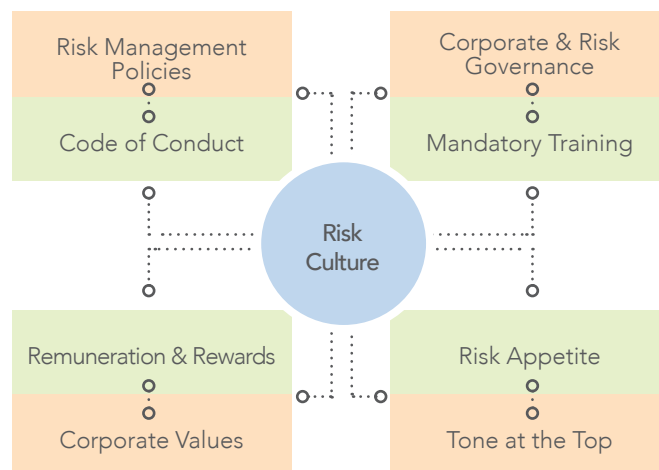
A comprehensive risk management policy framework, sound corporate and risk governance mechanisms, mandatory training, skills and competencies of the risk department and a remuneration framework that rewards a balanced approach to risk, creates a conducive risk culture throughout the Bank. The tone at the top, our corporate values and code of conduct further strengthens our risk culture supported by a comprehensive whistle blowing policy, which ensures confidentiality and penalties for retaliation. Over the years, the Bank has developed its risk culture to drive a common understanding of the desired attitudes, norms, and behaviours in relation to risk awareness, acceptance and management to deliver sustainable value to its stakeholders.

The risk management department works together with the human capital department of the Bank to ensure that recruitment, development, performance management and disciplinary policies and processes are aligned to the Bank's risk management goals and philosophies. Accordingly, performance goals and objectives of the Bank, departments and individuals include appropriate risk management objectives which form a key component of the criteria used for performance evaluation. Training continues to be reinforced with case studies drawn from industry and our own annals to dispel complacency and cultivate professional scepticism in assessing risk.

## RISK APPETITE

The Risk Appetite Statement (RAS) of the Bank clearly communicates its tolerance levels for its material risks in both qualitative and quantitative terms and is a key component of the risk management framework. Approved by the Board annually, it considers earnings, capital, risk thresholds, liquidity and other measures which impact the Bank's ability to thrive and grow, balancing the short, medium and long term goals. The RAS

Figure 10: Key Determinants of Risk Culture



is integrated with other key risk management tools, such as stress testing and emerging risk reports for consistency in risk management practices. Risk dashboards are prepared monthly for each main risk pillars including risk thresholds, highlighting areas of concern. These are reviewed by the relevant executive committees, the Board sub committees and the Board who initiate appropriate action.

Figure 11: Summary of Risk Appetite Statement

Risk Parameter	Appetite	Tolerance	Capacity	Compliance
NPL (Gross)	<2.0%	4.00%	6.00%	✓
Capital Adequacy	>15.0%	14.50%	14%	✓
RoA	1.50%	1.40%	1.25%	✓
Earning Volatility	-5%>X <20%	-10%>X <25%	-20%>X <33%	✓
RoE	16%	15%	12.50%	✓
Leverage (No of times over Core Capital)				
On B/S	15	20	25	✓
Off B/S	25	30	33	✓
Long Term National Credit Rating	AA-			✓
Economic Capital Utilization	70%	65%	50%	✓

## Risk & Capital Management Report

### STRESS TESTING

Stress testing of the Bank continues to evolve and a statistical model is used to assess the ability of the Bank to withstand different adverse conditions. Results of stress testing have been integrated in to the respective risk dashboards facilitating greater awareness of the impact of specific variables on our financial strength, capital allocation, profitability etc. Enhanced scope and coverage of stress testing models support to focus on stress testing information in better management of capital and improved alignment of risk appetite with strategy and performance of the Bank.

Stress testing is an integral part of the Bank's risk management framework which evaluates the resilience of the Bank to financial variables by assessing the impact of their movement on the profitability, liquidity and capital adequacy of the Bank. It is carried out in accordance with the Bank's stress testing policy guideline which is under the purview of the IRMD and results are reported to the Board on a regular basis facilitating the identification and mitigation of potential risks in a timely manner. Apart from individual units carrying out a stress testing for respective risk pillars, stress testing carried out in ICAAP of the Bank covers a detailed assessment in different predefined scenarios in credit, market, liquidity to understand the impact on CAR as per CBSL directive on Basel III, Pillar 2 requirements. The Bank has engaged a consultant to improve the stress testing impact on SLFRS 9 where macroeconomic models, lifetime

horizon, upturn scenario(s) weights are taken in to account. Further, the improved stress testing mechanism is expected to look at the overall group risk where applicable, not limiting to one-year horizon but for next three years.

Techniques used by the Bank include:

- Sensitivity analysis – examines the short term impact of change in some variables on the values of a portfolio/financial position. This can be done for a single variable or a number of variables or can be combined for a multifactor stress testing.
- Scenario Analysis – Assesses the impact of extreme but plausible scenarios on a given portfolio/financial position of the Bank using sophisticated modelling techniques which typically incorporate macroeconomic variables.

Minor, moderate and major shocks which are separately defined and applied as per the stress testing policy for each of the key variables to assess their impact. Risk appetite and risk goals are set as the yearly defined tolerance limits and dashboards are prepared for all risk pillars on a monthly basis and monitored by ERMCP, BIRMC where limit breaches are identified, and risk mitigating strategies are agreed for execution by the relevant business line heads.

Stress tests carried out in adverse movements in multiple variables for credit risk, market risk and operational risk reflect a sufficiency of capital which is well within regulatory requirements. Below table depicts some of influential assumptions made during the stress testing process.

Figure 12: Assumptions on Stress Testing

Credit Risk	Market Risk	Operational Risk
<ul style="list-style-type: none"> <li>• Industry downturn/adverse market events</li> <li>• Rising inflation</li> <li>• Increasing tax rates and impact on disposable income</li> <li>• Reduction in GDP growth</li> <li>• Impact of extreme weather conditions</li> <li>• Regulatory restrictions'</li> <li>• Significant breach of regulatory ratios</li> <li>• Competition in key product markets</li> </ul>	<ul style="list-style-type: none"> <li>• Depreciation in exchange rate</li> <li>• Changes in foreign exchange policy by Govt.</li> <li>• Volatility in interest rates</li> <li>• Deposit runs/roll over and customer confidence</li> <li>• Price changes in stock and commodities drop in inward remittances</li> <li>• Impact of global geopolitical events</li> <li>• Funding squeeze of corporate and retail customers</li> </ul>	<ul style="list-style-type: none"> <li>• Weakness in internal controls and corporate governance</li> <li>• Rising external and internal frauds</li> <li>• Negative public perception of the Bank</li> <li>• Changes in industrial relations</li> <li>• Drop in compliance level</li> <li>• Increasing cyber threats</li> <li>• Changes in regulatory and compliance requirements</li> <li>• Industry stagnation</li> </ul>

### INTEGRATED RISK MANAGEMENT & CAPITAL

The business of banking requires careful management of capital to ensure alignment with strategic goals, risk appetite and regulatory requirements with a view to meeting these requirements even under plausible stress conditions. The Internal Capital Adequacy Assessment Process (ICAAP) of the Bank integrates the Bank's strategic plan and the risk management framework including stress testing, balancing profitability and financial stability through a comprehensive capital management plan.

#### Regulatory Capital

ICAAP is managed in compliance with the Banking Act Direction No. 1 of 2016 capital requirements under Basel III for Licensed Commercial Banks and Licensed Specialised Banks which specifies the minimum capital ratios and buffers in respect of total risk weighted assets phased out between 1st July 2017 and 1st January 2019. Requirements relevant to HNB are given in figure 13.



Figure 13: Regulatory Capital Requirements

Components of Capital	Regulatory Requirement as at			Bank's Position as at		
	1.7.2017	1.1.2018	1.1.2019	30.9.2017	31.12.2017	31.12.2018
Common Equity Tier (CET) 1 (a)	6.25%	7.38%	8.50%	12.91%	13.72%	12.80%
Total Tier 1 (a)	7.75%	8.88%	10%	12.91%	13.72%	12.80%
Total Capital (a)	11.75%	12.88%	14%	16.42%	17.04%	15.22%

(a) Including Capital Conservation Buffer and Capital Surcharge on Domestic Systemically Important Banks

Subsequently, in October 2017, CBSL enhanced the minimum capital requirement for the Bank by Direction by 5 of 2017 with Locally incorporate Licensed Commercial Banks required to have a minimum of Rs 20 Bn including equity, reserves and other qualifying Tier I capital instruments. Chart 01 & Chart 02 depict the components of the both Bank's and Group's capital and compliance with regulatory requirements respectively. Basel III Market Discipline, Minimum Disclosures Under Pillar 3 are given on Page 74 in CG&RR as required by Direction No.1 of 2016.

The Bank strengthened its CET1 in March 2018 with a scrip dividend of 2,925,530 voting shares and 907,421 non-voting shares which amounted to Rs 2 per share after providing for 10% withholding tax.

### Risk Weighted Assets

Capital requirements are measured as a percentage of risk weighted assets which are calculated on the following basis as per CBSL direction No.1 of 2016:

- Credit Risk – The Standardised Approach
- Market Risk – The Standardised Measurement Method
- Operational Risk – Basic Indicator Approach

Figure 14: Risk Weighted Assets & Capital Charge

Item	Bank	
	Risk Weighted Assets	Capital Required
	Rs 000	Rs 000
Credit Risk	752,232,014	96,849,872
Market Risk	921,224	118,608
Operational Risk	59,694,765	7,685,701
Total	812,848,003	104,654,180

RWAs of the bank increased by Rs 135 Bn during the year due to increased credit risk and operational risk. The difference between total assets and risk weighted assets remained almost similar indicating a sequential growth in both the Bank and Group as depicted in Chart 03 and Chart 04 respectively.

Chart 01:

#### Capital Adequacy Bank

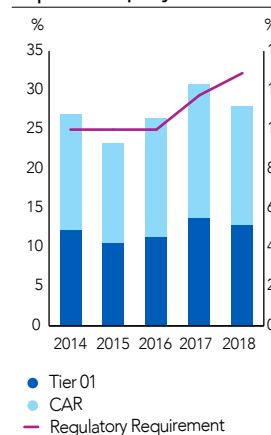


Chart 02:

#### Capital Adequacy Group

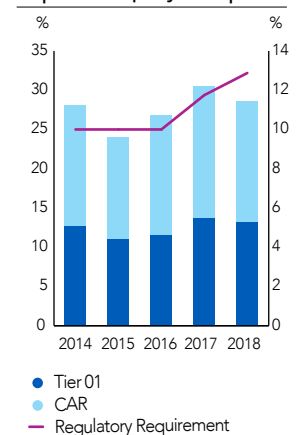


Chart 03:

#### Total Asset Vs RWA - Bank

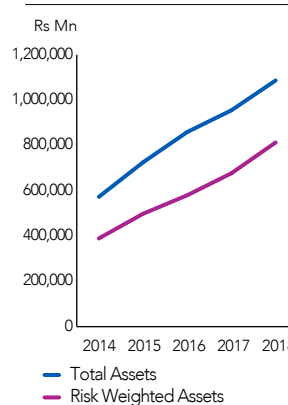
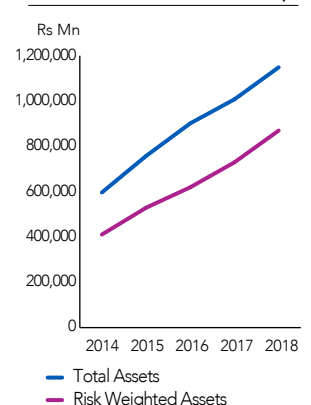


Chart 04:

#### Total Asset Vs RWA - Group



### Economic Capital

Economic capital is the Bank's internal estimate of risk capital required to remain solvent taking in to account all quantifiable risks at a given time under both normal and stressed conditions. While regulatory capital is computed according to regulatory guidelines, economic capital is the Bank's internal assessment of capital required to support our growth and economic profile. Consequently, economic capital is higher than the regulatory requirement. The bank's internal capital adequacy computed using its own internal methodologies adopted is submitted to CBSL through its proprietary ICAAP document.

## Risk & Capital Management Report

### CREDIT RISK

Credit Risk is the largest exposure for the Bank stemming from its portfolio of traditional lending products which amount to 71% of the total assets of the Bank. It is managed in line with the credit risk policy suite which are reviewed on an annual basis and updated to reflect new thinking and initiatives in line with the risk environments and the Bank's business model. We continue to strengthen our credit risk management mechanisms using information technology which enabled centralization of functions and high levels of specialization.

#### Credit Risk Review

Maximum credit exposures increased by 15% in 2018 as lending portfolios grew by 19% reflecting the Bank's prudent growth strategy. Allowance for individual impairment increased by 84% due to changes in the impairments assessment process with SLFRS 9 while the allowance for collective impairment increased by 151 % during the year due to prevailing macroeconomic conditions contributing to an 117% increase in provisions for impairment.

#### Credit Risk Governance

The Board is supported in management of credit risk by BIRMC and a Board committee dedicated to oversight of the subject, i.e. the Board Credit Committee (BCC). Their responsibilities are given in the respective committee reports and include recommending policy for approval of the Board and monitoring of credit risk.

ERMCPD comprising senior leadership monitors credit risk more frequently and implements actions as deemed appropriate within the approved credit risk policy guidelines. The Bank streamlined functions of the Credit Policy Committee and both ERMCPD & CCP were amalgamated during the year. As such ERMCPD now looks at review developments and recommend amendments to the existing suite of credit risk policies.

### COMPONENTS OF CREDIT RISK

- Default Risk
- Counterparty Risk
- Concentration Risk
- Residual Risk
- Recovery Risk

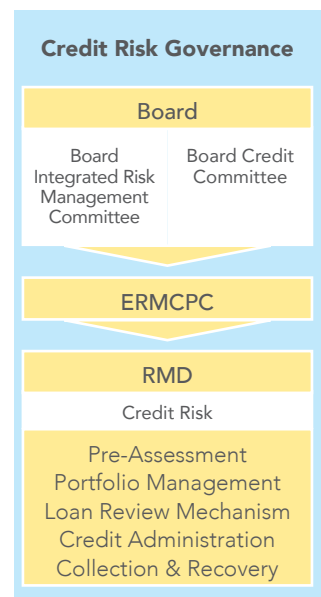
A dedicated credit risk function within the risk management department serves as the 2nd level of defence, supporting credit risk management throughout the life cycle of the loans as described below. Credit administration related functions were separated from risk management functionalities during the second quarter of the year.

- Pre-Assessment - Constructively challenges credit risk assessments of business units prior to approval with ability to refer to a higher authority than that specified in the delegated authority in case of a difference of opinion. Retail credit facilities are reviewed by trained staff at the Centre of Excellence (CoE) facilitating high levels of specialisation.
- Portfolio Management – Assessment of portfolio risk-return options and direct composition of the loans & advances book while improving visibility through well-structured credit risk dashboards to the top management and the Board.
- Loan Review Mechanism - Post approval reviews of credit facilities to identify areas for improvements in credit evaluation and administration processes.
- Collection & Recovery - Supports business units through a centralised collections unit.

Figure 15: Credit Risk Exposure

Audited	2018	2017	%
	Maximum Exposure		
	Rs 000	Rs 000	
Maximum Credit Exposures	1,201,196,636	1,043,787,910	15%
• Total Assets subject to Credit Risk	1,011,017,440	873,193,102	16%
• Off Balance Sheet Commitment subject to Credit Risk	190,179,196	170,594,808	11%
• Max Exposure to credit risk Gross Loans & Receivables to customers	771,692,625	649,547,067	19%
Net exposure to credit risk of Loans & Receivables to Customers	340,295,895	264,132,296	29%
Impaired Loans	32,614,427	15,048,382	117%
Provisions for impairment	22,643,805	10,445,006	117%
• Individual Impairment	9,946,260	5,390,947	84%
• Collective Impairment	12,697,545	5,054,059	151%
Impaired Loans as a % of gross Loans and Receivables	4.23%	2.35%	80%
NPA (Gross)	2.78%	2.28%	22%

Figure 16: Governance



## Approved Regulatory Capital Approach

The Bank uses the Standardised Approach to measure the capital charge for Credit Risk as required by CBSL Direction No.1 of 2016 in compliance with the requirements of Basel III. Accordingly, the calculation of regulatory capital is based on specified risk weightings applied to net counterparty exposures in defined categories after recognising a limited set of qualifying collateral. Template 7: Credit Risk Exposures and Credit Risk Mitigation (CRM) Effects Under The Standardised Approach: on page 78 in CG&RR provide details exposure before Credit Conversion Factor (CCF) and CRM and post CCF and CRM deriving with RWA and RWA density while, Template 8: Credit Risk Under Standardised Approach: Exposure by asset classes and risk weights on page 79 in CG&RR details the computation of risk weighted assets for credit risk.

The Bank is in the process of upgrading its internal risk rating system to a Basel III compliant internal risk rating methodology with a view to moving towards more advanced internal ratings based approach to compute the charge for credit risk and also to manage default risk. In 2018, the Bank has initiated a model validation exercise of the internal risk rating used and recalibration of the internal risk rating models which is expected to be completed by 2Q 2019. Upgraded IRR system will then be used for SLFRS 9 ECL calculation purposes and ICAAP.

## Risk Rating Models Used by the Bank

The Bank has developed separate credit rating models for corporates, SMEs and financial institutions considering their varied risk profiles based on their annual turnover

- Large Corporate
- Mid-Market
- SME
- Financial Institutions

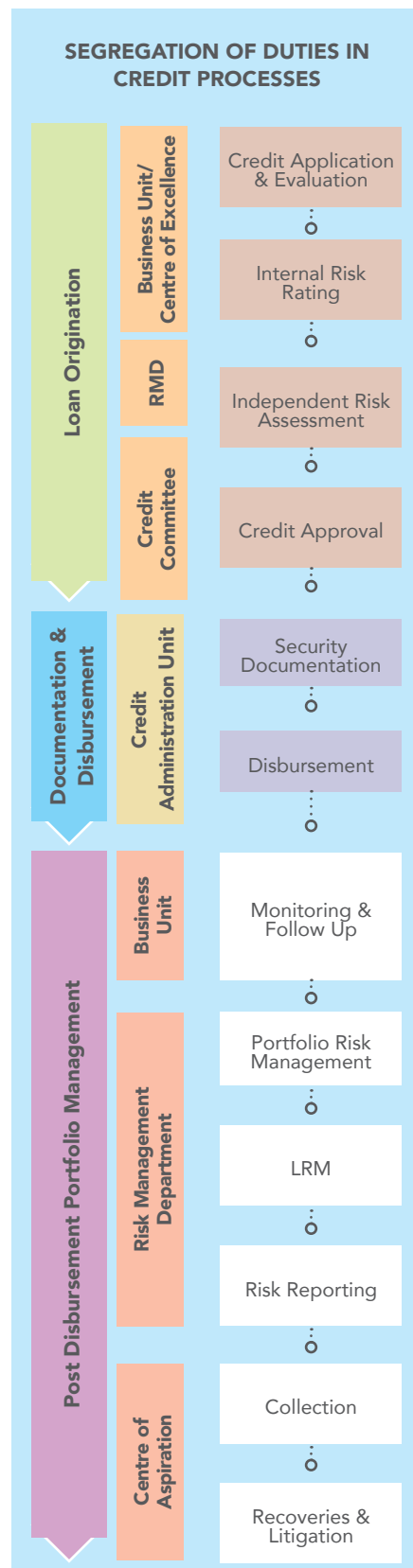
## Credit Risk Management Processes

The Bank's risk management policies and processes ensure that credit risk is managed throughout the life cycle of the loan as depicted in figure 17: Segregation of duties for credit risk management. Credit administration which was set up by the risk management department was moved out of RMD's purview during the year to maintain clear lines of independence.

Key credit risk management tools, controls and processes in place are briefly described below. The Bank continues to strengthen credit risk management through increased automation, a comprehensive training plan and streamlining processes as described in the adjacent column.

- **Segregation of credit risk management tasks** - Segregation of duties is key to managing credit risk effectively, ensuring that it is viewed from business and risk management perspectives. Specialised credit risk functions of RMD provide inputs throughout the lifecycle of the loan, supporting business units who own the relationships and products and have responsibility for evaluation of the credit application including assignment of an internal risk rating.
- **Independent Risk Assessment** - Corporate, Mid-Market and SME facilities are independently reviewed by the pre-assessment division of the credit risk management function. Retail facilities are reviewed by the COE enabling high levels of specialisation, and improved turnaround times.
- **Internal Risk Ratings** - Risk ratings are assigned to borrowers above a certain threshold agreed internally using the internal risk rating system.
- **Delegation of Authority** - Approval of credit facilities above a specified threshold have been assigned to committees. Prior to final approver/approving committee, the risk management division provides its independent assessment to facilitate a well-informed credit decision.
- **Loan Origination System (LOS)** – The Bank kicked off the state-of-the-art LOS enabling a paperless workflow

Figure 17: Segregation of Duties for Credit Risk Management



## Risk & Capital Management Report

for evaluation and approval with faster turnaround times and enhanced information security. The project is scheduled for completion in 2Q of 2019, the LOS facilitates the following:

- Managing all credit approvals within one system
  - Integrating with the core banking system and other peripheral systems to minimize duplication of data entry
  - Integrating the security documents preparation process with the credit approval process
  - Timely updating of information and facilitating improved quality management information
- **Collateral** - While the primary source of recovery is business cash-flows or earned income, the Bank obtains collateral to as a secondary recourse through mortgage bonds over movable and immovable property, guarantees, liens over financial assets and assignments of receivables. The centralised credit administration function which manages the centralized security repository ensures proper execution of collateral documentation and maintains custody of the same. Regular valuations are carried out to ensure adequacy of collateral throughout the lifecycle of the loan.
  - **Security Documentation and Disbursement** - The centralised credit administration unit checks completeness and authenticity of documentation including security documentation and compliance with pre-disbursement conditions. This function supports compliance and recovery processes with required documentation while the pre-disbursement function ensures that correct limits and rates are marked in the system facilitating accurate billing, monitoring and recovery processes.
  - **Loan Review Mechanism** - The LRM function carries out post disbursement of reviews of credit facilities in order to identify qualitative improvements in credit evaluation, administration processes and gain insights regarding the effective functioning of processes and controls in place. Reports from LRM are submitted to BIRMC, BCC and Board. Initially limited to the corporate and SME portfolio, the Bank has now extended this to cover all business lines.
  - **Early Warning Signs (EWS)** - The portfolio risk management unit and collections and recovery divisions together with business units identify monitor credits to identify early warning signs of credit deterioration. EWS and watch lists and management review lists, report Likely to fall in to NPA are used to initiate remedial action and alert business units, Board and committees facilitating rehabilitation or minimal loss exits
  - **Centre of Aspiration** - COA is a dedicated function which only focusses on early intervention , supporting business units with the management of delinquencies, facilitating swift remedial action. Specially trained staff use a sophisticated IT platform and predictive analytics to manage recoveries in a structured manner and identify high risk customers.
  - **Management of Large Exposures** - Large borrower exposures are managed within internal risk limits set for the Bank monitors material exposures and substantial exposures as a part of the Bank's internal risk goals.

Figure 18: Key Initiatives

### KEY INITIATIVES IMPLEMENTED IN 2018

- Kicked off of LOS, with the expectation of streamlining credit approvals and significantly reducing turnaround times and usage of paper.
- Engaged a consultant to develop SLFRS 9 tool kit for computing ECL and its impact on impairment calculation
- Established the risk intelligence unit as an independent unit to three main units of credit risk, operational risk and market risk to create a forward-looking risk culture for making better informed decisions.
- Strengthened the LRM to cover total advances book including retail portfolios

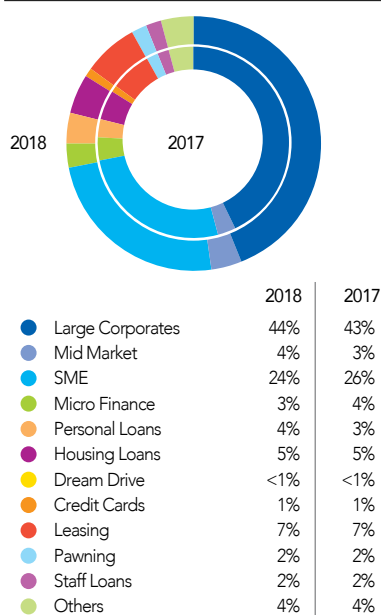
Further, Industry risk limits are set to ensure close monitoring over concentration in given industries with a view to take early action on any identified industries with elevated risk.

### Concentration Risk

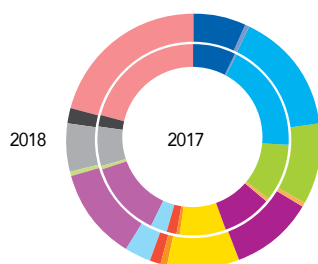
The Bank seeks to maintain a well-diversified portfolio, managing concentrations across products, industry sectors, counterparties, and geographies in line with its risk appetite. Concentration risk is reported through the credit risk dashboards prepared by the portfolio risk management unit of RMD and reviewed by ERMCP, BCC, BIRMC and the Board at their regular meetings. The following charts reflect the concentration of the Bank's credit exposures. Further, during the ICAAP computation credit concentration risk is quantified using HHI model to derive additional capital requirement under Pillar 2.

Chart 05 indicates the portfolio segmentation based on various counterparties and 68% of the portfolio represented by large corporate and SME business segments and composition remained in similar range throughout the year.

Chart 05:  
Exposure by Counterparties



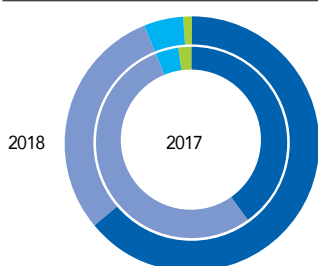
**Chart 06:**  
Exposures by Industry



	2018	2017
● Agriculture, Forestry & Fishing	7%	7%
● Arts, Entertainment & Recreation	<1%	<1%
● Construction & Infrastructure Development	16%	18%
● Consumption	10%	10%
● Education	<1%	<1%
● Financial Services	10%	8%
● Health Care, Social Services & Support Services	9%	8%
● Information Technology and Communication Services	1%	1%
● Lending To Ministry Of Finance	2%	2%
● Lending To Overseas Entities	3%	3%
● Manufacturing	12%	13%
● Professional, Scientific & Technical Activities	1%	1%
● Tourism	6%	6%
● Transportation & Storage	2%	2%
● Wholesale & Retail Trade	21%	21%

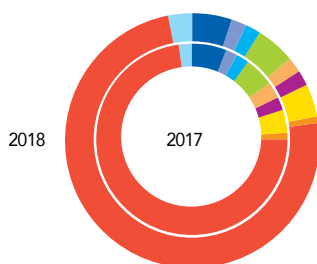
Industry classifications are refined based on revised CBSL industry categorization. CBSL definition of computation of mandatory exposure to agriculture sector differ from the methodology adapted in categorization indicated in chart 06.

**Chart 09:**  
Overseas Exposure



	2018	2017
● Maldives	64%	40%
● Cambodia	30%	54%
● Uganda	5%	4%
● Bangladesh	1%	2%

**Chart 07:**  
Exposure by Geography



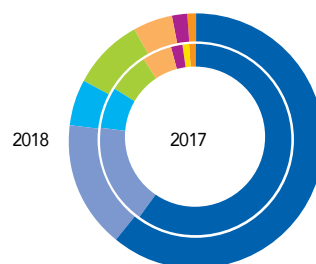
	2018	2017
● Central Province	5%	6%
● Eastern Province	2%	2%
● North Central Province	2%	2%
● North Western Province	5%	5%
● Northern Province	2%	3%
● Sabaragamuwa Province	2%	2%
● Southern Province	4%	4%
● Uva Province	1%	1%
● Western Province	74%	73%
● Overseas Exposures	3%	2%

Exposures based on geography and product type have been hovering around in similar range compared to previous year and comparisons are depicted in chart 07 and 08 respectively.

#### Off Shore Exposure

The Bank's exposures to entities outside Sri Lanka is over Rs 23 Bn, equivalent to 3.1% of the loan book and 22% of core capital. All exposures are in countries rated above B by international rating agencies and are maintained within country risk limits approved by the Board. Country limits are set as a percentage of core capital taking in to account various indicators including but not limited to political, economic, legal, sovereign, banking sector and currency risks etc., of a particular territory in addition to the rating justification by international rating agencies and country risks are reviewed bi-annually. Exposures to offshore lending is depicted in Chart 09. The Bank monitors trigger events in these countries which may adversely impact the performance of counterparties. Typically, off shore exposures are linked with Sri Lankan promoters or conglomerates with proven track records in respective countries to finance projects of national importance to those countries. Loan covenants are closely monitored facilitating prudent risk mitigation action in the event of a breach which can include reducing counter party limits and recall of facilities.

**Chart 08:**  
Portfolio by Product



	2018	2017
● Term Loan	61%	60%
● Overdraft	16%	17%
● Leasing	6%	7%
● Trade Finance	9%	7%
● Shanthi Housing	5%	5%
● Pawning	2%	2%
● Others	<1%	1%
● Credit Card	1%	1%

#### Government Exposures

The Bank's exposure to the Government sector including state owned enterprises amounts to Rs 54.9 Bn equivalent to 7% of the loan book and 53% of core capital at the close of the year. HNB continues to play a supportive role in government projects of national importance including infrastructure development projects with the limit set at 150% of core capital as approved by the Board within the Bank's credit risk appetite. Exposures amount to 64.5% of the approved limit and are backed by sovereign guarantees or channelled through the Ministry of Finance except in the case of one large state owned enterprise (SOE). One SOE has been classified as NPA and fully impaired which had a significant impact on the Bank's Impairment and NPA ratio, impairment for 2017 & 2018 and negotiations continue with the government to arrive at a settlement. All other government exposures are serviced satisfactorily according to original repayment schedules. The project finance unit of the Bank closely monitors progress of the each of those government projects and reports the status to BCC as a part of regular review and for follow-ups.



## Risk & Capital Management Report

### Default Risk & Mitigation

The internal risk rating models play a key role in mitigation of default risk. It is noteworthy that 60% of exposures are above A and are investment grade. The increase in sub investment grades which account for 3.2% of exposures are largely attributable to adverse movement in their risk ratings.

The ageing of dues in Chart 11 reflects prevailing economic situation, fragile political conditions and climate change impacts which resulted in supply constraints for agriculture and agri-based industries. Further, rupee depreciation has impacted trading business and resulted in a decline in current dues from 74% in 2017 to 71% in 2018 despite the positive impacts of initiatives taken to strengthen recoveries witnessed in 2018. Consequently, non-performing advances deteriorated beyond internal risk goals during the year albeit remaining well below the banks risk appetite, tolerance levels and Capacity. Nevertheless, the Bank managed its NPAs much below industry. Chart 10 illustrates the Bank's NPA for last 5 years and reigning NPAs within the Bank's risk appetite is the key priority in managing credit risk at present. Arrears are closely monitored and facilities are restructured where deemed appropriate to facilitate migration in to higher risk ratings through improved cash flows and business performance.

### EMBRACING SLFRS 9 REPORTING PROCESSES

The Bank has adopted SLFRS 9 and to institutionalize global best practices the Bank has engaged a consultant to develop SLFRS 9 tool kit for development of expected credit loss models and computing impact on impairment calculation.

Risk model development project was initiated to develop capabilities in risk management function to align itself to regulatory requirement and risk management best practices in moving in to Expected Credit Loss (ECL) based SLFRS 9 framework and Basel advanced approaches.

The Project covers the following

- Identify methods of actively engaging risk management division in SLFRS 9 governance process including control over risk estimates (PD, LGD, EAD & Macro Economic Models) for SLFRS 9 impairment provision computation of the Bank. As a part of the project, the Bank is developing a sophisticated macroeconomic model based tool kit to estimate forward-looking PDs.
- Introduction of risk based pricing model, which includes estimation of RAROC.
- Refinement of ICAAP document of the Bank and its computations on residual risk, concentration risk, and Interest Rate Risk In The Banking Book (IRRBB).
- Establishment of a framework on technical model validation across the Bank.
- Aligning the ICAAP of the Bank currently with CBSL time-based provision assumptions to ensure convergence with SLFRS 9 framework.

Chart 10:  
Non-Performing  
Advances 2014-2018

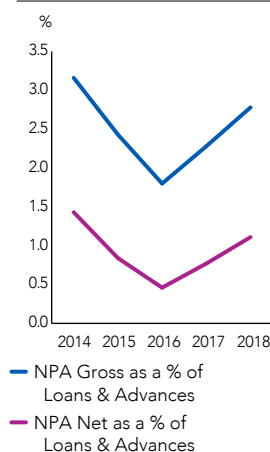
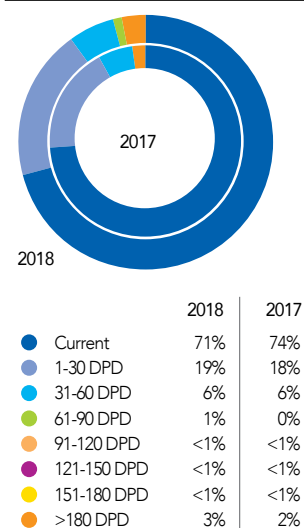


Chart 11:  
Ageing of  
Past due Loans



Established a risk intelligence unit during the year as an independent unit which will get transformed in to an advanced portfolio risk management unit which seeks to create a forward looking risk culture facilitating informed decisions. The unit acts as an information hub with different information sources in the nature of delinquency, customer and portfolio level credit assessments, elevated risks industries, expected and incurred loss assessments, impaired customers and their cash flow behaviours, impact on individual and credit portfolios on external and macro-economic scenarios etc. Application of collated data / information on ECL models and other tools to arrive at their impact on the Bank's liquidity, profitability and financial stability. Sharing this information among the management of the Bank facilitates increased awareness of market trends and their impact on the Bank's business to make informed decisions. The following activities support SLFRS 9 compliance:

- Determine the Bank's impairment provision and charge
- Develop risk based models for ECL estimations to support SLFRS 9 reporting
- Effectively contribute towards the Bank's process improvements
- Set Provision target for the network
- Management of delinquent account management information and submission of recoveries dashboard to the Board
- Staff development through training and knowledge transfer on ECL and SLFRS 9 assessments

## OPERATIONAL RISK

Operational risk is inherent in all transactions of the Bank and our vision is to embrace best practices with a view to preventing losses and facilitating expansion and growth by leveraging on optimum economic capital allocation for the same. As Information & cyber security risk has gained prominence during the year, it is covered as a separate topic reflecting the focus and resources allocated to manage the same.

### Operational Risk Review

Operational losses during the year amounted to 0.4% of the Bank's gross revenue, well below the tolerance level of 2% as the Bank continues to strengthen operational risk management notwithstanding the maintenance of a comparable regulatory capital buffer of 15%. The number of incidents has slightly increased during the year nevertheless the gross amount of losses declined, largely due to the decline in losses from internal and external frauds. However, execution, delivery and process management together with external losses have contributed around 80% of the operational losses based on incident types. Learning from the specific significant loss experiences were used to strengthen risk mitigation measures through revision of related policy guidelines and procedures and enhanced insurance cover. The Bank continues to develop effective tools to manage operational risk and increases awareness of operational risk factors as financial crime becomes more sophisticated and remains a key concern for banks. Chart 12 provides information on trends while Chart 13 provides information regarding the type of losses incurred during the year with compared to 2017.

### Operational Risk Governance

The Bank's operational risk policy provides guidance on management of operational risk, identifying roles of key participants in the process as set out in figure 19 and specifies activities for identification, assessment, monitoring and mitigating operational risk. BIRMC has oversight responsibility for management of risk including operational risk and assists the Board in discharge of their duties regarding risk management. The audit committee plays a key role in management of operational risk through oversight of the implementation of sound internal controls and obtaining assurance on the effective operation of the same through internal and external audits. The Board and its subcommittees set the tone at the top in effective discharge of their duties, influencing the risk culture of the Bank

## COMPONENTS OF OPERATIONAL RISK

- Compliance Risk
- Legal Risk
- Financial Crimes/fraud Risk
- Technology Risk

Figure 19: Governance

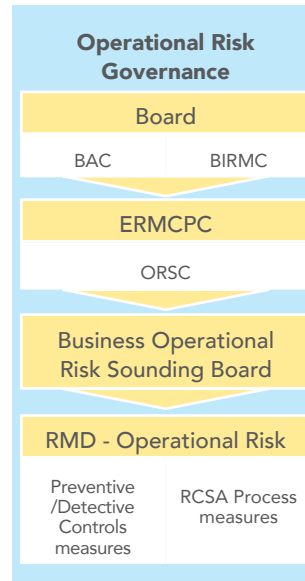


Chart 13:

### Operational Losses According to Incident Type

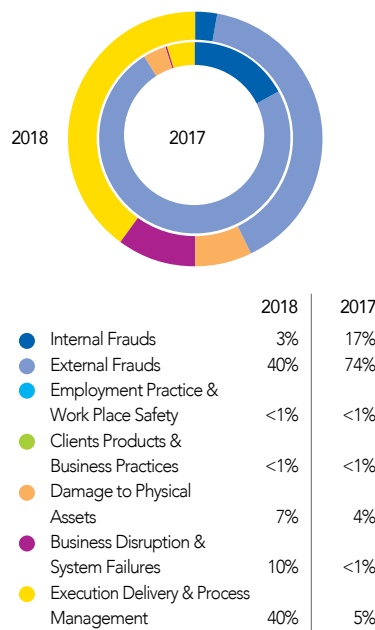


Chart 12:

### Operational Losses against Recoveries



# Risk & Capital Management Report

A dedicated Operational Risk Steering Committee supports ERMCP in monitoring operational risk and recommending initiatives to strengthen operational risk management. The business operational risk sounding board comprising representatives from key business lines supports the risk and control self-assessment process, facilitating higher levels of awareness of operational risk management across the Bank as depicted in figure 20. The operational risk unit of the RMD functions supports the Executive and Board level committees and are organized mainly in to two focus areas, preventive measures and detective measures.

Figure 20: Operational Risk Management Framework

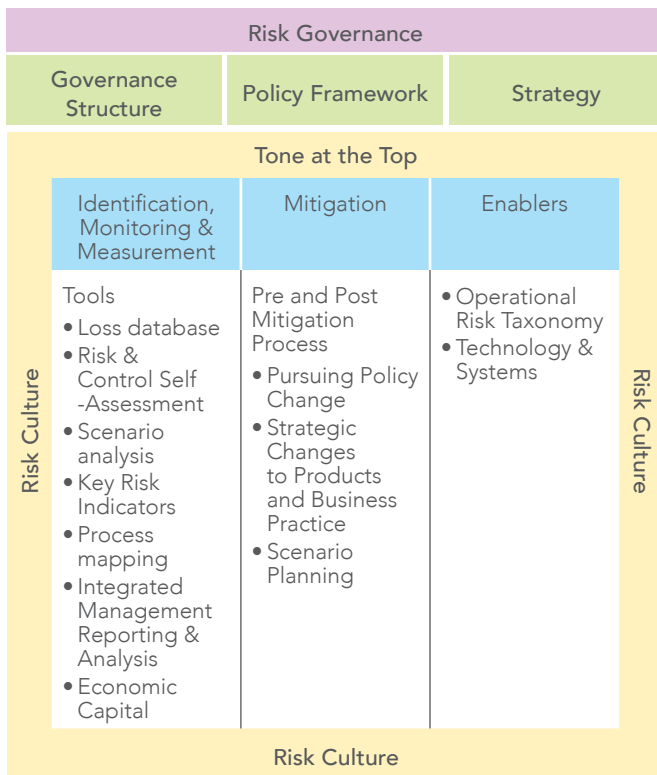


Figure 21: Key Initiatives

- KEY INITIATIVES IMPLEMENTED IN 2018**
- Improved Key Risk Indicators
  - Completed rollout of RCSA Process
  - Improved controls through Root cause analysis process
  - Project Initiated to Automate Insurance Claim Process
  - Carried out Risk based review of outsourcing activities
  - Revamped the bank wide BCP
  - Strengthened skills , knowledge sharing and resources

## Approved Regulatory Capital Approach

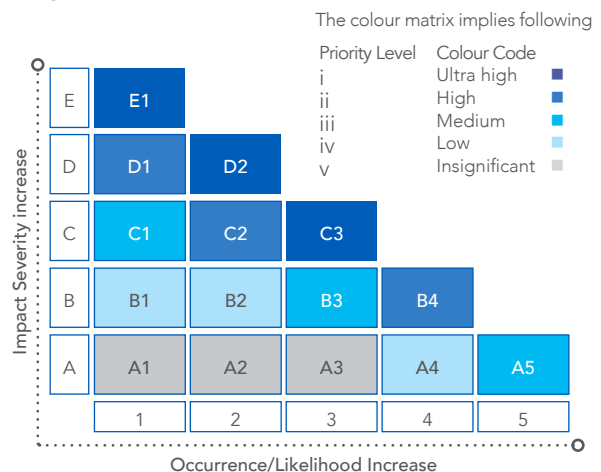
The Banking Act Direction No 1 of 2016 allows the use of the Basic Indicator Approach, the Standardised Approach and the Advanced Measurement Approaches for calculation of regulatory capital for operational risk. The Bank uses the Basic Indicator Approach for calculation of regulatory capital at present as set out in Template 10 on page 79 in CG&RR and is expecting to move in to advance approaches along with progressive developments made in the adaptation of Basel III guideline

## Operational Risk Management

The ORM framework sets out the following specific tools for managing operational risk:

- Risk & Control Self-Assessment (RCSA) - The RCSA process requires business units to assess their own processes and controls on a quarterly basis which is reviewed by the operational risk unit of RMD. These are then consolidated by the operational risk unit to assess the operational risk profile of the entire Bank facilitating prioritisation and resource allocation for strengthening operational risk control environment. This process ensures that behaviours and trends of key operational risks are monitored.
- Key Risk Indicators (KRI) - Key risk indicators provide early warnings of escalations in risks identified by the Bank which are monitored continuously. Triggers and thresholds are reviewed regularly and updated to reflect regulatory requirements and internal benchmarks which reflect trends observed externally and internally. This was a key area of focus in 2018 as described in the adjacent column.
- Internal Loss Data Capturing & Reporting - Loss data indicating internal losses and "near misses" for material risks are categorised according to Basel guidelines in the operational risk dashboard. This is reviewed by, ORSC, ERMCP and BIRMC to identify escalation in threats and appropriate action to manage the same.
- Risk Matrices - The Bank uses risk matrices to consolidate and prioritise risks considering the potential impact and likelihood of occurrence.

Figure 22: Risk Matrix





## MITIGATING OPERATIONAL RISK

Operational risk is mitigated through both pre and post operational risk event analysis. Preventive risk tools of the Bank include establishing risk management frameworks, policies and guidelines, training and development to strengthen our first lines of defence, making strategic changes in products and business practices and implementing a sound system of internal controls. Post event mitigation mechanisms rely on our ability to respond to operational risk events in a timely and effective manner, containing losses to lives and assets of the Bank. The following tools are key to mitigating operational risk:

Insurance – This tool is used judiciously to mitigate the financial impact of risk events that could result in or trigger a potential loss to the Bank. A comprehensive insurance cover is in place securing the Bank from low frequency- high severity and high frequency- low severity loss events.

Suitable insurance policies are in force covering losses arising from under mentioned assets /processes, functions or incidents.

- Cash and cash equivalents
- Pledged articles
- Premises and other fixed assets
- Public liability
- Computer frauds
- Employee infidelity
- Negligence

Further, the Bank is having discussions in obtaining a comprehensive insurance policy covering cyber risk.

Adequacy and effectiveness of insurance covers are reviewed annually. Effectiveness of insurance as a risk mitigation is expected to improve with the automation of the claims processing activities as described in new Initiatives implemented during the year 2018.

- **Business Continuity Planning & Disaster Recovery -**  
A comprehensive business continuity management policy is currently underway to secure continuity in operations in the event of an emergency or a disaster, including a comprehensive IT disaster recovery for critical processes. Mission Critical Units (MCUs) and procedures are identified and tested according to specified frequencies through drills and validated by internal audit. BAC reviews the feedback from internal audit and makes recommendations while learning and improvements to disaster recovery activities are ratified by the BIRMC. Following key areas are taken in to account in strengthening an effective BCM framework
  - Development of a consolidated BCM process for the Bank supporting the organization's business strategy
  - Business Impact Analysis (BIA) - A comprehensive BIA process has been initiated for mission critical departments and all relevant information is being gathered with

measurable time scales associated with functions. E.g. RTOs (Recovery Time Objectives) & RPOs (Recovery Point Objectives)

- This consolidation process will ensure that services which are critical to our corporate objectives will continue despite the occurrence of a potentially disruptive event and will minimize financial effects and impacts on service delivery targets in the event of a disruption.
- **Scenario planning** – The operational risk unit uses scenario planning mainly in its BCM and related activities to demonstrate and make use of the development of appropriate responses to few potential loss events that can or likely to take place together such as fire, security breach etc.
- **Outsourcing** – A comprehensive outsourcing policy and guideline sets out the activities, terms and conditions relating to outsourced activities and the compliance division monitors the same and managed within the policy and specific service level agreements Key activities outsourced include
  - Document archiving,
  - ATM cash management and cash transport and selected recovery functions,
  - Cheque booking printing and other documents printing services,
  - Security services,
  - IT related services (software/hardware maintenance / application support etc..)
  - Payroll and other corporate services
  - Outsourced staff service

KYC and due diligence tests are conducted prior to engagement of new service providers or renewal of existing contracts to assess the AML/CFT risks that may arise from outsourcing arrangements. Operational risk unit has initiated risk-based reviews of outsourcing activities with emphasis on performance, compliance, complaints, BCP together with documentation and contingency plans. The operational risk unit will also ensure that all critical outsourcing service providers have a satisfactory BCP and they perform regular tests on its BCP to ensure readiness against the effects of disruptive events and return to normal operations as quickly as possible. A comprehensive report on outsourced activities is submitted to CBSL annually by the compliance division.

# Risk & Capital Management Report

## INFORMATION & CYBER RISK

As technology continues to drive transformation within the banking industry, information & cyber risk moves in to sharper focus to identify and manage related threats. The tools for managing information & cyber risk needs updating at an unprecedented frequency, reflecting the pace of evolution and escalation of threats. Consequently, HNB has identified it as a separate risk pillar supporting its digital strategy although the Basel III framework includes this within operational risk.

### Information & Cyber Risk Review

Implementing comprehensive cyber security and information security policies during the year whilst working towards to increase the awareness of related threats and transforming the Bank's risk culture to be more proactive in managing these threats plays a key role. All these efforts in creating strong platform in information and cyber risk vertical has served to mitigate the increasing volumes and values of digital transactions during the year as we continued roll out of our digital strategy delivering outstanding value to customers while also facilitating scalability and operational excellence for the Bank. Investments in strengthening this vital area facilitated increased vigilance and prompt corrective actions were taken to minimize the damage. Chart 14 depicts type of incidents reported by banks and financial institutions of Sri Lanka to FinCSIRT during the year 2018.

### Information & Cyber Risk Governance

BIRMC has oversight responsibility for this key risk and briefs the Board regularly on developments and makes recommendations on policy and investments. The Board received training during the year from overseas consultants enhancing their awareness and knowledge of the subject, facilitating debate and discussion on matters related to information and cyber risk. Composition of the Board was also strengthened during the year with the appointment of a director with relevant expertise to further enhance the Board understanding of the subject.

ERMCPD reviews the IT risk dashboards and policy and they are supported by the IT steering committee who review developments in greater detail. Members of these committees also received training during the year with external consultants paving the way for roll out of the Bank's digital strategy.

The role of CRO was extended last year to include the responsibilities of the Chief Information Security Officer (CISO). Information and cyber risk is now managed as a dedicated separate risk vertical within RMD enhancing vigilance and management capability.

### INFORMATION SECURITY MANAGEMENT AND RISK MITIGATION

The cyber security policy and the information security policy set out the framework for management of its information assets which are vital strategic assets. The objective of the policy framework is to protect information assets from identified internal and external threat to ensure that all statutory and contractual obligations are met, and the brand is protected.

## COMPONENTS OF INFORMATION & CYBER RISK

- Information Risk
- Cyber Risk
- Financial Crime Risk
- Technology Risk

Figure 23: Governance

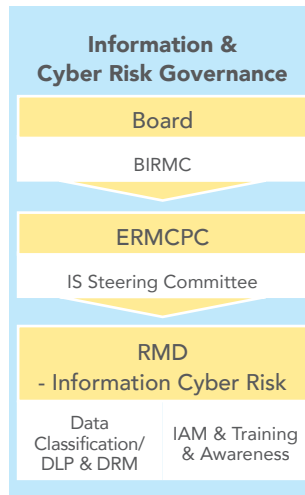
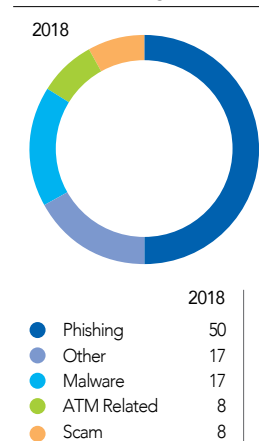


Chart 14: Security Incidents Reported by Banks & Financial Institutions during 2018



It sets out guidance for systematic management of information assets throughout its lifecycle supporting the operational and strategic needs of the Bank in compliance with regulations and internal risk appetite.

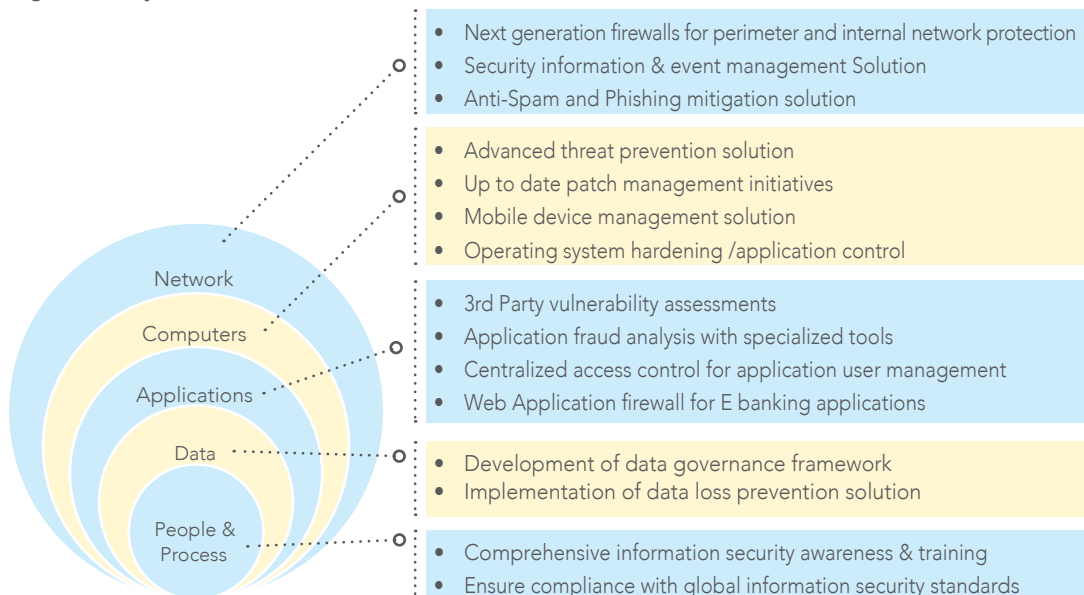
Tools used to ensure continuous protection of its information assets from emerging threats include the following:

- Implementation of DLP and DRM software
- Implementation of IAM Tool including PAM
- Progressive implementation of security operation centre
- Security as a managed service – engaged security experts and professionals to conduct security assessment on an ongoing basis
- Carryout third party vulnerability assessments and third party security & compliance reviews – carried out to manage risks arising from connectivity with third parties.
- Periodic reviews of the effectiveness of the Bank's internal IT/IS management by IT security team, Internal Audit and CISO carrying out separate reviews to assess the effectiveness of the information and cyber risk management processes and controls.
- Monitor cyber threat intelligence – Review up to date information on current and emerging cyber threats with a view to initiating necessary action in a timely manner.

- Introduction of a data classification methodology - This initiative supports safeguarding of information assets through clear categorization of information, using electronic labelling mechanism
- Establishment of controls over data in transit, at rest and in use - Email flow and USB/CD ROM restrictions implemented together with organization wide training and awareness campaigns to enhance knowledge levels of information security among staff for optimal control
- Implementation of Security Information & Event Management (SIEM) Solution - All critical systems and databases are integrated for log analysis enhancing capabilities of identifying IT & cyber risks.
- Continuous upgrade of anti-virus/malware/ransomware protection.
- Improvements to cyber risk dashboard - Effectively communicate developments in information & Cyber risk to executive and board committees on a monthly basis
- Improvements to IT disaster recovery plan - A key component of the Bank's business continuity plan, this is tested regularly and amended as appropriate.
- Conduct increased number of programs to strengthen knowledge and capacity levels.

The Bank has implemented a layered defence model as given below in figure 24 to manage this critical threat.

Figure 24: Layered Defence Model



Information security and cyber risk continues to escalate globally with financial crime becoming increasingly sophisticated and audacious. The rapid evolution of technology also presents challenges as they seek to change the way individuals access corporate systems. The Bank's digital strategy is a key enable

Figure 25: Key Initiatives

**KEY INITIATIVES IMPLEMENTED IN 2018**

- Obtained ISO 27001:2013 Certification for the IT Data centre including the disaster recovery data centre
- Implemented data classification tool and board approved policy framework
- Introduced Cyber Crisis Management Plan (CCMP) addressing the entire life cycle of incident detection, response, containment and recovery.
- Implemented a DLP solution
- Commenced a project to introduce the Identity And Access Management (IAM) including Privilege Access Management (PAM)
- Upgraded firewall infrastructure with next generation firewall capabilities
- Implemented two (02) factor authentication capability for internet banking applications
- Mandated the EMV chip based cards of all credit and debit card holders

for our overall strategy and the Bank will continue to roll out the plans with optimal safeguards, balancing interests of legitimate stakeholders and appropriate investments in resources to safeguard the Bank's information assets.

## Risk & Capital Management Report

### MARKET RISK

Movements in market factors impact the Bank's profitability as portfolios of assets and liabilities and most transactions involve at least one element of market risk. Bank's exposures and responses to movements are managed strictly within the Bank's risk appetite to optimise profitability and maintain financial stability.

### MARKET RISK REVIEW

The Bank's market risk exposures arise mainly from the Bank's non-trading portfolio (banking book) which accounts for 96% of the total assets and 98% of the total liabilities subject to market risk as set out below. Accordingly, Interest Rate Risk (IRR) and Foreign Exchange (FX) risk are the most significant components of market risk, as the Bank has no direct exposure to commodity price risk and equity risk exposure account for less than 5% of the total financial investments of the Bank.

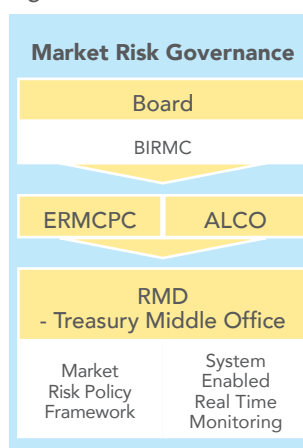
Figure 26: Market Risk Exposure

	Audited (Rs Mn)	
	Carrying Amount	
	2018	2017
<b>Assets Subject to Market Risk</b>		
Cash & Cash Equivalents	25,142	21,740
Balances with Central Banks	33,907	38,611
Reverse repurchase agreements	90	-
Placements with Banks	3,293	3,182
Derivative Financial Assets	4,508	615
Financial assets recognised through profit or loss	100	120
Financial assets at amortised cost - debt and other instruments/ Financial investments - loans and advances	160,146	122,199
Financial assets at amortised cost - loans and advances	749,049	639,102
Financial assets measured at fair value through other comprehensive income / Financial Investments – Available for sale	69,437	95,404
<b>Liabilities subject to Market Risk</b>		
Due to Banks	77,493	62,463
Derivative Financial Liabilities	2,519	1,306
Securities sold under repurchase agreements	16,678	5,064
Due to/Deposits from customers	799,975	701,519
Other Borrowings	24,894	27,258
Debt securities issued	4,488	-
Subordinated Liabilities	22,230	25,809

### COMPONENTS OF MARKET RISK

- Interest Rate Risk
- Foreign Exchange Risk
- Liquidity Risk
- Equity Price Risk
- Commodity Price Risk

Figure 27: Governance



### MARKET RISK GOVERNANCE

The governance structure for market risk is set out in figure 27 reflecting the responsibility of the Board for approving policy, risk appetite parameters and monitoring of the same. BIRMC has oversight responsibility and assists the Board in discharge of their duties with due care. ERMCP formulates policy and makes recommendations to strengthen and manage the same. ALCO manages market risk exposures and profitability, ensuring that risks taken are commensurate with the rewards and managed within the risk appetite of the Bank.

Treasury plays an important role in managing both banking/trading book and asset and liability position of the Bank and duties are segregated in line with best practices in to front office, middle office and back office. Treasury Middle Office (TMO) ensures that the treasury front office deals within its limits set out as per the Bank's risk appetite and treasury back office reconciles and escalates key issues promptly. The TMO of RMD independently measures, monitors and reports on market risk exposures using market risk dashboards and assists in review of the Bank's market risk related policies and exposure limits, supporting ALCO, ERMCP, BIRMC and the Board with information required for decision making.

Figure 28: Key Initiatives

### KEY INITIATIVES IMPLEMENTED IN 2018

- Completed the treasury system upgrade project
- Implementation of revised market risk management limit framework

## Market Risk Management

Market risk is managed in accordance with the treasury policy, investment policy and ALM policy. The trading portfolio is managed by treasury while the non-trading portfolio is impacted by the Bank's business lines. The balance sheet and income statement implications of market risk are summarised below.

Figure 29 : Balance Sheet and Income Statement Implications of Market Risk

Portfolio	Banking Book Financial investments – loan and advances and Financial assets measured at fair value through Other Comprehensive Income	Trading Book "Intend to Actively Trade"
Line Items	<ul style="list-style-type: none"> <li>Government Securities</li> <li>Loans</li> <li>Deposits</li> </ul>	<ul style="list-style-type: none"> <li>Bonds</li> <li>Treasury Bills</li> </ul>
Balance Sheet Value	Mark to market (Fair value through OCI)	Mark to market daily
Income Statement	Net Interest Margins	Net Interest margins + Net Change in Value (mark to market)
Risk exposure	<ul style="list-style-type: none"> <li>Reprising risk</li> <li>Basis risk</li> <li>Foreign exchange risk</li> </ul>	All components of market risk

Market risk management is a critical aspect in implementing Asset and Liability Management (ALM) framework of the Bank as summarized in figure 30.

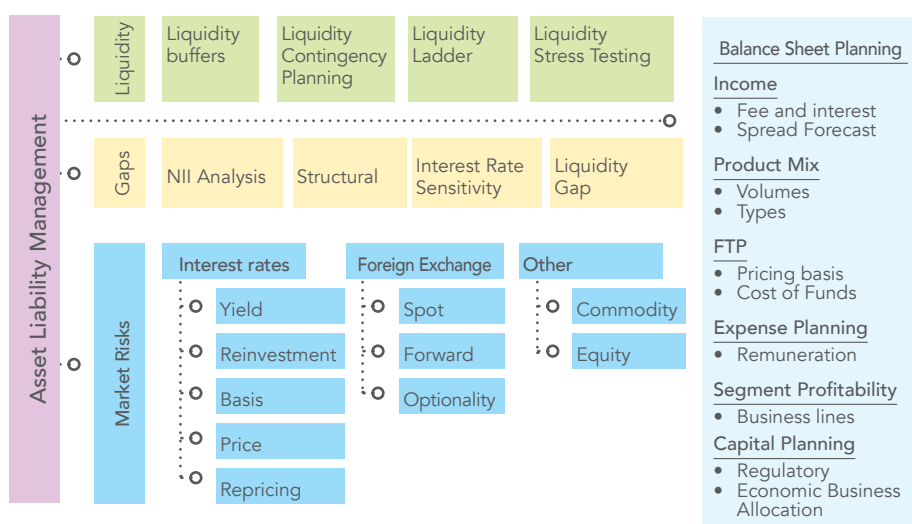
Key tools and processes used to manage market risk include the following:

- Market Risk Limits – Limits contain trading activities within a specified range in line with the Bank's risk appetite on market risk. These are reviewed and approved by the BOD and are regularly reviewed by ALCO and ERMCP.

Figure 31 : Market Risk Limits

Limit Description	Target Risk Area	Effectiveness
<b>Treasury Activity Limits</b>		
FCY Borrowings	Governs the maximum percentage foreign currency borrowings limiting undue exposures that could arise from liquidity mismatches and exchange rate risk	Governed by statutory limit of 2.5% and 10% of total assets of the Bank
SWAP Ratio	Governs the maximum percentage of foreign currency deposits convertible to LKR	Monitored daily, any breach escalated for appropriate covering approval and informed to treasury department for corrective action
Cap on inter-bank "Call" borrowing	Limits the Bank's exposure to adverse fluctuations in inter-bank call money rates	
<b>Transaction/dealer Limits</b>		
Stop-Loss Limit (Single deal/daily/monthly)	Restricts the extent of loss per single trading transaction/ loss on a particular day/ loss on a monthly basis	Monitored on daily basis

Figure 30: Asset Liability Management Framework



## Risk & Capital Management Report

### Interest Rate Risk in Banking Book (IRRBB)

IRRBB arises due to the differences in re-pricing of Rate Sensitive Assets (RSA) and Rate Sensitive Liabilities (RSL), which impact future interest income and expenses and its economic value. Consequently, the Bank's interest rate sensitive assets and interest rate sensitive liabilities are analysed by different maturity buckets to determine suitable strategies to optimize earnings based on identified gaps and future interest rate forecasts. The Bank uses modified duration gap approach for analysing the changes in economic value of equity, which requires the mapping of assets and liabilities into different time buckets based on their residual maturity as set out below depicting an increased/decreased sensitivity.

Figure 32 : Interest Rate Sensitivity Analysis for local and foreign currency denominated assets and liabilities as at 31 December 2018 (in Rs Mn).

	Upto 1 Month	1-3 Months	3-6 Months	6-12 Months	1-3 Years	3-5 Years	Over 5 Years	Non-Sensitive	Total (Rs Mn)
<b>Assets and Off Balance Sheet Exposures</b>									
Balances due from Head Office, Affiliates and Own Branches	-	-	-	-	-	-	-	3,772	3,772
Bills of Exchange	1,483	855	85	-	-	-	-	-	2,423
Cash on hand	-	-	-	53	-	-	-	20,813	20,866
Deposits with Central Bank	-	-	-	-	-	-	-	33,907	33,907
Investments (Net of provisions)	7,300	25	17,146	17,935	116,885	49,718	15,430	-	224,438
Loans and Advances	365,574	54,577	24,261	39,952	74,749	34,357	12,694	-	606,165
Non-Performing Loans	-	-	-	-	3,504	4,530	9,604	-	17,638
Other Assets	-	-	-	-	-	-	-	19,176	19,176
Overdrafts	70,606	8,161	5,583	29,975	-	-	-	-	114,326
Accrued Interest	-	-	-	-	-	-	-	4,878	4,878
Balances due from Other Banks	3,295	-	-	-	-	-	946	-	4,242
Fixed Assets	-	-	-	-	-	-	-	22,658	22,658
<b>Total</b>	<b>448,259</b>	<b>63,618</b>	<b>47,075</b>	<b>87,915</b>	<b>195,137</b>	<b>88,605</b>	<b>38,675</b>	<b>105,204</b>	<b>1,074,489</b>
<b>Liabilities and Off Balance Sheet Exposures</b>									
Balances due to Other Banks	23,770	43,177	11,391	19,628	-	-	-	-	97,966
Bills Payable	1,102	-	-	-	-	-	-	-	1,102
Demand Deposits	-	-	-	-	-	-	-	36,905	36,905
Interest Payable	-	-	-	-	-	-	-	20,047	20,047
Other Liabilities	-	-	-	-	-	-	-	41,044	41,044
Savings Deposits	231,286	-	-	-	-	-	-	-	231,286
Time Deposits	60,284	142,934	125,678	150,359	10,654	11,216	0	-	501,126
Bonds Issued	-	-	-	2,757	15,407	2,292	863	-	21,319
Borrowings	313	219	253	678	2,319	1,212	265	-	5,259
Capital & Reserves	-	-	-	-	-	-	-	119,622	119,622
Certificates of Deposits	-	-	-	-	-	-	-	-	-
Repo	16,165	417	72	10	-	-	-	-	16,663
<b>Total</b>	<b>332,920</b>	<b>186,746</b>	<b>137,394</b>	<b>173,432</b>	<b>28,381</b>	<b>14,720</b>	<b>1,129</b>	<b>217,618</b>	<b>1,092,339</b>
Period Gap	115,339	(123,128)	(90,318)	(85,517)	166,757	73,885	37,546		
Cumulative Gap	115,339	(7,789)	(98,107)	(183,624)	(16,867)	57,018	94,564		
RSA/RSL	1.35	0.34	0.34	0.51	6.88	6.02	34.27		

#### Notes

- 1) The above figures have been prepared as per SLAS including interest cash flows and may differ from SLFRS figures given in the Statement of Financial Position
- 2) Prepared as per requirement given in the Banking Act Direction No 7 of 2011 on "Integrated Risk Management Framework".

### Stress Testing On Projected NII

The Bank carries out stress tests on interest rate risk for its loans and advances portfolio and the fixed income securities portfolio as given below.

Figure 33: Loans and Advances

	2018		2017	
	100 bp Parallel Up Rs 000	100 bp Parallel Down Rs 000	100 bp Parallel Up Rs 000	100 bp Parallel Down Rs 000
As at December 31st	3,333,856	(3,391,804)	2,466,834	(2,515,086)
Average for the Year	3,011,707	(3,062,507)	1,412,790	(1,433,197)
Maximum for the Year	3,398,939	(3,457,578)	2,466,834	(613,904)
Minimum for the Year	2,466,813	(2,502,481)	583,370	(2,515,086)

Figure 34: Fixed Income Securities

Magnitude of shock	Original CAR	1%	2%	5%
Fixed Income Risk		CAR after Change		
Fixed Income Total Portfolio	15.22%	15.00%	14.78%	14.11%
Fixed Income Trading Portfolio		15.22%	15.22%	15.22%

There is no impact on trading portfolio at all shock levels. On the total fixed income portfolio a reduction of 1.11% is observed at the maximum shock level of 5%.

### Foreign Exchange Risk

Foreign currency inflows and outflows give rise to foreign exchange risk which is managed using currency swaps, exposure limits and VaR. Market risk exposure of the Bank's overnight foreign exchange positions is measured using day VaR, at 99% confidence level. TMO monitors limits in real time and at specified frequencies in accordance with the Bank's comprehensive market risk management limit structure to ensure compliance with Bank's risk appetite. Trigger points are escalated to CRO, MD/ CEO or Board of Directors depending on the potential loss that may arise. The Bank's exposure to FX risk as at the end of the reporting period is given in figure 35 and it is noteworthy that over 90% of the Bank's foreign currency exposure is in US dollars.

Figure 34: The Bank's Exposure to Foreign Exchange Risk

	Net Open Position (NOP) ,000	Overall Exposure in Respective Foreign Currency, 000	Overall Exposure in LKR 000
United States Dollar	5,641	2,262,716	413,737,600
Great Britain Pound	(5)	88,650	20,670,561
Euro	(6)	215,364	45,049,806
Japanese Yen	765	1,233,439	2,047,508
Singapore Dollar	10	4,224	566,979
Other currencies in USD	182	73,371	13,416,045
Total Exposure in USD	5,825	2,709,808	
Total Exposure in Rs 000		495,488,449	
Total Capital Funds as at December 31, 2018, Rs 000		123,724,773	
Total exposure as a % of Capital Funds as at December 31, 2018		0.86%	
VaR (99%, 1 day) 31st December 2018		0.55%	
VaR (99%, 1 day) 31st December 2017		0.29%	



## Risk & Capital Management Report

Foreign exchange exposures are subject to stress testing by applying shocks between 5% to 15% to estimate the impact on profitability and capital adequacy of the Bank. Accordingly, a 15% change in exchange rate has a minimal impact on CAR as given in the table below.

Figure 36: Stress Testing on Foreign Exchange Risk

Magnitude of shock	Original CAR	5%	10%	15%
Foreign Currency Risk		CAR after Change		
All foreign currencies	15.22%	15.22%	15.21%	15.20%
USD/LKR		15.22%	15.21%	15.21%

### Equity Price Risk

The Bank's equity portfolio is more strategic in nature, taking a long term view. Its track record earnings despite market volatility was tested during the year as the strengthening dollar and uncertain economic and political conditions resulted in an outflow of foreign funds and a decline in ASPI to 6052 from 6369 in 2018.

Exposure to equity price risk on the trading portfolio is a mere Rs 99 Mn, stress testing conducted at 10% to 40% change in equity prices indicate no change in CAR. The bank conducts mark-to-market calculations on a monthly basis for held-for-trading and fair value through other comprehensive income portfolios and VaR calculations on a 10 day of 99% confidence level. Year end positions are summarized in figure 37.

Figure 37: Exposure to Equity

	Dec 2018		Dec 2017	
	Exposure Rs Mn	VaR (99%, 10 day)	Exposure Rs Mn	VaR (99%, 10 day)
Equity (Market Value)	99 Mn	3.46Mn	120 Mn	4.26 Mn.

Figure 38 : Equity Risk Stress testing

Equity Risk	Original CAR	10%	20%	40%
		CAR after Change		
Equity Prices	15.22%	15.22%	15.22%	15.22%

### Approved Regulatory Capital Approaches

The Bank uses the Standardised Measurement method as required by CBSL Direction No.1 of 2016 in line with Basel III requirements for computing regulatory capital for Market Risk. Consequently, the calculation of regulatory capital is based on specified risk weightings applied to net exposures in defined categories as set out in Template 9: Market Risk Under Standardised Measurement Method on page 79 in CG&RR. With the ongoing developments in system upgrades and process improvements, the Bank is expecting to move towards more advanced internal model approach.

Figure 39: Computation of Market Risk Charge

	Item	Computation of Market Risk Charge
Interest Rate Risk	General Interest Rate Risk	Uses the duration method which computes market risk charge by calculating the price sensitivity of each instrument in the trading book separately and adding the resulting price sensitivities based on a maturity ladder, subject to disallowances if any.
	Specific Interest Rate Risk	Uses rates specified by CBSL for different categories of assets which consider the type of asset, risk ratings (if available) and their duration
Equity Risk	General Equity Risk	A specified capital charge is applied to net open positions in equity markets
	Specific Equity Risk	Applies a capital charge to gross equity positions with equities not in S&P SL Index requiring a capital charge plus buffers
Foreign Currency & Gold	Calculate net open positions for each currency including on and off balance sheet items	
	Convert net positions in each currency/gold using spot rates in to reporting currency (LKR)	
	Aggregate and apply specified capital charge	



## COMMODITY RISK

Commodity risk of the Bank is limited to the extent of the pawning portfolio which could be indirectly impacted by movements in the price of gold. A credit loss could arise in the event the exposure exceeding beyond the market value of the security held.

The Bank's exposure to commodity risk is around 2% of total advances due to the Bank's cautious approach to managing risks associated with the pawning portfolio.

The Bank also uses conservative loan to value ratios to manage its exposures to commodity price risk in appraising credit.

## LIQUIDITY RISK

Liquidity risk management ensures that the Bank has the appropriate amount, diversification and tenor of funding and liquidity to support its asset base and strategic goals at all times. Inherent to the business model of banks, liquidity risk arises from the possibility that counterparties who provide short-term funding, withdraw or do not roll over that funding, or normally liquid assets become illiquid as a result of a generalized disruption in asset markets.

### Liquidity Risk Review

Managing liquidity during the year was challenging due to demand for credit outpacing the deposit growth. The Bank had to resort to borrowings to support demand for credit growth. Nevertheless, the Bank was able to maintain regulatory liquidity ratios at satisfactory levels.

The Bank uses behavioural cash flows in managing liquidity and prudent timely measures were taken in managing assets and liabilities during the year.

However, it is noteworthy that, increasing liquidity requirements as prescribed by the regulator for 2019 will be challenging having to maintain higher liquid assets utilizing high cost funds. Contingency plans are in place to ensure regulatory requirements are met without any non-compliance in an eventuality.

### Liquidity Risk Governance

A comprehensive liquidity risk management framework is in place which includes a contingency plan encompassing both contracted and un-contracted liquidity positions as summarized in figure 40. The column on the extreme right reflects the governance structures identifying roles of those with responsibility for managing liquidity risk. The Board, BIRMC, ERMCP and ALCO regularly review reports on the Bank's liquidity indicators to ensure that they are managed within agreed parameters.

Regulatory updates and impact on the Bank

- Banking Act Directions No 11 of 2018 on foreign currency borrowings by Licensed Banks was revised on 30th November 2018
- Classification of short term borrowings were revised from 3 years to 1 year of remaining maturity limit was increased to 2.5% from 1.5% of total asset base. This will open the Bank for higher short term borrowings from overseas for better liquidity management
- SRR was reduced to 6% from 7.5% w.e.f. November 2018 which resulted in Rs. 8.4 Bn. release of additional liquidity to the Bank
- LCR ratio will increase to 100% w.e.f. Jan 2019 which will demand for additional liquidity to comply

Figure 40 : Liquidity Risk Management Framework

Regulatory Limit	Hard Limits & Ratios					Decision Limit Adjustment
	Boundaries & Prudent Risk Management Guidelines					
Bank-wide limits per Legal Entity	Internal Model Based Measures <ul style="list-style-type: none"> <li>Cumulative Gap Limits</li> <li>Long term funding limits</li> </ul>		Balance Sheet Based Ratios <ul style="list-style-type: none"> <li>Loan: Asset Ratio</li> <li>B/S Turnover</li> <li>Deposits to purchased funds ratio</li> <li>Limits on committed lines</li> </ul>			Proposed by ALCO, Vetted by BIRMC Decision by Board
Operational Limits for Steering of Liquidity Risk Position	Max Unsecured Funding Limits	Max Cash Outflow Limit Net Securities	Secured Funding Limits	Limits on Large Transactions	Other Relevant Limits	Proposed by Treasury/ALM Decision by ALCO
Limits for Trading Units	Max Unsecured Lending	Max Cash Outflow	Liquidity Gap Profiles	Total Foreign Currency Funding		Set by CRO/ Treasury Decision by ALCO

## Risk & Capital Management Report

### Liquidity Risk Management

Key liquidity risk indicators used by the Bank to assess its liquidity position include Statutory Liquid Asset Ratio (SLAR), Liquidity Coverage Ratio (LCR), net advances to deposit ratio, dynamic and static (structural) liquidity gap summary, core funding ratio, funding concentration and commitments vs funding sources.

Managing liquidity risk entails shifting of assets and liabilities, obtaining interbank loans and drawing down credit lines. Liquidity ladders, probabilistic analysis and stress tests are undertaken to evaluate liquidity requirements of the Bank using both stock and flow approaches. Internal limits in place are more stringent than the regulatory requirements in line with the Bank's overall approach to risk management.

Figure 41: Managing Liquidity Risk

Funding Plan	Managing Liquidity Risk	Managing Intra Day Liquidity Risk	Identify Contingent Funding Requirement	Managing Regulator
Identify concentration risk in banking book	Establish liquidity policy and appetite	Maintain liquidity buffers	Early warning indicators	Maintaining LCR
Pricing liquidity risk via transfer pricing mechanism within the Bank	Monitor intra day limits and carry out stress testing	Daily clearing and settlement	Conduct liquidity simulations	Reporting on liquidity assets and reserves

Behavioural Assumptions taken in to account in preparing the gap analysis

- Behaviour of FD rollovers are analysed based on historical rollover patterns
- Unutilised overdrafts are assumed to be utilized on straight line basis over a year
- Out of undisbursed loans to be disbursed, 75% are within the year and 25% (1-3 years)
- 40% of the pawning advances will be rolled over

Liquidity gaps are monitored based on the behavioural analysis of the Bank's assets and liabilities, historical rollover patterns, drawdown of Unutilised overdrafts and disbursement of approved but undisbursed loans. The liquidity gaps as at 31st December 2018 are given above in Chart 15 Liquidity Gap Based on Behavioural Analysis.

The Bank also measures its liquidity position in all major currencies at both individual and aggregate levels to maintain potential risks within specified limits. Potential liquidity commitments resulting from loan disbursements and undrawn overdrafts are also monitored to assess adequacy of funding sources. Liquidity risk is mitigated by maintaining an adequate margin in high quality liquid assets and diverse funding sources. Contingency funding agreements with peer banks are in place ensuring availability of sufficient liquidity buffers in accordance with the Bank's contingency funding plan.

### Funding Diversification by Product

Deposits from customers' are accounted for 76% of funds making it the primary source of funding for the Bank. The chart 16 provides an analysis by product of the Bank's funding diversification as at year end. Funding position maintained in similar range in comparison to 2017 position.

Chart 15: Liquidity Gap Based on Behavioural Analysis

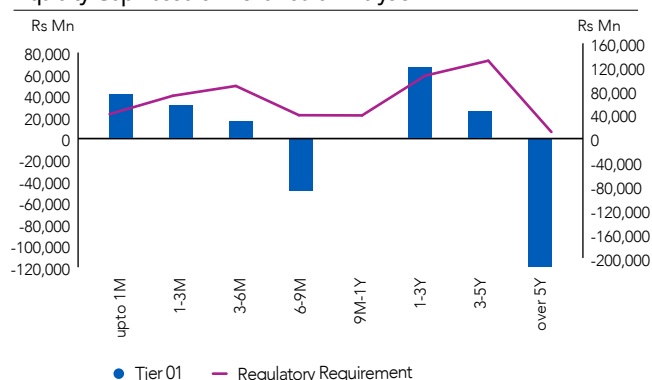


Chart 16: Funding Diversification by Product

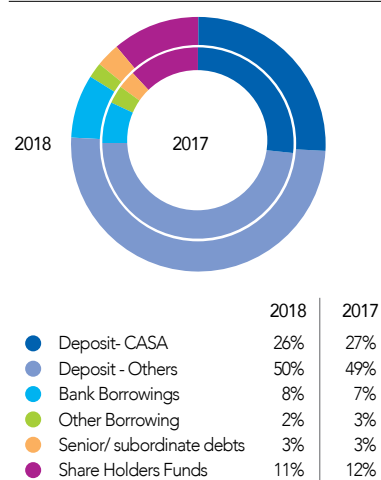


Figure 42 : Key Initiatives

Project	Impact
Treasury System Upgrade	System upgrade was successfully completed during 2018, this enhanced treasury risk management capability with enhanced real time monitoring, limit management and automation of internal controls facilitating faster processing times. Importantly, it enables leveraging competency of staff to maximise business opportunities in line with their experience and expertise while ensuring compliance with the Bank's risk appetite.
Implementation of Market Risk Management Tools	Tools such as value at risk for treasury products were implemented with the upgraded system facilitating better analytics and risk management on the treasury activities.
Mapped Risk Appetite to Individual's KPIs	Individual dealer books, desk books with respective limits for exposures that dealers and treasury could undertake will enable the Bank to map the risk appetite to individuals based on their ability and experience.
Enhanced Risk Monitoring	Implemented risk monitoring, risk measurement and risk reporting by using systems, statistical tools, and market information to ensure that the Bank is within the internal and regulatory guidelines for market risk. This encompasses provision of market risk information to ALCO, development of enhanced ALM reports, supporting computation of regulatory capital for market risk etc., to manage market risk.
Reviewed and Update of Policies and Procedure Manuals	Updated the policies relating to treasury activities, procedure manual to incorporate latest developments and best practices. Provide gap analysis to the management on the best practices, regulatory requirements and make recommendations to bridge gaps.

The Bank ensures the compliance with regulatory requirements and warranting a sufficiency of information to monitor and manage market risk remains a key focus area.

Figure 43 : Bank's Credit Ratings

The following credit rating stand as at the close of the year.

Rating Type	Counterparty Risk Rating	Long Term National Rating
Issuer	Moody's Investor Service Singapore Pte Ltd.	Fitch Ratings Lanka Ltd.
Rating	B2 (international rating)	AA- (lka)
Outlook	Not Applicable	Stable
Date Issued	Issued in June 2018 and revised in November 18	January 2019 (affirmed)
What can change rating up	Given the negative outlook on the sovereign rating of Sri Lanka was downgraded from B1 to B2 (negative), and as a result the bank's international rating also was revised as local currency deposit ratings of HNB are positioned at the same level	Moderation of its risk appetite and the Bank achieving sustained improvements in its financial profile, particularly in its funding and liquidity
What can change the rating downwards	<ul style="list-style-type: none"> <li>• Further downgrade of Sri Lanka's sovereign rating</li> <li>• Material deterioration in solvency factors, such as asset quality, profitability, and capital; and/or</li> <li>• Tighter liquidity and an increased reliance on market funding.</li> </ul>	<ul style="list-style-type: none"> <li>• Aggressive risk taking while the operating environment remains weak, unless sufficiently mitigated through capital and financial performance.</li> <li>• Weakening in the liquidity position would also be negative for the rating.</li> </ul>

# Risk & Capital Management Report

## NON-FINANCIAL RISKS

All banks are exposed to non-financial risks which can have significant financial impacts to stakeholders. The Bank seeks to identify, monitor and manage these risks within its risk management framework with a view to ensuring its profitability and financial stability in the long term.

## REPUTATION RISK

Reputation risk refers to the potential adverse effects which can arise from the Bank's reputation being tarnished due to factors such as unethical practices, regulatory actions, customer dissatisfaction, complaints, negative/adverse publicity, unable to meet obligations. The Bank uses a scorecard approach to assess reputation risk and risk drivers taken in to account are given in figure 44.

The Board and leadership of the Bank set the tone at the top, nurturing the right behaviours and creating an environment of transparency and accountability across the Bank. A code of ethics issued to all employees ensures that corporate values and expectations of conduct are clearly communicated throughout the Bank. Employees are further encouraged and incentivised to safeguard the Bank's reputation by making this a criteria for performance assessment. Customer surveys are carried out while print and electronic media exposure is monitored to understand concerns of stakeholders with a view to addressing legitimate concerns. A comprehensive training and development plan facilitates employee learning on the subject and sharing of learnings while supporting competency development in this area including response plans and identification of spokespersons in an event of crisis, supports organisation readiness to handle reputation risk events, supporting initiating of timely and effective action to minimise potential impacts.

The Reputational Risk Task Force (RRTF) established under the supervision of ORSC reviews, reputational risk trigger events and manages attributes that impact the reputation of the Bank,

Figure 44: Reputation Risk Drivers

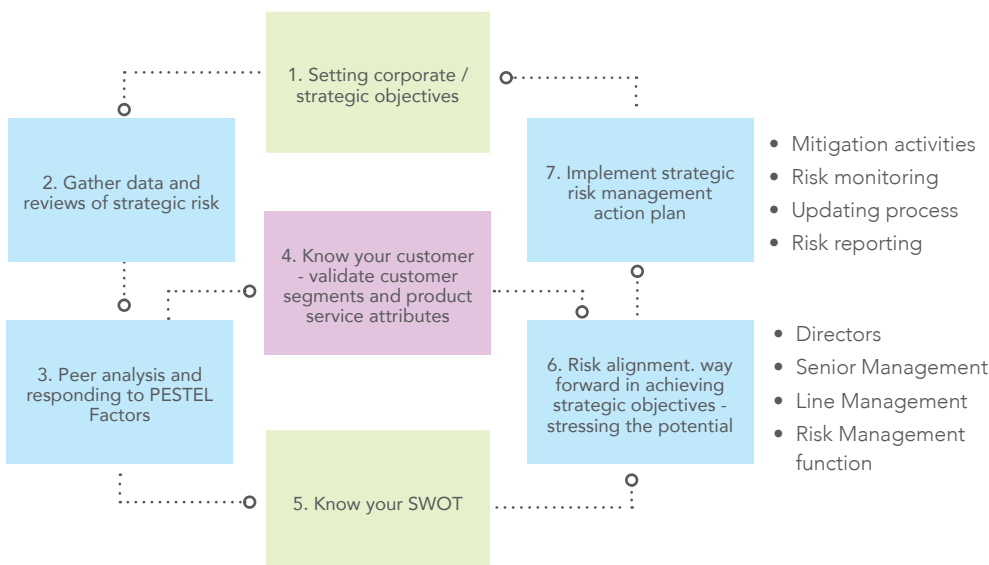


reducing the capital requirement. It comprises representatives from different business verticals whose recommendations are escalated to ORSC, ERMCP and other respective management committee for their necessary action. These pre-emptive measures support scoring, reducing capital allocation under reputational risk. The RRTF committee refined the reputation risk scorecard parameters and looked at more granular level details to make the best use of parameters applicable to HNB.

## STRATEGIC RISK

Strategic risk is the risk that the Bank's future business plans and strategies may be inadequate to prevent financial loss or protect the Bank's competitive position and shareholder returns.

Figure 45: Strategic Risk Scorecard



The Leadership of the Bank is collectively responsible for providing strategic direction and undertake evaluation of alternative strategies which are deliberated in depth to chart its course. A robust strategic planning process supports the testing of key assumptions and analysis to identify and assess potential areas of concern. Care is also taken to ensure compliance with all regulatory requirements and monitoring trends to identify potential areas of regulation, facilitating early understanding of related impacts and issues.

Strategic and business risks arise as a result of adverse business decisions and deficient execution, non-compliance with regulatory requirements, delays in recognizing and responding to emerging PESTEL factors, industry developments etc. The Bank carries out strategic risk assessment in both quantitative and qualitative dimensions using the scorecard in figure 45 to compute capital allocation for strategic risk as a part of Pillar II risk assessment under ICAAP.

Optimizing risk and return with a thorough understanding risks and opportunities is key to managing strategic risk. The Bank engages external resources to support its strategic planning processes, bringing in global expertise to support management of strategic risk, recognizing the systemic importance of the Bank to the country's economy.

**LEGAL RISK**

Legal risk scorecard was introduced as a part of improvements made to ICAAP document of the Bank and same was considered as a quantitative risk assessing parameter to be used in Pillar 2 risk assessment under material risk. The Bank looks at 7 risk drivers in assessing legal risk as given in figure 46.

Figure 46: Legal Risk Drivers

Legal Risk Governance and Framework
Claims arising from / deprived due to defective documentation in contracts
Mis – selling / Mis – buying
Legislative / regulatory developments resulting in claims against / deprivation of making claims
Dispute Management
Claims arising from / deprived of due to non - contractual rights / obligations risks
Constraints faced due to technological advancements

**MODEL RISK**

Model risk is termed as the risk of loss that an institution may incur as a consequence of the decision that could be primarily based on the output of the internal models, particularly the risk models, due to errors in the development, implementation or use/maintenance of the models. Model risk would potentially lead to over/undermining the future losses. Therefore, it is critical to deploy a strong model governance framework in order to effectively manage and mitigate the model risk.

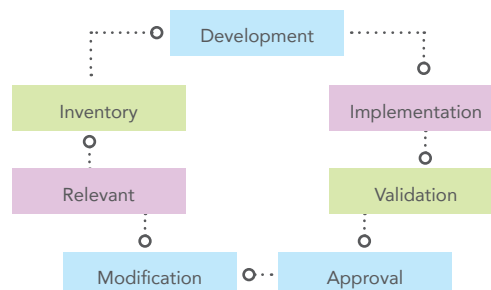
The following are some of the areas which are managed through specific model in the Bank

- ICAAP Document
- Impairment Assessment under SLFRS 9
- Stress Testing
- Internal Risk Rating Assessment
- Market Risk Estimates i.e. VaR

As such, the Bank has engaged with a consultant to develop a governance structure for model risk. Model governance spans across all the stages of the model lifecycle and forms part of the Bank's overall governance framework. The model governance framework should detail the stages of internal model governance, stakeholders involved and the roles and responsibilities of every user of the model and the risk management functions

Regulator directives on, Basel guidelines and SLFRS 9 standards would be the key risk indicators in understanding the impact of risks associated with models in banking business and it has increasingly forced banks to rely on statistically derived models than subjective human assessment. However, the applicability and reliability of these models are dependent upon the quality of assumptions and the robustness of the underlying statistical methodologies. Therefore, it is imperative to have a well-structured model risk management framework, which will ensure consistency relevancy and accuracy of underlying model assumptions and methodologies used.

Figure 47: Model Life Cycle



# Risk & Capital Management Report

## CONDUCT RISK

Conduct risk in banking business can be defined as any action of a bank or the banking industry that leads to customer detriment or negatively impacts market stability due to unacceptable or unexpected behaviour in meeting bank's obligations towards its stakeholders

Non conduct risks are risks of operational losses other than conduct risk. Managing conduct risk as a NFR has become increasingly critical in the banking industry with the growing number of events arisen as a result of lack of controls, non-compliance, negligence etc., Consequently banking and financial sector have been penalized by regulators globally with hefty penalties and resulting loss of customer confidence and trust in both global and local context during last two decades.

Understanding what has driven poor conduct in the past helps the Bank in estimating and preventing poor conduct in the future. Thus, the Bank defines its key conduct risk drivers to avoid any poor conduct as depicted in figure 48.

Lines of defence in managing conduct risk:

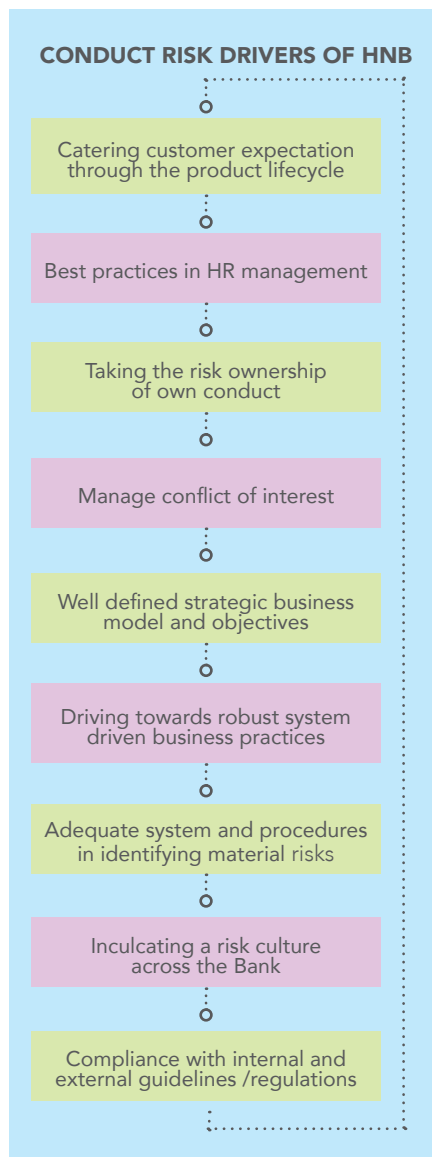
- Operational: Day to day monitoring, and daily management of information. This line of defence remains with the respective business unit itself.
- Compliance: Implementation of policies and procedures as prescribed by regulator. The operational risk management department is under the purview of RMD, and the audit and compliance department ensures the management of the risk control framework and ongoing compliance monitoring.
- Board: Management of conduct risks through review and analysis of periodic management information.

## MANAGING GROUP RISK

The Bank has 9 subsidiaries of which 4 are held directly while the remainder are held indirectly. All subsidiaries are engaged in providing financial services except for Sithma Development Ltd., which is the real estate arm of the HNB Group. Only HNB Assurance PLC is listed on the Colombo Stock Exchange at present while HNB Finance Ltd is preparing for a listing in 2019.

Performance of subsidiaries are closely monitored with the presence of the corporate management of HNB on the Board of same. Risk management divisions of the subsidiaries forward risk management review reports to the HNB risk management function which is the group risk management function, identifying key risks faced by each entity, trends and measures taken to manage or mitigate same together with financial statements of the preceding month/quarter. Risk aggregating is a challenge due to the operating models of the group companies and the Bank is addressing this to facilitate assessment of the Group's material risks.

Figure 48: Conduct Risk Drivers of HNB



The following factors provide assurance on management of Group risk:

- Continuous monitoring of performance of group companies which are reported from pages 86 to 92 in IR
- HNB's capital at risk is limited to amount invested in these companies in the form of equities at the time of companies were incorporated or acquired
- Subsidiaries engaged in insurance, finance business and stock broking are subject to regulatory oversight.
- Key management personnel/director representation on boards of group companies ensuring adherence to core values, alignment of business strategy and a sufficient information flow as given in figure 50

Figure 49: Key Initiatives

KEY INITIATIVES IMPLEMENTED IN 2018
<ul style="list-style-type: none"> <li>Implementation of information security controls i.e. ISO27001, user access management and data classification</li> <li>Further strengthened the risk governance</li> <li>Improved risk monitoring via dashboards</li> <li>Implementation of customer complaint management system in HNBA</li> <li>Strengthened operational risk management by rolling out of RCSA, KRI and BCM activities in HNB Finance</li> </ul>

Figure 50: HNB Representation in Subsidiaries

Group Co.	Board Representation	Chairman	Board Risk Committee Representation
HNB Assurance PLC	✓	✓	✓
Acuity Partners (Pvt) Ltd	✓	✓	✓
Sithma Developments Ltd	✓	✓	✓
HNB Finance Ltd	✓	✓	✓

#### HNB Assurance

HNB Assurance PLC (HNBA) and its fully owned subsidiary HNB General Insurance Limited (HNBGI) have well established compliance and risk management systems in place to manage its fiduciary obligations to its customers. Regulatory oversight by the Insurance Regulatory Commission of Sri Lanka mandates high levels of compliance and management of a wide range of risks in line with the company's vision and applicable regulatory frameworks. As a listed company, HNBA is also subject to market regulation by the CSE and the SEC requiring accountability and transparency in financial and narrative reporting.

The company's risk management framework is guided by the risk management policy of the company and integrates with the risk management framework of the parent company HNB PLC. The company reports the details of the risk management activities carried out by HNBA and HNBGI to the BIRMC of HNB PLC on a quarterly basis. Further, in order to manage the compliance risk, confirmation on compliance requirements are submitted to the compliance division of HNB PLC on a quarterly basis.

Figure 51: Key Performance Indicators

Key Performance Indicator	2018	2017
<b>HNB Assurance PLC</b>		
Gross Written Premium	4,421 Mn	3,964 Mn
Profits After Tax	2,475 Mn	726 Mn
Claims Ratio (without policy maturities)	8%	9%
Expense Ratio	49%	49%
Combined Ratio	57%	58%
Capital Adequacy Ratio	319%	358%
<b>HNB General Insurance Limited</b>		
Gross Written Premium	4,341Mn	3,907 Mn
Profits After Tax	230 Mn	184 Mn
Claims Ratio	66%	64%
Expense Ratio	36%	38%
Combined Ratio	102%	102%
Capital Adequacy Ratio	200%	178%

As at 31 December 2018, the Company maintained a CAR of 319% calculated as per the Solvency Margin (Risk Based Capital) Rules 2015 issued by the Insurance Regulatory Commission of Sri Lanka as required under the Regulation of Insurance Industry Act No. 43 of 2000. This is well above the minimum CAR of 120% as per the same rules.

Profit of the company for the Year ended 31st December 2018 includes Rs 381.1 Mn transferred to the shareholders' funds as one-off surplus attributable to policyholders' non-participating fund of the life insurance fund as per the Direction No. 16 of the IRCSL. Further, a deferred tax asset of Rs 1,280.4 Mn was recognised on brought forward tax losses and a 100% provision was made for notional tax credits recorded relating to shareholders fund of Rs. 103.1 Mn and policyholders funds of Rs 162.5 Mn as per the inland revenue act. Similar transactions were not carried out during last year as shown in the comparative figures.

The following officers of HNB PLC represent risk management committee of HNB Assurance PLC which overlooks the risk management activities of HNB Assurance PLC and HNB General Insurance Limited.

Figure 52: HNB Representation in HNBA

Name	Position of the Board Risk Management Committee of HNB Assurance PLC	Position in HNB PLC
Mr. Dilshan Rodrigo	Chairman	Chief Operating Officer
Mrs. Rose Cooray	Member	Director / Chairman - BIRMC
Mr. Damith Pallewatte	Invitee	Chief Risk Officer/CISO

In addition to the risk management committee, directors of HNB Assurance PLC and HNB General Insurance Limited who represent the interest of HNB PLC are members of the HNB assurance's audit committee, related party transactions review committee, HR and remuneration committee, nomination committee, strategy review committee, and investment committee. These committees are also reviewing risks pertaining to areas coming under their purview.



## Risk & Capital Management Report

Figure 53: Key Initiatives

Implemented in 2018	Planned for 2019
<ul style="list-style-type: none"> <li>• Formation of an Asset Liability Management Committee (ALCO)</li> <li>• Developed a new policy on managing related party transactions</li> <li>• Extended coverage of ISO certification for life new business underwriting operations building on certification obtained for life claims operation.</li> <li>• Formed a customer complaints investigation unit to have a closer and continuous review of customer complaints and to identify the root causes of customer complaints.</li> <li>• Carried out an independent review of IT security environment through a specialized third party organization.</li> <li>• Developed key risk indicators and periodically reported to the board risk management committee.</li> <li>• Reviewed policies of the company including risk management policy, compliance policy, anti-money laundering policy, IT security etc.</li> <li>• Implemented data classification policy</li> </ul>	<ul style="list-style-type: none"> <li>• Enhance the coverage of ISO certification to cover all the processes of Life insurance operations.</li> <li>• Obtain ISO 27001 certification for IT activities of HNBA and HNBGI.</li> <li>• Carry out a Lean Management exercise on all processes of HNBA and HNBGI</li> </ul>

Figure 54: Top & Emerging Risks

Risk	Impact
Implementation of SLFRS	SLFRS 17 will have significant impact to the insurance industry as a whole. The impact to the life insurance business would be significantly more compared to the general insurance business.
Volatile Interest Rates	Increase in interest rates have a favourable impact to income from the life fund but has a negative impact on life insurance business as customers may prefer to invest in other financial instruments
Performance of CSE	Drop in value of equity investments affects the investment income of both companies
Unfavourable GDP Growth	Adverse economic conditions leading to decline in premium collections and affordability of insurance
Exchange Rate Volatility	Depreciation of the Rupee will increase the cost of vehicle spare parts resulting in higher claims cost.
Climate Change	Increased claims from natural disasters and increased rates from reinsurers
Unstable Fiscal Policy	Fiscal policy implemented to reduce imports of motor vehicles will have an adverse impact on the growth potential of the insurance industry due to the high concentration in motor insurance as a product

### HNB Finance Company Ltd.

HNB Finance Company Ltd. transitioned from a Micro Finance company in 2017 to a fully-fledged Finance Company and plans to get listed in 2019. This transformation necessitated the establishment of a comprehensive risk management framework aligned to the Bank's risk objectives and parameters.

The CRO of HNB is an invitee to the BIRMC of HNB Finance Company Ltd., facilitating assessment of its risk management policies, structures, processes and controls. HNB Finance Company Ltd. risk division comprehensively assesses the quality of the loan book, NPA ratios, portfolio quality indicators, risk coverage ratios etc. As a part of continuous improvements to risk management processes, HNB Finance Company Ltd. progressively develops tools and techniques to assess the credit risk, operational risk, strategic risk, financial / liquidity risk and monitors and reports its material risks to the BIRMC and escalate them to BOD, based on its merit.

Figure 55: Key Performance Indicators

Key Performance Indicator	2018	2017
Deposit Growth (Rs Mn)	20,151.13	19,398.26
Advances Growth (Rs Mn)	24,020.93	17,607.17
Profitability (Rs Mn)	876.19	1,084.65
Total Assets (Rs Mn)	30,242.47	25,567.11
Shareholder Funds (Rs Mn)	4,817.66	4,274.34
CAR (%)	10.23	13.61
Impairment Charge (Rs Mn)	490.12	882.79
NPA Ratio (%)	4.35	2.16



Figure 56: Key Initiatives

Key Initiatives in 2018	Planned for 2019
<ul style="list-style-type: none"> <li>Development of a comprehensive risk management structure, policy and processes for HNBF which included TOR for BIRMC, IRM framework, risk appetite statement, risk dashboards and heat maps.</li> <li>Establishment of an Executive Risk Management Committee (ERMC) and creating a forum at management level for discussion of identified risks towards appropriate risk mitigation.</li> <li>Improved risk identification, assessment and measurement covering credit, operational, strategic, financial and liquidity risks including the risks related to IT operations</li> <li>Implementation of RCSA process and refinement of KRI</li> <li>Strengthened the credit risk management to mitigate elevated risks including risks, that stemmed during credit appraisal, by introduction of a credit risk rating models, credit evaluation formats for SSE and SME and LRM covering SME, SSE and leasing products.</li> <li>Introduced stress testing and scenario analysis.</li> <li>Introduced BCM and working towards successful implementation.</li> <li>Conducted training to enhance risk awareness and to develop a risk culture within HNBF.</li> </ul>	<ul style="list-style-type: none"> <li>Establish IT Steering Committee (ITSC)</li> <li>Revision of risk management policy of HNBF</li> <li>Review and enhance operational and credit risk policies</li> <li>Ensure Key Operational Risk Controls (KORCs) are documented, compiled and revised in a timely manner</li> <li>Embed the BCM framework</li> <li>Improve and upgrade Risk management framework of the company</li> <li>Introduce Anti Money Laundering (AML) and CFT screening and related initiatives.</li> </ul>

Figure 57: Top & Emerging Risks

Risk	Impact
Implementation of SLFRS 9	SLFRS 9 would create significant impact on provisioning in turn would affect the bottom line of the organization
Interest Rates	Ceiling on interest rates of 35% for microfinance facilities and increasing interest rates on borrowings will impact net interest margins
Deteriorating Asset Quality	Increasing trend in non-performing loans due to moderate economic growth is a concern and is being addressed with the strengthening of credit risk management processes. Credit risk levels were elevated with the early announcement of government decision to write off microfinance loans up to Rs 100,000 in 12 drought affected districts leading to willful defaults in some cases.
Climate Change	Two consecutive periods of drought alternating with floods in the preceding years impacted output of the agriculture sector and related industry, moderating growth and elevating credit risk for the financial services sector
Increasing Cyber Risks	Escalating cyber-crime and increased automation and connectivity of the company increases cyber risk

## ACUITY PARTNERS

Acuity Partners is a full service Investment Bank equally owned by DFCC Bank and HNB PLC. It is the only integrated and full service Investment Bank in Sri Lanka offering a comprehensive suite of products and services that include Corporate Finance, Equities, Fixed Income Securities, Venture Capital Services & Asset Management. Key Activities carried out during the year 2018 include:

- Corporate Financing
- Stockbroking
- Primary Dealer Activities
- Venture capital Investments
- Managing Unit trust

APL Group risk exposure is monitored and followed by the APL Group's audit committee with an oversight of HNB BIRMC. APL group submits a quarterly report on Risk management activities to the BIRMC of HNB PLC. Acuity Stock Brokers operates under a license issued by the SEC and complies with its requirements.

## Risk & Capital Management Report

Additionally, the following officers of HNB PLC are members of the Board of APL.

Figure 58: HNB Representation in APL

Name	Position of the Board of APL	Position in Hatton National Bank PLC
Mr. Jonathan Alles	Member of Board and Audit Committee	Chief Executive Officer
Mr. Rajive Dissanayake	Member of Board and Audit Committee	Chief Strategy Officer
Mr. Damith Pallewatte	Member of Board	Chief Risk Officer/CISO

Material risks identified by the APL are market risk, compliance risk and liquidity risk. Those risks are assessed and mitigated through laid down procedures based on regulatory and internal procedures.

Figure 59: Key Initiatives

Key Initiatives in 2018	Planned for 2019
<p><b>Corporate Finance</b></p> <ul style="list-style-type: none"> <li>Launched of "Huddlestock", a global investment platform thus opening up more investment opportunities for our clients</li> <li>Successfully completed two Debenture Issues, including a 10-year debenture for Sri Lanka Telecom PLC</li> <li>Completed 10 advisory service projects for listed and unlisted clients in industries such as financial services, real estate &amp; property development, plantations, manufacturing, diversified conglomerates etc for transactions covering rights issues, mandatory offers, share consolidations and reorganization.</li> <li>Secured and mandated for multiple equity, debt, M&amp;A and advisory transactions.</li> <li>Obtained approval as a sponsor for the empower board listings on the CSE</li> <li>Carried out awareness programmes for SME clients for the purposes of attracting a new segment of the market for capital raising transactions</li> </ul>	<ul style="list-style-type: none"> <li>Use strategic alliance with IDLC Bangladesh to explore business opportunities in Bangladesh.</li> <li>Explore business opportunities in Maldives.</li> <li>Partner with ADSS of UAE to pitch for Govt./SOE foreign debt raising issues.</li> <li>Pitch for commercial banks/corporate debenture issues.</li> <li>Develop Huddle Stock.</li> <li>Complete Sri Lanka Telecom Private Placement (PP) and pitch for Lanka hospitals/any other PP (listing requirement).</li> <li>Complete HNB listings/and two other potential listings.</li> <li>Complete advisory assignments already mandated.</li> <li>Source new mandates for listings, debt, advisory and M&amp;A.</li> </ul>
<p><b>Acuity Securities Ltd</b></p> <ul style="list-style-type: none"> <li>Strengthened the scope and coverage of Risk Management Committee (RMC) meetings.</li> <li>Updated and improved risk related manuals/procedure manuals</li> <li>Carried out overall review of bond trading portfolio with the view of mitigating future risks</li> </ul>	<ul style="list-style-type: none"> <li>Build up risk appetite on the longer end of yield curve</li> <li>Consolidate and increase success ratio at treasury bond auctions</li> <li>Target for a 10% increase in client volumes</li> <li>Value additions for HNB clients via banking platform</li> <li>Retail/HNI bond trading initiatives</li> </ul>
<p><b>Acuity stock brokering</b></p> <ul style="list-style-type: none"> <li>Strengthened the process Updating KYC forms of clients based on CSE requirements</li> <li>Updated the client agreements and credit agreement forms</li> </ul>	<ul style="list-style-type: none"> <li>Aggressively target HNWI clients in key locations within DFCC &amp; HNB branch network.</li> <li>Initiate business partnerships with international brokerage houses having a strong presence in the sub-continent.</li> <li>Use DFCC Bank and HNB's corporate banking transactions to source deals for ASB</li> </ul>

## SITHMA DEVELOPERS

Sithma Developers owns and operates the building which houses the head office of HNB PLC, deriving rental income from HNB PLC and other tenants. It also manages the commercial business properties of HNB and derives income from this operation as well. All members of the Audit Committee of Sithma which is not a listed company are employees of HNB PLC as given in figure 60.

Figure 60: HNB Representation in Sithma Developers

Name	Position of the Board of APL	Position in Hatton National Bank PLC
Mr. Dilshan Rodrigo	Member of Board and Audit Committee	Chief Operating Officer
Mrs. Anusha Gallage	Member of Board and Audit Committee	Chief Financial Officer
Mr. Chandana Panditharathne	Member of Board and Audit Committee	AGM Services

## Top & Emerging Risks

The main risk for Sithma is its inability to increase rent per square feet and the risk of tenants terminating rental agreements due to a complex combination of factors including economic, political and financial stability of the country. However, the operating model is simple and does not warrant complex risk management processes on regular basis. An annual review of risks is deemed sufficient for the current operating model.

Figure 61: Top & Emerging Risks

Risk	Impact
Increasing Availability of Rentable Office Space	Since all the developments in Colombo are positioning themselves towards Grade A or redefined Grade A facilities there will be a moderate impact on renting out available space
Natural Disaster	Perceived to be moderate impact due to risk mitigations already in place
Termination of Tenant Agreement	It's likely that the multinational's corporate offices currently in the HNB Towers will be shifted to an address in the Central Business District (CBD)
Competitiveness in Rates	With the repositioned CBD (port city), it is expected rates to go up however, since HNB towers will be pushed to the perimeter of the SBD (secondary business district), ability to demand higher rent will diminish

## Market Discipline – Disclosure Requirements Under Pillar III

With the implementation of Basel III directives w.e.f 1st July 2017, all licensed banks are required to disclose pillar III disclosure requirements in order to complement the minimum capital requirements and supervisory review process by developing a set of disclosure requirements which will allow the market participants to gauge the capital adequacy and risk exposures of licensed banks.

These requirements will improve the comparability and consistency of disclosures among licensed banks and facilitate assessment of the banks by others, including investors, analysts, customers, other banks and rating agencies which leads to good corporate governance.

### TEMPLATE 01

#### Key Regulatory Ratios - Capital and Liquidity

Item	Bank		Group	
	2018	2017	2018	2017
<b>Regulatory Capital (LKR '000)</b>				
Common Equity Tier 1	104,029,151	92,876,653	114,423,431	100,246,115
Tier 1 Capital	104,029,151	92,876,653	114,423,431	100,246,115
Total Capital	123,724,773	115,340,970	134,011,553	122,560,440
<b>Regulatory Capital Ratios (%)</b>				
Common Equity Tier 1 Capital Ratio ( <i>Minimum Requirement - 7.375%</i> )	12.80%	13.72%	13.16%	13.74%
Tier 1 Capital Ratio ( <i>Minimum Requirement - 2018 - 8.875%</i> )	12.80%	13.72%	13.16%	13.74%
Total Capital Ratio ( <i>Minimum Requirement - 2018 - 12.875%</i> )	15.22%	17.04%	15.41%	16.80%
Leverage Ratio ( <i>Minimum Requirement - 3%</i> )	8.33%	8.64%	8.78%	8.92%

Item	Bank	
	2018	2017
<b>Regulatory Liquidity</b>		
Statutory Liquid Assets (LKR'000)	225,544,960	217,431,828
<b>Statutory Liquid Assets Ratio (<i>Minimum Requirement – 20%</i>)</b>		
Domestic Banking Unit (%)	22.03%	24.06%
Off-Shore Banking Unit (%)	43.52%	46.15%
Liquidity Coverage Ratio (%) – Rupee ( <i>Minimum Requirement - 2019-100% ; 2018-90%</i> )	153.16%	182.39%
Liquidity Coverage Ratio (%) – All Currency ( <i>Minimum Requirement - 2019-100% ; 2018-90%</i> )	103.85%	124.32%

## TEMPLATE 02

### Basel III Computation of Capital Ratios

Item	Bank 2018 (LKR '000)	Group 2018 (LKR '000)
Common Equity Tier 1 (CET1) Capital after Adjustments	104,029,151	114,423,431
Common Equity Tier 1 (CET1) Capital	108,092,716	117,656,896
Equity Capital (Stated Capital)/Assigned Capital	32,338,025	32,338,026
Reserve Fund	6,260,000	6,260,000
Published Retained Earnings/(Accumulated Retained Losses)	18,777,991	23,289,858
Published Accumulated Other Comprehensive Income (OCI)	-	-
General and other Disclosed Reserves	50,716,701	50,889,561
Unpublished Current Year's Profit/Loss and Gains reflected in OCI	-	-
Ordinary Shares issued by Consolidated Banking and Financial Subsidiaries of the Bank and held by Third Parties	-	4,879,452
<b>Total Adjustments to CET1 Capital</b>	<b>4,063,565</b>	<b>3,233,465</b>
Goodwill (net)	-	122,942
Intangible Assets (net)	713,228	813,228
Others (specify)	-	-
Defined benefit pension fund assets	1,399,510	1,399,510
Investments in the capital of banking and financial institutions where the bank does not own more than 10 per cent of the issued ordinary share capital of the entity	266,031	349,848
Significant investments in the capital of financial institutions where the bank owns more than 10 per cent of the issued ordinary share capital of the entity	1,684,797	547,937
<b>Additional Tier 1 (AT1) Capital after Adjustments</b>	<b>-</b>	<b>-</b>
<b>Additional Tier 1 (AT1) Capital</b>	<b>-</b>	<b>-</b>
Qualifying Additional Tier 1 Capital Instruments	-	-
Instruments issued by Consolidated Banking and Financial Subsidiaries of the Bank and held by Third Parties	-	-
<b>Total Adjustments to AT1 Capital</b>	<b>-</b>	<b>-</b>
Investment in Own Shares	-	-
Others (specify)	-	-
<b>Tier 2 Capital after Adjustments</b>	<b>19,695,621</b>	<b>19,588,121</b>
<b>Tier 2 Capital</b>	<b>19,695,621</b>	<b>19,588,121</b>
Qualifying Tier 2 Capital Instruments	14,131,358	14,023,858
Revaluation Gains	2,090,479	2,090,479
General Provisions	3,473,785	3,473,785
Instruments issued by Consolidated Banking and Financial Subsidiaries of the Bank and held by Third Parties	-	-
<b>Total Adjustments to Tier 2</b>	<b>-</b>	<b>-</b>
Investment in Own Shares	-	-
Others (specify)	-	-
Investments in the capital of financial institutions and where the bank does not own more than 10 per cent of the issued capital carrying voting rights of the issuing entity	-	-
<b>CET1 Capital</b>	<b>104,029,151</b>	<b>114,423,431</b>
<b>Total Tier 1 Capital</b>	<b>104,029,151</b>	<b>114,423,431</b>
Total Capital	123,724,773	134,011,553
Total Risk Weighted Assets (RWA)	812,848,003	869,562,289
RWAs for Credit Risk	752,232,014	794,670,740
RWAs for Market Risk	921,224	1,005,555
RWAs for Operational Risk	59,694,765	73,885,993
<b>CET1 Capital Ratio (including Capital Conservation Buffer, Countercyclical Capital Buffer &amp; Surcharge on D-SIBs) (%)</b>	<b>12.80%</b>	<b>13.16%</b>
of which: Capital Conservation Buffer (%)	1.875%	1.875%
of which: Countercyclical Buffer (%)	N/A	N/A
of which: Capital Surcharge on D-SIBs (%)	1.00%	1.00%
<b>Total Tier 1 Capital Ratio (%)</b>	<b>12.80%</b>	<b>13.16%</b>
<b>Total Capital Ratio (including Capital Conservation Buffer, Countercyclical Capital Buffer &amp; Surcharge on D-SIBs) (%)</b>	<b>15.22%</b>	<b>15.41%</b>
of which: Capital Conservation Buffer (%)	1.875%	1.875%
of which: Countercyclical Buffer (%)	N/A	N/A
of which: Capital Surcharge on D-SIBs (%)	1.00%	1.00%

## Market Discipline – Disclosure Requirements Under Pillar III

### TEMPLATE 03

#### Computation of Leverage Ratio

Item	Amount (LKR '000)	
	Bank	Group
	2018 (LKR'000) Basel III	2018 (LKR'000) Basel III
Tier 1 Capital	103,782,139	114,102,299
Total Exposures	1,246,065,348	1,299,297,812
On-Balance Sheet Items (excluding Derivatives and Securities Financing Transactions, but including Collateral)	1,084,920,160	1,137,597,126
Derivative Exposures	6,500,347	6,500,347
Securities Financing Transaction Exposures	17,133,040	17,688,539
Other Off-Balance Sheet Exposures	137,511,800	137,511,800
Basel III Leverage Ratio (%) (Tier 1/Total Exposure)	8.33%	8.78%

### TEMPLATE 04

#### Basel III Computation of Liquidity Coverage Ratio - All Currency

Item	Amount (LKR'000)			
	2018 - December		2017 - December	
	Total Un-weighted Value	Total weighted Value	Total Un-weighted Value	Total weighted Value
Total Stock of High-Quality Liquid Assets (HQLA)	96,361,469	90,942,189	114,870,080	111,415,311
Total Adjusted Level 1A Assets	68,437,312	68,437,312	102,603,924	102,603,924
Level 1 Assets	67,655,237	67,655,237	102,085,442	102,085,442
Total Adjusted Level 2A Assets	25,525,245	21,696,459	8,393,000	7,134,050
Level 2A Assets	25,525,245	21,696,459	8,393,000	7,134,050
Total Adjusted Level 2B Assets	3,180,987	1,590,493	4,391,638	2,195,819
Level 2B Assets	3,180,987	1,590,493	4,391,638	2,195,819
Total Cash Outflows	908,732,314	162,080,877	821,254,637	135,594,004
Deposits	556,729,752	55,672,975	549,003,929	54,900,393
Unsecured Wholesale Funding	196,929,536	75,437,532	145,289,624	55,172,692
Secured Funding Transactions	16,164,607	-	4,020,888	-
Undrawn Portion of Committed (Irrevocable) Facilities and Other Contingent Funding Obligations	123,422,711	15,484,662	122,940,196	14,651,873
Additional Requirements	15,485,708	15,485,708	-	10,869,046
Total Cash Inflows	141,188,930	74,512,931	92,294,506	45,972,734
Maturing Secured Lending Transactions Backed by Collateral	-	-	-	-
Committed Facilities	3,000,000	-	3,000,000	-
Other Inflows by Counterparty which are Maturing within 30 Days	121,107,448	65,262,112	80,997,232	42,086,367
Operational Deposits	1,861,454	-	936,154	-
Other Cash Inflows	15,220,029	9,250,819	7,361,120	3,886,367
Liquidity Coverage Ratio (%) (Stock of High Quality Liquid Assets/ Total Net Cash Outflows over the Next 30 Calendar Days) * 100		103.85%		124.32%

## TEMPLATE 05

### Main Features of Regulatory Capital Instruments

Description of the Capital Instrument	Stated Capital	Debtures - 2007	Debtures - 2006 Type E	Debtures - 2006 Type F	Debtures - 2011	Debtures - 2016	Debtures - 2016	Debtures - 2016	Foreign Borrowing
Issuer	HNB PLC	HNB PLC	HNB PLC	HNB PLC	HNB PLC	HNB PLC	HNB PLC	HNB PLC	German Development Financial Institution
Unique Identifier									
Governing Law(s) of the Instrument	Sri Lanka	Sri Lanka	Sri Lanka	Sri Lanka	Sri Lanka	Sri Lanka	Sri Lanka	Sri Lanka	German
Original Date of Issuance	N/A	August 1, 2007	April 1, 2006	April 1, 2006	September 5, 2011	March 28, 2016	November 1, 2016	November 1, 2016	June 12, 2012
Par Value of Instrument	N/A	LKR 100/-	LKR 100/-	LKR 100/-	LKR 100/-	LKR 100/-	LKR 100/-	LKR 100/-	N/A
Perpetual or Dated	Perpetual	Dated	Dated	Dated	Dated	Dated	Dated	Dated	Dated
Original Maturity Date, if Applicable									
Amount Recognised in Regulatory Capital (in LKR '000 as at the Reporting Date)	32,338,028	560,000	406,901	778,998	1,200,000	4,200,000	1,200,000	4,000,000	1,828,500
Accounting Classification (Equity/Liability)	Equity	Liability	Liability	Liability	Liability	Liability	Liability	Liability	Liability
Issuer Call subject to Prior Supervisory Approval	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Optional Call Date, Contingent Call Dates and Redemption Amount (LKR '000)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Subsequent Call Dates, if Applicable	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Coupons/Dividends	Dividends	Coupons	Coupons	Coupons	Coupons	Coupons	Coupons	Coupons	Coupons
Fixed or Floating Dividend/Coupon	N/A	Fixed	Fixed	Fixed	Fixed	Fixed	Fixed	Fixed	Floating
Coupon Rate and any Related Index	N/A	16.75%	11.00%	11.25%	11.50%	11.25%	11.75%	13.00%	6 Month LIBOR + 4.25% p.a.
Non-Cumulative or Cumulative									
Convertible or Non-Convertible	N/A	Non-Convertible	Non-Convertible	Non-Convertible	Non-Convertible	Non-Convertible	Non-Convertible	Non-Convertible	Non-Convertible
If Convertible, Conversion Trigger(s)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
If Convertible, Fully or Partially	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
If Convertible, Mandatory or Optional	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
If Convertible, Conversion Rate	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

## Market Discipline – Disclosure Requirements Under Pillar III

### TEMPLATE 06

#### Capital Planning Overview

- The Bank's balance sheet is projected based on the strategy of the Bank, macro-economic outlook and the expectation for business growth.
- Based on the projected balance sheet, future capital requirement would be assessed and the requirement for additional capital apart from the capital generated internally would be determined.
- Options for raising capital such as rights issues, debenture issues, divestment of capital inefficient investments would be evaluated.
- The most appropriate option would be recommended to the Board of Directors for approval and Board decision would be implemented in raising the required capital.
- Accordingly, for the current period, the Bank has identified the need for a Rs 10 Bn tier II capital requirement and the Bank is currently in the process of raising the said amount by way of a Basel III compliant, tier II, listed, rated, unsecured, redeemable debenture with a non-viability conversion feature.

### TEMPLATE 07

#### Credit Risk under Standardised Approach – Credit Risk Exposures and Credit Risk Mitigation (CRM) Effects

Item	Amount (LKR'000) as at December 31, 2018					
	Exposures before Credit Conversion Factor (CCF) and CRM		Exposures post CCF and CRM		RWA and RWA Density (%)	
	On-Balance Sheet Amount	Off-Balance Sheet Amount	On-Balance Sheet Amount	Off-Balance Sheet Amount	RWA	RWA Density
Claims on Central Government and CBSL	296,459,651	-	257,320,949	-	29,424,099	0.11
Claims on Foreign Sovereigns and their Central Banks	-	-	-	-	-	-
Claims on Public Sector Entities	-	-	-	-	-	-
Claims on Official Entities and Multilateral Development Banks	-	-	-	-	-	-
Claims on Banks Exposures	8,633,838	-	8,633,838	-	4,485,027	0.52
Claims on Financial Institutions	30,262,578	3,062,699	30,262,578	3,062,699	17,920,337	0.54
Claims on Corporates	297,507,991	391,388,659	291,226,545	122,372,400	395,574,611	0.96
Retail Claims	344,342,860	74,136,003	301,555,794	15,067,146	225,283,644	0.71
Claims Secured by Residential Property	40,016,605	-	40,016,605	-	26,099,016	0.65
Claims Secured by Commercial Real Estate	-	-	-	-	-	-
Non-Performing Assets (NPAs)	12,092,643	-	12,092,643	-	13,424,794	1.11
Higher-risk Categories	1,057,139	-	1,057,139	-	2,642,849	2.50
Cash Items and Other Assets	59,009,663	-	59,009,663	-	37,377,638	0.63
<b>Total</b>	<b>1,089,382,968</b>	<b>468,587,362</b>	<b>1,001,175,755</b>	<b>140,502,245</b>	<b>752,232,014</b>	



## TEMPLATE 08

### Credit Risk under Standardised Approach: Exposures by Asset Classes and Risk Weights

Description	Risk Weight	Amount (LKR'000) as at December 31, 2018 (Post CCF & CRM)								Total Credit Exposures Amount
		0%	20%	50%	60%	75%	100%	150%	>150%	
Claims on Central Government and Central Bank of Sri Lanka		110,200,453	147,120,495	-	-	-	-	-	-	257,320,949
Claims on Foreign Sovereigns and their Central Banks		-	-	-	-	-	-	-	-	-
Claims on Public Sector Entities		-	-	-	-	-	-	-	-	-
Claims on Official Entities and Multilateral Development Banks		-	-	-	-	-	-	-	-	-
Claims on Banks Exposures		-	5,124,812	97,923	-	-	3,411,103	-	-	8,633,838
Claims on Financial Institutions		-	3,559,307	25,114,989	-	-	4,650,981	-	-	33,325,277
Claims on Corporates		-	12,869,904	15,456,822	-	-	385,272,219	-	-	413,598,945
Retail Claims		-	-	-	111,925,571	116,556,914	70,709,739	-	-	299,192,224
Claims Secured by Gold		17,426,333	4,383	-	-	-	-	-	-	17,430,717
Claims Secured by Residential Property		-	-	27,835,178	-	-	12,181,427	-	-	40,016,605
Claims Secured by Commercial Real Estate		-	-	-	-	-	-	-	-	-
Non-Performing Assets (NPAs)		-	-	506,298	-	-	8,415,745	3,170,600	-	12,092,643
Higher-risk Categories		-	-	-	-	-	-	-	1,057,139	1,057,139
Cash Items and Other Assets		21,632,025	-	-	-	-	37,377,638	-	-	59,009,663
Total		-	-	-	-	-	-	-	-	1,141,678,000

## TEMPLATE 09

### Market Risk under Standardised Measurement Method

Item	Amount (LKR '000)
	As at December 31, 2018
(a) RWA for Interest Rate Risk	-
General Interest Rate Risk	-
(i) Net Long or Short Position	-
(ii) Horizontal Disallowance	-
(iii) Vertical Disallowance	-
(iv) Options	-
Specific Interest Rate Risk	-
(b) RWA for Equity	11,812
(i) General Equity Risk	6,239
(ii) Specific Equity Risk	5,573
(c) RWA for Foreign Exchange & Gold	106,796
Capital Charge for Market Risk [(a) + (b) + (c)] * CAR	921,224

## TEMPLATE 10

### Operational Risk under Basic Indicator Approach

Business Lines	Capital Charge Factor	Fixed Factor	Gross Income (LKR'000) as at December 31, 2018		
			1st Year	2nd Year	3rd Year
The Basic Indicator Approach	15%		43,114,218	49,769,056	60,830,747
Capital Charges for Operational Risk (LKR'000)					7,685,701
Risk Weighted Amount for Operational Risk (LKR'000)					59,694,765

## Market Discipline – Disclosure Requirements Under Pillar III

### TEMPLATE 11

#### Mapping of Financial Statement Categories with Regulatory Risk Categories – Bank Only

Item	Amount (LKR '000) as at December 31 ,2018				
	a	b	c	d	e
	Carrying Values as Reported in Published Financial Statements	Carrying Values under Scope of Regulatory Reporting	Subject to Credit Risk Framework	Subject to Market Risk Framework	Not subject to Capital Requirements or Subject to Deduction from Capital
<b>Assets</b>	<b>1,086,489,258</b>	<b>1,091,278,889</b>	<b>998,022,255</b>	<b>100,342</b>	<b>93,147,147</b>
Cash and Cash Equivalents	25,141,890	25,145,708	25,145,708	-	-
Balances with Central Banks	33,907,057	33,907,057	33,907,057	-	-
Placements with Banks	3,292,733	3,291,300	3,291,300	-	-
Reverse repurchase agreements	90,094	90,000	90,000	-	-
Derivative Financial Instruments	4,507,576	-	-	-	-
Financial assets at amortised cost - debt and other instruments/Financial investments - loans and receivables	160,145,680	158,882,465	158,882,465	-	-
Financial assets recognised through profit or loss - measured at fair value	100,342	100,342	-	100,342	-
Loans and Receivables to Banks	-	-	-	-	-
Financial assets at amortised cost - loans and advances to customers	749,048,820	761,593,269	673,386,056	-	88,207,213
Financial assets measured at fair value through other comprehensive income/Financial investments - available for sale	69,436,989	66,332,534	64,097,538	-	2,234,995
Investments in Subsidiaries	3,017,285	3,017,285	1,973,000	-	1,044,285
Investments in Joint Ventures	755,000	755,000	-	-	755,000
Property, Plant and Equipment	21,304,370	21,304,370	21,304,370	-	-
Investment Properties	325,818	325,818	325,818	-	-
Goodwill and Intangible Assets	905,653	905,653	-	-	905,653
Deferred Tax Assets	-	-	-	-	-
Other Assets	14,509,951	15,628,089	15,618,943	-	-
<b>Liabilities</b>	<b>970,735,286</b>	<b>973,477,125</b>	<b>-</b>	<b>-</b>	<b>-</b>
Due to Banks	77,492,582	76,961,138	-	-	-
Derivative Financial Instruments	2,519,172	-	-	-	-
Securities sold under repurchase agreements	16,678,946	16,663,102	-	-	-
Financial liabilities at amortised cost - due to depositors	799,975,357	781,942,560	-	-	-
Dividends payable	994,812	994,812	-	-	-
Financial liabilities at amortised cost - other borrowings	24,894,155	24,661,341	-	-	-
Debt Securities Issued	4,487,763	4,433,406	-	-	-
Current Tax Liabilities	9,184,814	9,010,693	-	-	-
Deferred Tax Liabilities	1,808,898	7,326,954	-	-	-
Other Provisions	3,559,925	3,601,867	-	-	-
Other Liabilities	6,908,911	26,424,104	-	-	-
Subordinated Term Debts	22,229,951	21,457,148	-	-	-
<b>Off-Balance Sheet Liabilities</b>	<b>763,214,236</b>	<b>763,214,236</b>	<b>-</b>	<b>-</b>	<b>-</b>
Guarantees	141,352,517	141,352,517	141,352,517	-	-
Performance Bonds	-	-	-	-	-
Letters of Credit	29,760,771	29,760,771	29,760,771	-	-
Other Contingent Items	164,549,238	164,549,238	164,549,238	-	-
Undrawn Loan Commitments	427,551,709	427,551,709	427,551,709	-	-
Other Commitments	-	-	-	-	-
<b>Shareholders' Equity</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
Equity Capital (Stated Capital)/Assigned Capital	32,338,026	32,002,073	-	-	-
of which Amount Eligible for CET1	-	-	-	-	-
of which Amount Eligible for AT1	-	-	-	-	-
Retained Earnings	15,728,513	19,648,717	-	-	-
Accumulated Other Comprehensive Income	-	-	-	-	-
Other Reserves	67,687,433	66,150,974	-	-	-
<b>Total Shareholders' Equity</b>	<b>115,753,972</b>	<b>117,801,764</b>	<b>-</b>	<b>-</b>	<b>-</b>

## TEMPLATE 12

### Explanation of Significant Differences between Accounting and Regulatory Exposure Amounts

#### (a) Derivative financial instruments

Derivatives are financial instruments which derive values in response to changes in interest rates, financial instrument prices, commodity prices, foreign exchange rates, credit risk and indices.

The fair value of these derivative financial instruments are determined using forward pricing models. The positive fair value changes of these financial instruments as at the balance sheet date are reported as assets while the negative fair value changes are reported as liabilities. The details of derivative financial instruments have been disclosed in Note 29 to the financial statements.

#### (b) Loans and advances to customers

The loans and advances to customers considered in regulatory reporting differs with the published financial statements since CBSL time based provisions were netted off when arriving at loans and receivables for regulatory reporting purposes, while impairment allowances based on expected losses have been netted off in loans and advances for publication purposes. The impairment allowance is based on the credit losses expected to arise by considering the change in the risk of default occurring over the remaining life of the financial instrument provision has been described in detail in Note 31(b) to the financial statements.

#### (c) Financial assets at amortised cost - debt and other instruments

The loans and receivables considered in regulatory reporting differs with the published financial statements since impairment allowances based on expected losses were netted off for publication purposes. The details of financial assets at amortised cost-debt disclosed in Note 32 to financial statements.

#### (d) Financial assets at fair value through OCI

Financial assets at fair value through OCI have been measured at fair value in published financial statements while these investments have been measured at cost for regulatory reporting purpose. The details of financial investments - available for sale have been disclosed in Note 33 to the financial statements.

## TEMPLATE 13: BANK RISK MANAGEMENT APPROACH

The Risk Report from pages 37 to 73 in CG&RR sets out the Bank's approach to risk management including governance structures, policies, processes, limits and the current risk profile of the Bank.

## TEMPLATE 14: RISK MANAGEMENT RELATED TO KEY RISK EXPOSURES

Risk	Compliance
<ul style="list-style-type: none"><li>Section I -Credit Risk</li></ul>	<ul style="list-style-type: none"><li>Refer Note 4 to the Financial Statements on pages 156 to 170 in IR</li></ul>
<ul style="list-style-type: none"><li>Section II Market Risk</li></ul>	<ul style="list-style-type: none"><li>Refer Note 4 to the Financial Statements on pages 174 to 175 in IR</li></ul>
<ul style="list-style-type: none"><li>Section II (a) IRR</li></ul>	<ul style="list-style-type: none"><li>Refer Pages 82 to 83 in CG&amp;RR</li></ul>
<ul style="list-style-type: none"><li>Section II (b) Equity Position Risk</li></ul>	<ul style="list-style-type: none"><li>Refer Page 83 in CG&amp;RR</li></ul>
<ul style="list-style-type: none"><li>Section II (c) Foreign Exchange Risk</li></ul>	<ul style="list-style-type: none"><li>Refer Page 84 in CG&amp;RR</li></ul>
<ul style="list-style-type: none"><li>Section III Liquidity Risk</li></ul>	
<ul style="list-style-type: none"><li>Section III (a)</li></ul>	<ul style="list-style-type: none"><li>Refer Page 85 in CG&amp;RR</li></ul>
<ul style="list-style-type: none"><li>Section III (b)</li></ul>	<ul style="list-style-type: none"><li>Refer Pages 86 to 87 in CG&amp;RR</li></ul>
<ul style="list-style-type: none"><li>Section III (c) &amp; (d)</li></ul>	<ul style="list-style-type: none"><li>Refer Pages 63 to 64 in CG&amp;RR</li><li>Refer Note 4 to the Financial Statements on pages 170 to 174 in IR</li></ul>
<ul style="list-style-type: none"><li>Operational Risk (IV)</li></ul>	<ul style="list-style-type: none"><li>Major Financial Losses incurred by Bank on page 53 in CG&amp;RR</li><li>Details of activities that have been outsourced together with parties and basis for payment for such services on page 55 in CG&amp;RR.</li><li>Details of due diligence tests of third party service providers on page 55 in CG&amp;RR.</li></ul>
<ul style="list-style-type: none"><li>Section (V) Interest Rate Risk in Banking Book (IRRBB)</li></ul>	<ul style="list-style-type: none"><li>Refer page 88 in CG&amp;RR</li></ul>

## Market Discipline – Disclosure Requirements Under Pillar III

### TEMPLATE 14 - SECTION II MARKET RISK - (A) INTEREST RATE RISK

#### Interest Rate Sensitivity Gap Analysis as at 31-Dec-2018-LKR

(Values are in Millions LKR)

			1M	3M	6M	1Y	3Y	5Y	>5Y
Rate Sensitive Assets	Inflows	Balances due from Head Office, Affiliates and Own Branches	0.00	0.00	0.00	0.00	0.00	0.00	3,772.29
		Bills of Exchange	765.18	2.34	0.00	0.00	0.00	0.00	0.00
		Cash on hand	21,685.20	0.00	0.00	0.00	0.00	0.00	0.00
		Deposits with CBSL	1,695.35	1,695.35	1,695.35	3,390.71	8,476.76	8,476.76	8,476.76
		Investments (Net of provisions)	1,175.00	24.87	17,145.81	17,935.11	29,511.47	5,786.62	5,672.94
		Loans and Advances	312,889.24	32,414.74	18,597.74	38,619.45	74,957.92	37,820.22	24,211.63
		NPLs	0.00	0.00	0.00	2,803.95	0.00	0.00	8,411.85
		Other Assets	380.34	1,008.63	189.02	1400.29	43.88	462.55	13,666.79
		Overdraft	69,015.58	8,058.55	5,489.93	8,312.09	8,098.52	8,045.85	8,013.90
		Accrued Interest	2,663.67	377.14	457.93	723.37	193.75	0.00	0.00
		Balances due from Other Banks	0.00	0.00	0.00	0.00	0.00	0.00	575.66
		Fixed Assets L1	0.00	0.00	0.00	0.00	0.00	0.00	22,658.14
			410,269.56	43,581.63	43,575.78	73,184.95	121,282.31	60,591.99	95,459.96
Rate Sensitive Liabilities	Outflows	Balances due to Other Banks	0.00	0.00	0.00	5,000.00	0.00	0.00	0.00
		Bills Payable	1,101.84	0.00	0.00	0.00	0.00	0.00	0.00
		Demand Deposits	8,144.85	8,144.85	6,108.63	8,144.84	0.52	0.52	10,181.40
		Interest Payable	2,750.53	4,990.51	4,289.79	3,631.35	1,154.88	473.11	779.03
		Other Liabilities	302.85	273.79	306.15	6,786.20	15,734.36	1,186.89	9,922.95
		Savings Deposits	12,508.60	27,490.49	8,513.12	11,339.47	42,566.45	42,565.60	42,565.60
		Time Deposits	48,945.95	115,509.35	90,174.26	123,812.97	8,056.68	6,650.99	0.19
		Bonds Issued	0.00	0.00	0.00	2,757.24	15,406.90	2,292.13	863.04
		Borrowings	312.75	218.50	252.71	678.15	2,319.48	1,211.55	265.43
		Capital & Reserves	0.00	0.00	0.00	0.00	0.00	0.00	119,621.58
		Repo	16,164.61	416.62	71.87	10.00	0.00	0.00	0.00
			90,231.98	157,044.11	109,716.54	162,160.22	85,239.27	54,380.78	184,199.21
Net Gap			320,037.58	(113,462.49)	(66,140.76)	(88,975.27)	36,043.04	6,211.21	(88,739.25)
Cumulative Gap			320,037.58	206,575.09	140,434.33	51,459.06	87,502.10	93,713.31	4,974.06
Rate Sensitive Assets total		(Excl- Cash on hand, Deposits with CBSL)	386,889.01	41,886.27	41,880.43	69,794.25	112,805.54	52,115.23	86,983.20
Rate Sensitive Liabilities total		(Excl- Demand Deposits, Capital)	82,087.14	148,899.27	103,607.90	154,015.38	85,238.75	54,380.26	54,396.23
Net Gap			304,801.87	(107,013.00)	(61,727.48)	(84,221.13)	27,566.79	(2,265.03)	32,586.97
Cumulative Gap			304,801.87	197,788.88	136,061.40	51,840.27	79,407.06	77,142.03	109,729.00

#### Notes

- 1) The above figures have been prepared as per SLAS including interest cash flows and may differ from SLFRS figures given in the Statement of Financial Position
- 2) Prepared as per requirement given in the Banking Act Direction No 7 of 2011 on "Integrated Risk Management Framework".

## Interest Rate Sensitivity Gap Analysis as at 31-Dec-2018-USD

(Values are in Thousands USD)

			1M	3M	6M	1Y	3Y	5Y	>5Y
Rate Sensitive Assets	Inflows	Bills of Exchange	3,800.34	4,563.41	465.15	0.00	0.00	0.00	0.00
		Cash on hand	4,457.93	0.00	0.00	0.00	0.00	0.00	0.00
		Investments (Net of provisions)	33,500.00	0.00	0.00	0.00	477,840.00	240,256.64	53,000.00
		Loans and Advances	282,723.23	119,738.08	28,373.31	7,084.97	12,992.75	1,087.04	0.00
		NPLs	0.00	0.00	0.00	4,700.03	0.00	0.00	14,100.09
		Other Assets	0.00	7,105.30	0.00	255.8	0.00	0.00	0.00
		Overdraft	8,700.32	561.11	509.05	1,174.34	1,361.84	1,361.71	1,362.24
		Accrued Interest	1,648.86	231.70	205.88	390.12	19.51	0.00	0.00
		Balances due from Other Banks	18,021.81	0.00	0.00	0.00	0.00	0.00	894.34
		352,852.49	132,199.59	29,553.39	13,605.26	492,214.11	242,705.39	69,356.66	
Rate Sensitive Liabilities	Outflows	Balances due to Other Banks	130,000.00	236,133.09	62,296.71	80,000.00	0.00	0.00	0.00
		Demand Deposits	4,719.52	4,719.53	3,539.63	4,719.47	138.16	138.15	5,991.49
		Interest Payable	768.97	2,493.13	2,611.94	1,491.09	1,923.70	568.94	0.00
		Other Liabilities	321.04	5,759.15	403.16	43,033.22	1,203.43	1,203.40	3,159.06
		Savings Deposits	13,018.75	13,019.73	9,759.92	13,000.21	48,800.56	48,799.59	48,799.59
		Time Deposits	38,819.35	127,543.67	139,900.78	120,897.04	14,140.19	24,933.08	0.00
		187,647.64	389,668.29	218,512.13	263,141.04	66,206.03	75,643.16	86,436.04	
Net Gap		165,204.85	-257,468.69	-188,958.74	-249,535.78	426,008.07	167,062.23	-17,079.38	
Cumulative Gap		165,204.85	-92,263.84	-281,222.58	-530,758.37	-104,750.29	62,311.93	45,232.55	
Rate Sensitive Assets total (Excl - Cash on Hand)			348,394.56	132,199.59	29,553.39	13,605.26	492,214.11	242,705.39	69,356.66
Rate Sensitive Liabilities total (Excl- Demand Deposit)			182,928.12	384,948.76	214,972.50	258,421.57	66,067.88	75,505.01	80,444.56
Net Gap			165,466.44	-252,749.16	-185,419.11	-244,816.30	426,146.23	167,200.38	-11,087.89
Cumulative Gap			165,466.44	-252,749.16	-185,419.11	-79,349.86	173,397.06	-18,218.73	-90,437.75

## TEMPLATE 14 - SECTION II MARKET RISK -(B) EQUITY POSITION RISK

(Values are in Thousands LKR 000')

Equity	Carrying Value	Fair Value	Realized Gains/Losses	Unrealized Gains/Losses	Capital Adequacy Calculation
Investment Portfolio	2,809,775	4,245,922	-	1,436,147	-
Trading Portfolio	176,405	99,056	1,640	(77,349)	Capital Charge - 11.8 Mn RWA increase - 91.2 Mn

## Market Discipline – Disclosure Requirements Under Pillar III

### TEMPLATE 14 - SECTION II MARKET RISK -(C) FOREIGN EXCHANGE RISK

#### Report on Liquidity Gap Summary as at 31st Dec 2018 (Consolidated Foreign Currency)

(Amount in Thousands USD)

		1M	3M	6M	1Y	3Y	5Y	>5Y
Total Inflows	Bills of Exchange	3,926.76	4,668.07	465.15	0.00	0.00	0.00	0.00
	Cash on hand	6,698.22	0.00	0.00	0.00	0.00	0.00	0.00
	Investments (Net of provisions)	35,910.71	0.00	1,723.60	3,536.59	491,982.38	250,530.89	64,519.36
	Loans and Advances	41,467.59	81,740.99	40,840.14	50,371.54	156,221.51	96,446.28	28,605.70
	NPLs	0.00	0.00	0.00	4,704.39	0.00	0.00	14,113.18
	Other Assets	0.00	1,782.96	0.00	0.00	0.00	0.00	4,723.35
	Other	0.00	0.00	5,840.17	11,682.09	0.00	0.00	0.00
	Overdraft	1,177.50	1,229.70	1,264.92	2,494.38	3,828.94	3,546.87	3,271.79
	Accrued Interest	1,668.90	231.97	216.86	390.12	19.51	0.00	0.00
	Balances due from Other Banks	18,066.25	0.00	0.00	0.00	0.00	0.00	2,027.89
	Forward Contracts	176,999.06	94,494.37	87,459.36	91,831.58	0.00	0.00	0.00
		285,914.98	184,148.05	137,810.19	165,010.69	652,052.34	350,524.04	117,261.26
Total Outflows	Balances due to Other Banks	31,338.79	50,099.11	9,598.33	221,066.10	179,718.08	38,874.87	12,678.19
	Demand Deposits	5,599.80	5,599.80	4,199.83	5,599.71	236.15	236.15	7,157.15
	Interest Payable	900.16	2,751.64	2,985.92	1,684.62	1,924.48	570.34	0.00
	Letters of Credit/ Guarantees/Acceptances	0.00	5,840.17	5,840.17	5,841.92	0.00	0.00	0.00
	Other Liabilities	327.15	575.99	424.27	42,906.95	1,226.30	1,226.27	3,167.41
	Savings Deposits	16,333.11	16,634.15	12,932.96	17,756.94	65,586.76	63,243.27	60,946.81
	Time Deposits	63,013.94	153,724.20	199,818.01	151,543.61	18,549.52	30,965.42	0.00
	Forward Contracts Payable	234,563.45	86,596.14	31,392.46	25,786.75	0.00	0.00	0.00
	352,076.40	321,821.20	267,191.95	472,186.60	267,241.28	135,116.32	83,949.56	
Net Liquidity Gap	(66,161.43)	(137,673.15)	(129,381.76)	(307,175.91)	384,811.06	215,407.72	33,311.70	
Net Gap as % of Total Outflows	(18.79)	(42.78)	(48.42)	(65.05)	143.99	159.42	39.68	
Cumulative Gap	(66,161.43)	(203,834.58)	(333,216.34)	(640,392.24)	(255,581.19)	(40,173.47)	(6,861.77)	

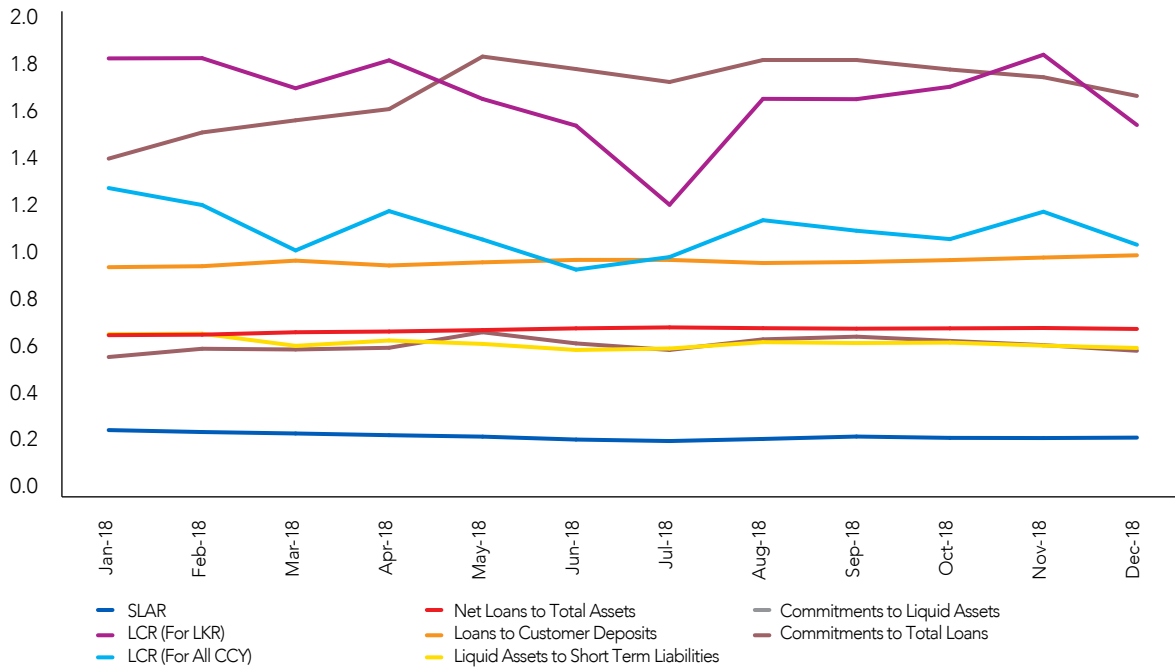
#### Notes

- 1) The above figures have been prepared as per SLAS including interest cash flows and may differ from SLFRS figures given in the Statement of Financial Position.
- 2) Prepared as per requirement given in the Banking Act Direction No 7 of 2011 on "Integrated Risk Management Framework".

**TEMPLATE 14 - SECTION III (A) LIQUIDITY RISK - KEY LIQUIDITY RATIOS**

**Key Liquidity Ratios**

Ratio	Jan-18	Feb-18	Mar-18	Apr-18	May-18	Jun-18	Jul-18	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18
SLAR	27.50%	26.70%	26.10%	25.40%	24.80%	23.60%	22.99%	23.85%	24.84%	24.29%	24.22%	24.40%
LCR (For LKR)	180.60%	180.70%	168.30%	179.80%	163.90%	152.90%	120.31%	163.94%	163.81%	168.92%	182.11%	153.16%
LCR (For All CCY)	127.20%	120.20%	101.50%	117.70%	106.00%	93.60%	98.77%	113.96%	109.61%	106.16%	117.44%	103.85%
Net Loans to Total Assets	66.60%	66.80%	67.80%	68.10%	68.70%	69.40%	69.80%	69.47%	69.27%	69.40%	69.55%	69.16%
Loans to Customer Deposits	94.60%	95.00%	97.30%	95.30%	96.60%	97.60%	97.60%	96.31%	96.72%	97.52%	98.57%	99.50%
Liquid Assets to Short Term Liabilities	67.00%	67.20%	62.20%	64.40%	63.00%	60.50%	61.10%	63.72%	63.36%	63.54%	62.30%	61.32%
Commitments to Liquid Assets	139.32%	150.09%	155.10%	159.71%	181.36%	176.22%	170.88%	179.94%	179.94%	176.02%	172.85%	165.14%
Commitments to Total Loans	57.60%	61.00%	60.70%	61.40%	67.80%	63.20%	60.50%	64.87%	65.98%	64.24%	62.50%	60.17%





## Market Discipline – Disclosure Requirements Under Pillar III

### TEMPLATE 14 - SECTION III (B) LIQUIDITY RISK - CURRENCY WISE

#### Report on Liquidity Gap Summary as at 31st Dec 2018 (LKR/ Behavioural)

(Amount in Million LKR)

	1M	3M	6M	1Y	3Y	5Y	>5Y
Total Inflows							
Balances due from Head Office, Affiliates and Own Branches	0.00	0.00	0.00	0.00	0.00	0.00	3,772.29
Bills of Exchange	765.18	2.41	0.00	0.00	0.00	0.00	0.00
Cash on hand	21,632.03	0.00	0.00	53.17	0.00	0.00	0.00
Deposits with CBSL	1,695.35	1,695.35	1,695.35	3,390.71	8,476.76	8,476.76	8,476.76
Investments (Net of provisions)	1,546.01	1,672.29	17,973.26	20,678.67	37,022.12	7,796.29	6,138.61
Loans and Advances	75,485.71	94,728.20	64,376.11	93,459.02	198,335.52	92,383.92	88,979.12
Other Assets	380.34	1,008.63	189.02	0.00	43.88	462.55	13,666.79
Other	0.00	0.00	654.56	1,309.32	0.00	0.00	0.81
Overdraft	9,968.39	11,235.91	12,329.03	23,784.04	43,108.86	35,367.01	27,791.64
Accrued Interest	2,663.67	377.14	457.93	723.37	193.75	0.00	0.00
Balances due from Other Banks	0.00	0.00	0.00	0.00	0.00	0.00	575.66
Fixed Assets L1	0.00	0.00	0.00	0.00	0.00	0.00	22,658.14
Forward Contracts	7,646.37	10,193.49	1,646.14	3,968.70	0.00	0.00	0.00
Reverse Repo	90.16	0.00	0.00	0.00	0.00	0.00	0.00
	121,873.21	120,913.43	99,321.40	147,366.99	287,180.90	144,486.54	172,059.82
Total Outflows							
Balances due to Other Banks	0.00	0.00	0.00	5,504.25	0.00	0.00	0.00
Bills Payable	1,101.84	0.00	0.00	0.00	0.00	0.00	0.00
Demand Deposits	8,144.85	8,144.85	6,108.63	8,144.84	0.52	0.52	10,181.40
Interest Payable	2,750.53	4,990.51	4,289.79	3,631.35	1,154.88	473.11	779.03
Letters of Credit/ Guarantees/Acceptances	0.00	654.56	654.56	654.76	0.00	0.00	0.00
Other Liabilities	302.85	273.79	306.15	5,385.91	15,734.36	1,186.89	9,922.95
Savings Deposits	13,199.01	13,744.67	11,148.97	15,815.58	57,421.77	53,157.37	48,977.35
Time Deposits	52,143.53	122,892.07	98,718.09	136,292.48	10,489.22	10,512.62	0.36
Bonds Issued	0.00	787.50	340.74	3,737.11	19,661.66	3,163.64	2,475.40
Borrowings	398.39	249.59	292.43	811.25	2,676.94	1,349.05	322.44
Capital & Reserves	0.00	0.00	0.00	0.00	0.00	0.00	119,621.58
Forward Contracts Payable	7,314.62	19,324.53	14,519.77	16,430.45	0.00	0.00	0.00
Repo	16,176.49	428.98	76.56	10.89	0.00	0.00	0.00
	101,532.10	171,491.05	136,455.71	196,418.87	107,139.35	69,843.20	192,280.52
Net Liquidity Gap	20,341.11	(50,577.62)	(37,134.31)	(49,051.88)	180,041.55	74,643.34	(20,220.70)
Net Gap as % of Total Outflows	20.03	(29.49)	(27.21)	(24.97)	168.04	106.87	(10.52)
Cumulative Gap	20,341.11	(30,236.50)	(67,370.81)	(116,422.69)	63,618.85	138,262.20	118,041.50
Adjustments for Behavioural Maturities							
Time Deposits	42,642.98	102,788.17	68,477.27	95,904.01	(143,221.77)	(72,763.04)	(81,666.53)
Unutilised O/D	(10,587.34)	(10,587.34)	(10,587.34)	(10,587.34)			
Undisbursed Loans	(3,182.09)	(3,182.09)	(3,182.09)	(3,182.09)	(5,303.49)		
Pawning Rollovers	(326.42)	(774.56)	(1,461.82)	(5,132.39)	7,695.18		
Total Adjustments	28,547.13	88,244.18	53,246.02	77,002.19	(140,830.07)	(72,763.04)	(81,666.53)
Adjusted Net Liquidity Gap	48,888.24	37,666.57	16,111.72	27,950.31	39,211.48	1,880.30	(101,887.23)
Adjusted Net Gap as % of Total Outflows	66.98	45.25	19.36	23.41	15.81	1.32	(37.19)
Adjusted Cumulative Gap	48,888.24	86,554.81	102,666.53	130,616.84	169,828.31	171,708.61	69,821.39

#### Notes

- 1) The above figures have been prepared as per SLAS including interest cash flows and may differ from SLFRS figures given in the Statement of Financial Position.
- 2) Prepared as per requirement given in the Banking Act Direction No 7 of 2011 on "Integrated Risk Management Framework".

## Report on Liquidity Gap Summary as at 31st Dec 2018 (USD/ Behavioural)

(Amount in Thousands USD)

		1M	3M	6M	1Y	3Y	5Y	>5Y
Total Inflows	Bills of Exchange	3,800.34	4,568.20	465.15	0.00	0.00	0.00	0.00
	Cash on hand	4,457.93	0.00	0.00	0.00	0.00	0.00	0.00
	Investments (Net of provisions)	35,910.71	0.00	1,723.60	3,536.59	491,982.41	250,530.91	64,159.00
	Loans and Advances	39,294.58	80,846.19	37,726.36	54,379.77	154,061.56	94,979.98	41,572.04
	Other Assets	0.00	1,782.96	0.00	0.00	0.00	0.00	0.00
	Other	0.00	0.00	4,386.64	8,774.59	0.00	0.00	0.00
	Overdraft	1,177.50	1,229.70	1,264.92	2,494.38	3,828.94	3,546.87	3,271.79
	Accrued Interest	1,648.86	231.70	205.88	390.12	19.51	0.00	0.00
	Balances due from Other Banks	18,066.25	0.00	0.00	0.00	0.00	0.00	894.34
	Forward Contracts	24,741.97	92,646.95	79,170.24	91,831.59	0.00	0.00	0.00
		129,098.13	181,305.69	124,942.78	161,407.03	649,892.42	349,057.75	109,897.17
Total Outflows	Balances due to Other Banks	31,338.79	50,099.12	9,598.33	221,066.11	179,718.09	38,874.88	12,678.19
	Demand Deposits	4,719.52	4,719.53	3,539.63	4,719.47	138.16	138.15	5,991.49
	Interest Payable	768.97	2,493.13	2,611.94	1,491.09	1,923.70	568.94	0.00
	Letters of Credit/ Guarantees/Acceptances	0.00	4,386.64	4,386.64	4,387.95	0.00	0.00	0.00
	Other Liabilities	321.04	437.58	408.00	42,798.18	1,203.43	1,203.40	11,008.53
	Savings Deposits	13,360.21	13,630.60	10,634.36	14,641.38	54,000.05	51,894.57	49,831.25
	Time Deposits	39,670.36	130,948.60	144,717.01	126,504.85	18,478.17	30,927.40	0.00
	Forward Contracts Payable	227,902.27	84,635.81	31,392.46	25,426.40	0.00	0.00	0.00
			318,081.18	291,350.99	207,288.37	441,035.43	255,461.59	123,607.35
Net Liquidity Gap		(188,983.05)	(110,045.30)	(82,345.59)	(279,628.40)	394,430.83	225,450.41	30,387.71
Net Gap as % of Total Outflows		(59.41)	(37.77)	(39.73)	(63.40)	154.40	182.39	38.22
Cumulative Gap		(188,983.05)	(299,028.35)	(381,373.93)	(661,002.33)	(266,571.50)	(41,121.10)	(10,733.38)
Adjustments for Behavioural Maturities	Time Deposits	28,843.01	108,037.09	110,252.91	80,475.94	(156,699.31)	(63,978.11)	(93,072.07)
	Unutilised O/D	(5,195.26)	(5,195.26)	(5,195.26)	(5,195.26)			
	Undisbursed Loans	(19,855.50)	(19,855.50)	(19,855.50)	(19,855.50)	(33,092.49)		
Total Adjustments		3,792.26	82,986.33	85,202.15	55,425.18	(189,791.80)	(63,978.11)	(93,072.07)
Adjusted Net Liquidity Gap		(185,190.79)	(27,058.97)	2,856.57	(224,203.22)	204,639.03	161,472.30	(62,684.36)
Adjusted Net Gap as % of Total Outflows		(58.92)	(12.99)	2.34	(58.14)	45.96	86.08	(36.32)
Adjusted Cumulative Gap		(185,190.79)	(212,249.76)	(209,393.19)	(433,596.41)	(228,957.38)	(67,485.08)	(130,169.44)

### Notes

- 1) The above figures have been prepared as per SLAS including interest cash flows and may differ from SLFRS figures given in the Statement of Financial Position.
- 2) Prepared as per requirement given in the Banking Act Direction No 7 of 2011 on "Integrated Risk Management Framework".

## Market Discipline – Disclosure Requirements Under Pillar III

### TEMPLATE 14 - SECTION (V) INTEREST RATE RISK IN THE BANKING BOOK (IRRBB)

#### Present Market Value of RSA/ RSL on Movement of Market Interest Rates - LKR

(Values are in Millions LKR)	1M	3M	6M	1Y	3Y	5Y	>5Y
Rate Sensitive Assets total	386,889	41,886	41,880	63,544	112,806	52,115	86,984
Rate Sensitive Liabilities total	82,087	148,899	103,608	147,765	85,239	54,380	142,016
Net Gap	304,802	(107,013)	(61,727)	(84,221)	27,567	(2,265)	(55,032)
Cumulative Gap	304,802	197,789	136,061	51,840	79,407	77,142	22,110
Duration weight	0	0	1	1	3	5	7
Market Rates	9%	9%	10%	10%	11%	11%	10%
Present Value at market rates	304,779	106,989	61,698	84,134	27,476	2,252	54,637
Present Value at market rates + 50 basis pt	304,652	106,855	61,544	83,716	27,069	2,197	52,764
Change in Market value for 50 basis point interest movement	(127)	133	154	418	(408)	55	1,873

#### Present Market Value of RSA/ RSL on Movement of Market Interest Rates - USD

(Values are in Thousands USD)	1M	3M	6M	1Y	3Y	5Y	>5Y
Rate Sensitive Assets total	348,395	126,877	29,553	-28,508	492,214	242,705	40,871
Rate Sensitive Liabilities total	182,928	379,626	214,973	216,308	66,068	75,505	51,959
Net Gap	165,466	-252,749	-185,419	-244,816	426,146	167,200	-11,088
Cumulative Gap	165,466	-252,749	-185,419	-244,816	426,146	167,200	-11,088
Duration weight	0	0	0	1	3	5	7
Market Rates	2%	2%	3%	3%	3%	3%	3%
Present Value at market rates	165,183	251,290	183,117	238,099	390,678	144,439	9,023
Present Value at market rates + 10 basis pt	165,170	251,229	183,028	237,867	389,542	143,739	8,962
Change in Market value for 10 basis point interest movement	(13)	61	89	231	(1,136)	(699)	61

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