Habib Bank AG Zurich

Habib Bank Zurich plc

Annual Report 2019


Canada
United Kingdom
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UAE
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Corporate Information

Board of Directors

Mr Muhammad H. Habib (Chairman)	Non-Executive Director
Mr Carey Leonard	Independent Non-Executive Director
Mr Gerald Arthur Gregory	Independent Non-Executive Director
Mr Anjum Iqbal	Non-Executive Director
Mr Rajat Garg	Non-Executive Director
Mr Satyajeet Roy (CEO)	Executive Director
Mr Masum Billah	COO / Executive Director

Board Committees

Risk Committee		Audit & Compliance Committee	
Mr Carey Leonard	Chairman	Mr Gerald Arthur Gregory	Chairman
Mr Gerald Arthur Gregory	Member	Mr Carey Leonard	Member
Mr Anjum Iqbal	Member	Mr Anjum Iqbal	Member
Mr Rajat Garg	Member	Mr Rajat Garg	Member

Management Committees

Executive Committee (EXCO)
Asset and Liability Committee (ALCO)
Audit, Risk and Compliance Committee (ARCC)
Country Credit Committee (CCC)
Operations and Technology Committee (OTCO)
Human Resources Committee (HRC)
Sirat Committee (SC)
Business Committee (BC)

Company Secretary

Taylor Wessing
5 New Street Square
London EC4A 3TW

Registered Office

Habib Bank Zurich plc
Habib House
42 Moorgate
London EC2R 6JJ

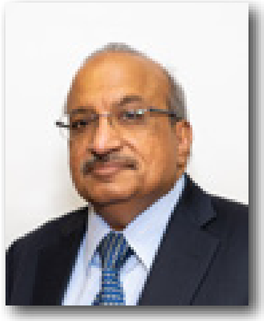
Auditors

KPMG LLP, Statutory Auditor
Chartered Accountants
15 Canada Square
London E14 5GL

Legal Advisors

Saleem Malik
40 Eagle Lane
Snaresbrook
London E11 1PF

Chairman's Message



On behalf of the Board of Directors of Habib Bank Zurich plc, I am pleased to introduce this year's Annual Report and Financial Statements.

By the Grace of God, the Bank continued to deliver sustainable growth in 2019. It recorded a profit after tax of £3.5 million, increased its customer deposits and customer lending by 10% and 8% respectively, and achieved a balance sheet growth of 7%. These results mark another year of good progress with continued profitability driven by a well-articulated strategy with a risk management focus, grounded in relationship management. The downward trend in the non-performing book was due to loan recoveries and also reflected a prudent approach to lending and robust underwriting standards. I find these results to be satisfactory given the heightened economic and political uncertainties the UK experienced due to its exit from the European Union.

The Bank also expanded its range of products and services with the introduction of Islamic Banking deposit products, increase in trade finance products, and membership of the Current Account Switch Service (CASS). These initiatives reflect our customers' expectations and diversification of our growth strategy.

During the past few weeks, the challenges faced by the UK economy and the financial services sector have grown. The COVID-19 crisis has surpassed the existing challenges of Brexit related uncertainty and the ongoing low base rate environment. Whilst the government and monetary authorities have reacted strongly with stimulus packages, it is clear that the effects will be strongly felt for some time to come. As we are only at the onset of this crisis, it is difficult to estimate the human and economic cost. Against this backdrop, our focus has been on being able to serve our customers, support official initiatives and put in place preventive measures to safeguard our colleagues and customers.

Our objective is to enable our customers, colleagues and communities to succeed, with a strategic focus on delivering sustainable growth for the Bank. In order to achieve our objectives and to meet the current unprecedented challenges, we will continue to support our customers through this difficult time.

The Board works closely with the CEO and the Executive Team to ensure that the Bank remains aligned with the business strategy, regulatory expectations and good practices. The Board takes comfort that the executive team works within a robust control framework, builds operational resilience, keeps customer's interest in view and ensures employee engagement.

The board composition is under regular review to ensure that it has the right balance of skills and experience which is paramount for good governance.

I would like to thank members of the Board for their guidance and support during the year, the Executive Team for their leadership and all employees for their hard work and dedication. Above all I would like to thank our customers for their loyalty and patronage.

Muhammad H. Habib
Chairman

CEO Statement

I begin this letter to you with humility and a sense of pride about our Bank and the employees. 2019 was yet another year of strong growth, in a period of uncertainty due to Brexit, US China tensions, HK protests including political upheaval in the UK. The Bank however capitalised on initiatives taken in recent years of good corporate governance, strong client engagement, efficient use of resources and responsible lending. This resulted in adding new business acquisition channels and enhanced customer experience, which was reflected through stronger balance sheet growth and higher operating revenues.

It is praiseworthy for how much we have accomplished, not only in terms of financial performance but in our steadfast dedication to help individuals, businesses and our community in the UK. In 2019, the Bank continued to accelerate investment in new products, services, technology and human capital – maintaining the commitment on providing better customer services through implementation of features such as Current Account Switch Service (CASS), Open Banking, improved Lending process, enhanced security on Debit cards and a fresh new look for our Branches.

Our values have been our moral compass which guide our working practices and all interactions. Trust, Integrity and Respect are the most valuable assets that we offer to our customers and thus we are blessed with long standing relationships.

Recent developments

The coronavirus outbreak has spread globally and turned into a pandemic impacting every business, in particular airlines, hotels, leisure, construction, those dependent upon supply chain and small businesses. The situation has now moved towards the demand which is bringing in a huge reduction in domestic products and de-growth. The Bank of England reacted by cutting interest rates by half a percentage point, from 0.75 per cent to 0.25 per cent and then to 0.1 per cent to combat the economic effect of coronavirus to help UK businesses manage through an economic shock. Other central banks have also taken similar measures to manage the growing uncertainty in financial and capital markets. As a responsible lender, we are also closely monitoring the situation through continuous dialogue with our customers to provide them necessary support and relief where needed. We have also taken the necessary measures to protect our employees who are the most valuable assets.

Financial overview

We accelerated the positive momentum that was gained in the past years by executing our strategy for driving sustainable growth and putting our vision of providing banking services with a personal approach. We achieved increased profitability through revenue growth of 8% from last year. The Bank witnessed an improved lending portfolio during the period, resulting in 9% increase in the performing portfolio as the non-performing book reduced by 31% during the year. Our customers deposit base continued to maintain its growth as seen in recent years. The deposit growth of 10% came from our existing client base, including newly launched Islamic Banking coupled with fixed rate Internet Deposit customers.

We continued to progress our sustainable business model through responsible and practical risk management strategy, effective liquidity and capital management and meeting the requirements of the changing regulatory environment.

Meeting customer expectations

Beyond the numbers, the Bank is constantly striving to keep the customer at the forefront of everything we do for Businesses and high net worth individuals. The Bank not only continued to provide a range of products and services to its target market but also introduced new lending channels. The launch of Islamic banking services under the brand name 'Sirat', caters to the needs of our target market while strengthening our group's core values and vision for future success.

Other business initiatives were taken up, such as the recent involvement in the Royal Bank of Scotland's Business Banking Switch scheme, offering their customers our lending products, and CASS allowed the Bank to increase its UK footprint without physical presence. During 2019 we revived our position as an active trade finance bank in the UK, by starting to capture the complete value chain of export. We continue to diversify our export trade portfolio with an added value product composition of discounting LCs from FIs across a broad geography e.g. Africa and China in addition to the South Asian Countries. We anticipate business to grow into larger value/higher volume of transactions – winning LCs for large corporates in the UK with a customer-centric proposition with efficient product delivery.

Our commitment to service is in our DNA and along with that we continued to build our expertise using a wide range of resources to enhance our skill set from leadership skills, credit lending training to regulatory workshops. This helps us to support and understand better our customers' needs. As part of our transformation we are using technology to improve our services and make it more efficient and reliable for our customers. The Bank has extended an extensive suite of its services onto a secure online platform without compromising its rigorous compliance and security standards. Ensuring that our customers have the flexibility to manage the majority of their day-to-day banking needs via online web banking remains fundamental to our strategy. We will continue to develop our offering by utilising technology to create excellent customer outcomes.

We believe that we have a role to play in helping to address the challenges relating to climate change and supporting the transition to a low-carbon economy. We aim to review our exposures on a geographical basis in respect of natural hazard risk, for example considering flood risk for properties that we have provided financing on. These reviews are designed to help us identify key areas of vulnerability to climate change, the associated impact on property portfolios and risks associated with climate change for our own buildings and branches and how this might change over time.

Way forward

The UK carried her complications and pressure on business relationships and trading markets due to Brexit uncertainty related to final outcome of trade talks with the European Union, which could go beyond December 2020. However, the threat of the coronavirus has masked the Brexit issues and posted a new unknown threat which could have a deep and long economic impact. Outside the UK, the Global economy is also going through a period of de-growth and deflation due to the impact of coronavirus.

We need to recognise that factors outside of our control will always play on our business model, portfolio and balance sheet, however, despite ongoing concerns and uncertainties, the Bank is committed to remain as a fighting unit, work for the best outcome of the SMEs within the risk appetite and have the right resources to meet the ever-changing requirements of a rapidly evolving new normal. We feel we have the requisite liquidity, capital and human resources to meet the economic challenges and contingency plans to encounter business continuity.

I am truly proud and inspired by the way our Bank has risen to this challenge – with flexibility, resilience, responsibility and a caring heart. My thoughts remain with the communities and individuals, including NHS and critical workers.

I am fortunate to have a strong management team and the employees who have maintained their commitment by making a difference every day to the customers and clients we are here to serve. Despite challenges, we are geared up with the determination to meet our goals in the future, hence delivering on our commitments to the shareholders and all stakeholders in 2020 and beyond.

Satyajeet Roy
Chief Executive Officer

Strategic Report

The Directors have the pleasure in presenting the Strategic Report for the year ended 31 December 2019 for Habib Bank Zurich plc (the "Bank"). The Strategic Report is a part of the Bank's Annual Report and Financial Statements. Habib Bank Zurich plc is the wholly owned UK incorporated subsidiary of Habib Bank AG Zurich, Switzerland.

Overview

The purpose of the Strategic Report is to outline the Bank's strategic objectives, business model, governance, significant developments and the Bank's financial position at the end of the reporting period which is useful to the stakeholders in assessing the performance and position of the Bank. This report includes a description of the principal risks and uncertainties associated with the Bank's business and an analysis of its overall business and financial performance using key performance indicators.

Principal activity

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

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

Services are mainly delivered through the branch managers, specialist lending relationship managers and personal bankers for deposit mobilisation. The customer takes comfort in continuity with a relationship manager and quick turnaround on their requests as well as continued access to the decision makers at the Bank.

The products offered by the Bank to its customers include retail banking, savings accounts and deposits, property lending, trade finance, notice accounts, Internet deposits, fixed term deposits, cash management and treasury services. Our latest offerings are a range of Islamic personal and business banking products under the brand name "Sirat".

We feel proud in creating long-term value for our customers, employees, suppliers, communities we serve and our shareholders. The Bank is covered by the Financial Services Compensation Scheme (FSCS).

Strategy and objectives

The Bank's strategy has been developed to place customers at the centre serving their banking needs. The Bank's core value is grounded in 'Service with security'. Our approach as a community Bank is to focus on delivering personalised services with security to a broad base of business and personal customers from our niche markets. This means listening to our customers and adapting our products and services to ensure we have the capabilities to support their evolving needs.

The Bank's primary customer base and target market are often family-owned and managed businesses from the South Asian Diaspora owned by SMEs' or high net worth individuals. These traditionally mercantile communities are known for their business and entrepreneurial traits. The key attribute of this segment is generational continuation and expansion of their business interests across generations. This is a substantial and growing segment, which provides an opportunity for the Bank to build a sustainable business model. The Bank also provides a range of trade finance services to help its customers finance their growth.

The Bank has geared up itself for sustainable growth through measures taken in the past few years. Continuous improvement in governance, risk management and controls over processing was considered as part of business as usual. The Bank relentlessly worked on strengthening its front-line resources to enhance customer experience increase in delivery channels such as Sirat, intermediary and Royal Bank of Scotland's Business Banking Switch and improved operational processes and systems for better turnaround times.

As part of our transformation we are using technology to improve our services and make it more efficient and reliable for our customers. The Bank has extended an extensive suite of its services onto a secure online platform without compromising its rigorous compliance and security standards. Ensuring that our customers have the flexibility to manage the majority of their day-to-day banking needs via mobile and online banking remains fundamental to our strategy. During 2019 the Bank also became part of the Current Account Switch Service (CASS). This allows stress-free way for customers, small businesses, charities and trusts to switch current accounts from one bank or building society to another. Backed by the Current Account Switch Guarantee, the Service aims to increase competition on the high street and support new banks in the current account marketplace.

Business model

The Bank's business model is built to deliver high quality service, and taking a long-term view on building customer relationships. The model is geared towards focusing on selected segments to deliver on their strategic objectives. The Bank's core value of 'Service with security' has led to a natural longevity in customer relationships, which are cross-generational and cross-border, strengthening the Bank's reputation as a businessman's bank. Owing to its history from the Indian subcontinent and based on the intrinsic value of the Bank as a family-owned conservative financial institution, customers identify the brand with security and trust.

The Bank offers product lines through a conveniently located network of eight branches in London, Manchester, Leicester and Birmingham. It also offers fixed term bonds accessible directly through the web-based channel. The Bank offers two main services; real estate finance and commercial banking services. The Bank also offers regular cash management, trade finance and retail banking in line with the customer needs. The Bank's product and service offering is comprised of buy-to-let finance, commercial loans, working capital finance, current accounts, savings accounts, notice accounts, fixed term deposits and treasury services.

The Bank has introduced an Islamic Banking Window branded as 'Sirat' aligned to the Bank's customer-centric approach and vision. 'Sirat' offers selected Shariah-compliant banking products to existing and new customers. Sirat offers Islamic personal and commercial banking products, managed by a dedicated Sirat team, which has a UK-wide mandate.

The Bank was successful in becoming a participant of the Royal Bank of Scotland's Business Banking Switch scheme during the year, which is another channel for establishing customer relationships for both lending and deposits. The Bank is seeing growing interest from potential customers particularly in the area of commercial lending.

Intermediaries continue to offer their customers our lending products and services, while we continue to maintain full control of customer relationships. This enables products to be offered through intermediaries comprising of commercial lending, residential and commercial buy-to-let and mixed use buy-to-let mortgages and are designed to be flexible and collaborative so that the Bank can adopt the most appropriate strategy for intermediaries and their customers.

The Bank became a member of CASS which provides easy ways for customers to switch their current account from one provider to another. Backed by the Current Account Switch Guarantee, it is aimed to increase competition in the high street and supports banks in the current account marketplace.

Business review

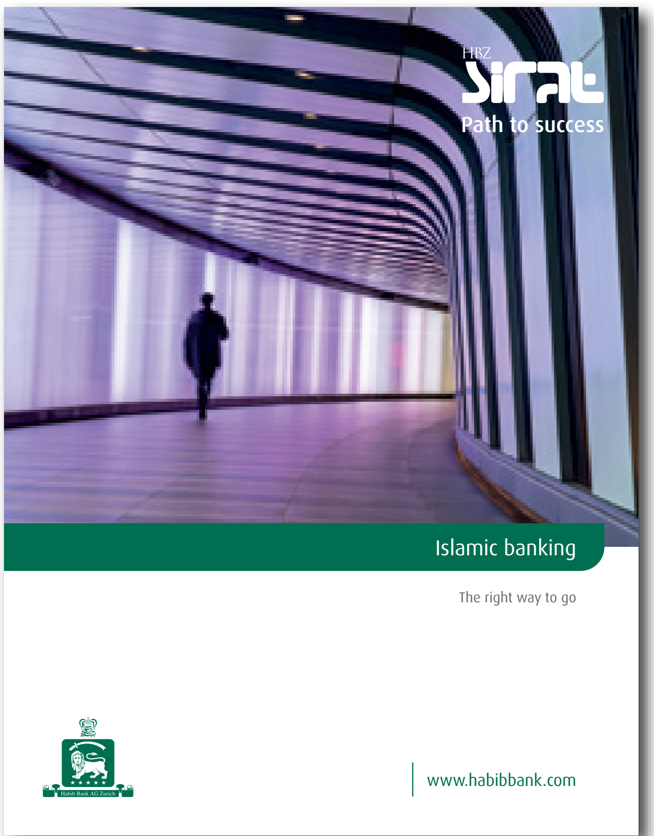
2019 was a year of relentless and profound progress for the Bank toward the overarching goal laid out in our long-term strategy. The Brexit process has already affected the UK economy. It has made some businesses and households more pessimistic about the central outlook. Despite the challenging external environment and Brexit uncertainties, the Bank delivered sustainable growth and successfully exceeded its profit targets set for the year 2019. The Bank will continue to monitor ongoing trade deal negotiations with the European Union (EU) as risks associated with a no deal scenario which might result in increased economic uncertainties. These risks are monitored at respective Board and Management Committee level.

Even though the unpredictable environment surrounding the UK economy, the Bank managed to disburse £80m fresh loans to new and existing customers. 50% of disbursements during the year were from new businesses and other on enhancements which display the Bank’s solid position and strength of its relationship team.

Expected credit losses decreased in 2019 as compared to 2018 as the quality of lending portfolio improved significantly due to fresh disbursements, settlement of legacy non-performing loans and movement of advances from Stage 2 to Stage 1.

We continue to progress our sustainable business model through practical risk management, effective liquidity and capital management and meeting the requirements of the changing regulatory environment.

2019 saw the launch of our Islamic Banking services under the brand name 'Sirat', which reflects our group's core values and vision for future success. At its start the Bank is only offering Sirat current account services which in 2020 will be followed by complete range of products including financing products. The Bank sees the introduction of Islamic Banking as a natural fit with Islamic financing solutions available for conventional real estate commercial and residential financing.



The Bank has adopted International Financial Reporting Standard IFRS 16 “Leases” effective 1 January 2019. Application of this standard has resulted in all operating leases related to rented branch premises onto our balance sheet as a finance lease.

During the year 2019 the Bank identified that certain payments from April 2016 to December 2018 will attract VAT reverse charge that include payments to Group companies against outsourcing / management charges and other offshore suppliers. The element of the VAT due under the reverse charge was accounted for in the financial statements by adjusting the Equity of relevant years and also restating the Profit & Loss and Balance Sheet of 2018. Further details can be found in Note 32.

Financial Review

The Bank's financial performance remained strong during the year 2019 despite Brexit related economic uncertainties. The net operating income of the Bank increased by 8% in 2019 (£19.61 million compared to £18.13 million in 2018). The increase was attributed by the addition of new loans, decrease in NPLs and gain on sale of certain investments during the year.

The Bank earned a net profit after taxation of £3.48 million in 2019 (2018: £3.37 million)

The financial highlights for 2019 are provided below:

Profit and Loss Analysis

	2019 (£000)	2018* (£000) Restated
Operating Profit		
Net interest income	17,395	16,248
Net fee and Commission income	1,310	1,276
Net other income	908	606
Net operating income	**19,613**	**18,130**
Total operating expenses	(16,176)	(14,959)
Operating profit before impairment losses on loans and advances and tax expenses	**3,437**	**3,171**
Reversal of credit impairment losses on loans and advances	303	926
Profit before tax	**3,740**	**4,097**
Taxation	(256)	(731)
Profit after Tax	**3,484**	**3,366**

* The Financial Statements for the year 2018 were restated to account for the prior year's adjustment (Note 32)

Total interest income of £17.40 million (2018: £16.25 million) consists of the interest received from loans, return from investment portfolio and interest on placement with banks. The financial markets in 2019 were challenging, with continuing margin pressure. Nevertheless, the business continued to deliver solid growth in balances. The 7% increase in net interest income during 2019 was driven by disbursement of new loans of £80 million, increased size of performing loans and investing funds in better avenues.

Operating expenditure mainly represents staff and other operating expenses incurred during the year for the Bank's operations. Total Operating expenses of £16.18 million include total staff costs of £10.12 million and other operating costs £6.06 million. Group direct costs paid by the Bank during 2019 are also included in operating expenses. Overall, there was an 8% increase in operating expenditure for the year 2019 as compared to 2018. This is mainly due to increase in staff costs as a result of an increase in number of employees and increments for the year.

Balance sheet analysis

	2019 (£ 000')	2018* Restated (£ 000')
Assets		
Loans and advances to customers	430,736	398,977
Balances with banks	157,262	125,741
Financial investments	84,586	103,385
Other	11,195	7,802
Total Assets	**683,779**	**635,905**
Liabilities and Equity		
Due to customers	577,013	523,493
Due to Banks	6,722	17,399
Subordinated liabilities	20,098	20,104
Tier 1 Capital / Equity	71,474	69,651
Other	8,472	5,258
Total Liabilities and Equity	**683,779**	**635,905**

* The Financial Statements for the year 2018 were restated to account for the prior year's adjustment (Note 32)

The considerable growth in the balance sheet is evident of the Bank's continued progress towards its strategic objectives. Loans and advances to customers increased by 8% to £430.74 million reflecting prominent growth in lending despite the economic uncertainties seen in 2019 related to Brexit. The net increase in customer lending was £31.8 million in 2019 compared to £18.6 million in 2018 demonstrating the Bank's notable performance in the reduction of non-contractual settlements and in retaining the customers despite the uncertain economic environment.

Total Investment decreased by 18% due to sale of certain financial investment to keep the balance sheet more liquid to meet any funds outflow in the event UK had left the EU in a disorderly manner. The Bank also kept additional liquidity in a Reserve Account with Bank of England.

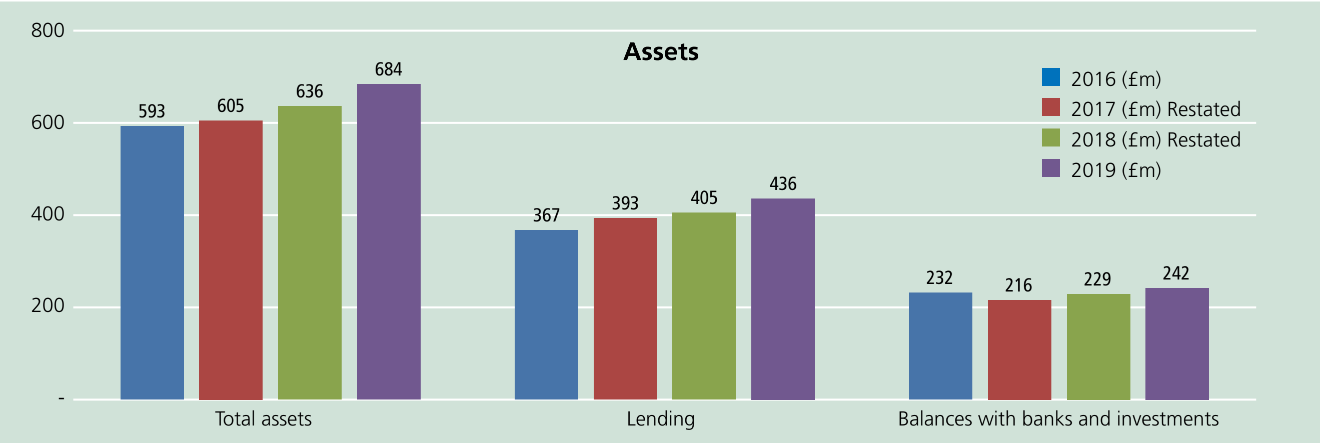
The Bank made concerted efforts during the years to increase its trade finance business through expansion and strengthening of correspondent banking relationship with FIs, establishing account relationship with the beneficiaries and focusing on business growth through larger value/higher volume of transactions.

Customer deposits depicted a growth of 10% as compared to 2018 due to a well-managed liability strategy and the introduction of new products such as interest-bearing current account and Sirat current account. Internet deposits continues to remain a key part of Bank's overall liability strategy, which also serves as a source of Bank's branding to a wider population.

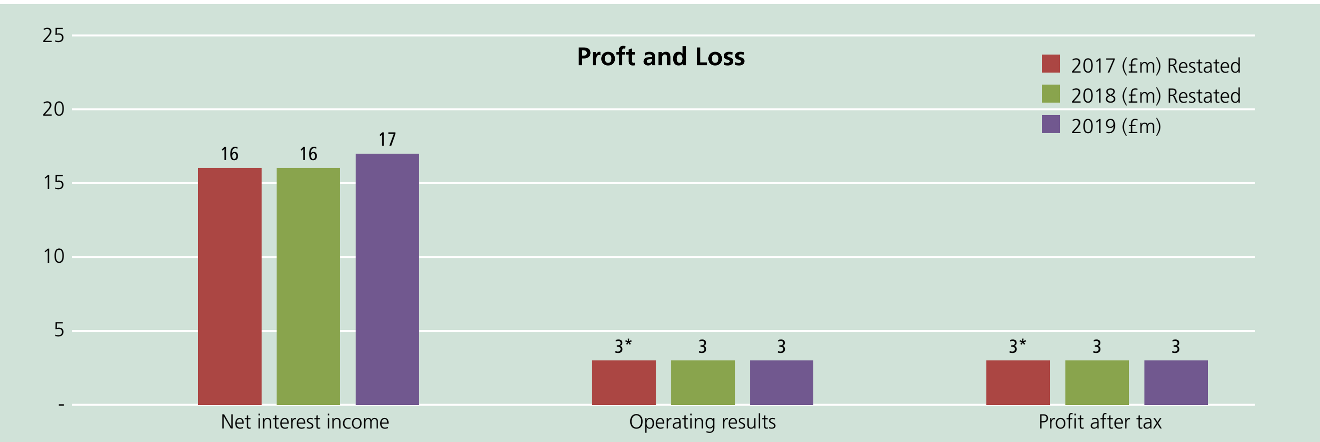
The Bank continues to monitor various models which are being used in the calculation of Expected credit losses (ECL) as required by IFRS 9. No changes were made in the models during the year as they were considered to be appropriate except for refreshing of macroeconomic variables to take into account changes in forward looking economic conditions in the variables used by the Bank.

The following charts provide the key financial highlights of the Bank.

Assets and liabilities



Profit and loss



* 2017 results exclude receipt of insurance claim

Capital structure

The Bank has a strong capital base with net equity of £71 million (2018: £70 million) and a five-year subordinated loan of £20 million (2018: £20 million) to support long-term asset growth and cover risks inherent to the business. Such strength in capital allows the Bank to deploy funds in areas that provide sustainable returns in line with the set objectives.

The regulatory capital base differs slightly from the amount reported above due to the different treatment of certain reserves. The Bank's regulatory capital and risk-weighted assets are summarised below:

		£ in million
Description	2019	2018
Share capital – Tier 1	60.00	60.00
Retained earnings – Tier 1	11.23	9.68
Subordinated loan – Tier 2	20.43	20.35
Risk-weighted assets	442.49	387.18

The Bank's total capital requirement (TCR) is calculated as follows:

		£ in million
	2019	2018
Risk weighted assets (£ million)	442.49	387.18
Total capital requirement – TCR (£ million)	61.15	53.51
Capital		
Share capital – Tier 1 (£ million)	60.00	60.00
Retained earnings	11.23	9.68
Subordinated liabilities – Tier 2 (£ million)	20.43	20.35
	91.66	90.03
Excess capital over requirement (£ million)	**30.51**	**36.52**

The capital adequacy ratio as of 31 December 2019 was 19.93% (2018: 23.30%), which was in surplus of the regulatory requirements and internal management buffer. The Bank has already performed various stress tests in its Individual Capital Adequacy Assessment Process (ICAAP) and find the capital quite adequate to meet unforeseen shocks. The Bank also believes that the current strength of its capital would mitigate the current stress of the Coronavirus outbreak.

Other key regulatory ratios

The Bank maintained sufficient high-quality liquid assets ("HQLA") against the net cash outflows over a 30-day horizon on a daily basis. The Bank maintains its liquidity coverage ratio ("LCR") above the regulatory threshold at all times as set out by the Prudential Regulation Authority ("PRA"). The Bank maintained LCR of 160% as at 31 December 2019 (2018: 198%) as compared to a 100% regulatory threshold. Reduction in LCR was mainly due to shuffle in investment portfolio from HQLA to Non-HQLA with high investment grade credit rating and placement of funds into the tenure beyond 30 days in order to improve the overall return on investment and Due from banks portfolio while maintaining enough liquidity.

The Bank continues to monitor its liquidity position by taking into consideration any impact of large outflows due to Coronavirus. Keeping in view strong liquidity position and vigorous monitoring process, the Bank believes that it will be able to meet any plausible stress on its liquidity due to the Coronavirus outbreak.

The Bank's leverage ratio as of 31 December 2019 was 9.49% (2018: 10.10%) as against the regulatory threshold of 3%.

Customer related contingent liabilities largely comprise trade finance business including letters of credit and guarantees and undrawn commitments.

Key performance Indicators (“KPIs”)

The Bank uses a broad range of financial and non-financial measures to evaluate the performance and trends against the strategic objectives. To assess our performance, we use a number of sources including regular management reporting of our key metrics; as well as a newly implemented balanced scorecard to look at the business from customer, commercial, colleague and control aspects for continuous improvement. The process allows the branch managers to self-evaluate their performance against given targets and the management to keep an oversight on business performance against targets.

We consider a range of metrics across all stakeholder groups and continuously assess whether new measures should be added or removed from our dashboards, in order to ensure these remains relevant and appropriate to our strategy.

Keeping in view the Bank’s business activities capital adequacy, liquidity monitoring and operations and technology risks including cyber risk have been considered more important by the Directors than to other risks.

Capital adequacy measures the Bank’s capital strength, expressed as a ratio of total capital to risk-weighted assets. By having a mix of high-quality assets and capital free of deductions, the Bank maintained a capital adequacy ratio above the required regulatory requirement. The available capital resources of £90.18 million are considered sufficient with a view to support the business over a five-year period, which is demonstrated through the individual capital adequacy and assessment process (“ICAAP”).

The ICAAP document summarises and demonstrates to the Board and to senior management that the Bank has adequate financial and capital resources to support its business and the risks attached to its business plan and model. The ICAAP also demonstrates the adequacy of non-financial resources (in the form of people, systems, policies and procedures) to manage the adequacy of these financial resources on an ongoing basis.

The ICAAP document also summarises the results of the Board’s assessment of the amounts, types and distribution of capital that it considers adequate to cover the level and nature of the risks to which the Bank is or might be exposed based on five-year financial projections.

The Assets Liabilities Committee (“ALCO”) performs a detailed assessment of the assumptions and overall conclusions of the ICAAP on an annual basis in order to confirm that they remain essentially valid. The Executive Committee (“EXCO”) reviews the ICAAP document to ensure that it’s aligned with the overall business strategy and takes into account emerging risks owing to changing market conditions. Following this, the Board Risk Committee

("BRC") considers the ICAAP, challenges the appropriateness of the assumptions used and the resulting capital requirements and capital adequacy. The Board is ultimately responsible for the Bank's capital arrangements.

The Bank maintains a liquid balance sheet in the form of HQLA and non HQLA assets and placements with banks with a tenor of up to 12 months. The customer deposit base is sticky and stable with a mix of relationship-based retail depositors and business owners. Fixed rate bonds act as a source of well diversified deposit base, which continues when priced in line with market offering. The Bank's liquidity risk is managed by the Treasury function with oversight from ALCO and BRC.

An assessment of liquidity needs, known as the internal liquidity adequacy assessment process ("ILAAP"), is undertaken at least annually and is presented to ALCO, EXCO and the Board Risk Committee for review, challenge and approval by the Board of Directors. The ILAAP describes how liquidity risks are assessed, controlled, monitored, mitigated and reported and helps management to determine what might be required to maintain liquidity assuming certain stressed conditions. In addition, reverse stress testing is also performed at least annually.

Operation and technology risks have emerged as a major risk for the banking sector in the past few years on the risk matrix. This refers to the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. To mitigate the risk, the Bank has put in place a robust risk event reporting process alongside self-assessment of an internal control system ("ICS") and risk control self-assessment ("RCSA") process. The Operations and Technology Committee ("OTCO") is responsible for monitoring of the risk with oversight from BRC. All operational risk events are analysed in detail in OTCO with appropriate controls measures put in place through root cause analysis. The operational risk profile of the Bank remains stable.

The Bank's core banking system is managed by the Parent Bank under a defined service level agreement ("SLA"). The Parent Bank has made substantial investments in IT infrastructure, cyber control and process improvement given the significant emphasis on the pace of evolution in the industry and continued exposure to the risk of cyber crime.

LIBOR change

The London Interbank Offered Rate (LIBOR) is the reference interest rate for tens of millions of contracts, ranging from complex derivatives to residential mortgages. LIBOR is also hardwired into all manner of financial activity, such as risk, valuation, performance modelling and commercial contracts. The UK's Financial Conduct Authority (FCA) announced in 2017 that it no longer intends to support the LIBOR benchmark interest rate from 2021 onwards. Alternative reference rates are therefore currently being discussed around the world.

The Bank participated in a group-wide Change Risk Assessment (CRA performed in autumn 2018) to assess the potential risks related to LIBOR replacement faced by the Bank. As an outcome of such assessment certain action items were identified, which included fact-finding exercise to determine the facts on the ground, e.g. which products are LIBOR based, what is the number / volume of products with maturities > 2021. As an outcome of the exercise it was concluded that the Bank will not have any significant impact on its risk profile or product.

The Bank's main lending products are priced out of its own HBZ Base Rate, which is not linked to LIBOR. Similarly, customer deposits are fixed rate products. Only few debt securities, which the Bank holds in its investment portfolio will mature beyond 2021, which does not have any impact as the Bank will only be required to put in place a process to verify accuracy of income received on such investment. Trade finance products, which constitute a very small proportion of Bank's revenue are priced using LIBOR. The Bank is currently working with the group to put in place a mechanism for using alternate reference rates for pricing trade finance products, which will be available well in time before LIBOR transition.

The Bank transacts derivatives to hedge its own foreign exchange rate risk and that of its customers. As per the current practice being followed by the Bank, the LIBOR is not connected in FX swap and hedge transactions. The LIBOR / IBOR transformation risk is considered immaterial.

Principal risks and mitigation plan

The management of risk is a critical underpinning to the execution of the Banks strategy. The Bank's risk appetite is set by the Board of Directors and takes into account the Bank's Strategic Intent. The executive management of the Bank is responsible for implementation of the risk appetite throughout the Bank's operations and business. The Board Risk Committee (BRC) maintains oversight of the business performance against the risk appetite. The material risks and uncertainties the Bank faces across its business and portfolios are key areas of management focus.

The Bank's approach to Risk Management is built on the principle of low to medium risk appetite and investment return horizon, which is medium to long term. In order to achieve this, the Bank's business strategy is built on:

- A clearly defined target market (selected customer and industry segments).
- Relationship-based banking service.
- Comprehensive governance and control framework.

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

- Governance at the Board and Management level.
- Risk oversight.
- Risk management controls.
- The Bank's risk management strategy and risk appetite are aligned with its motto 'Service with security', core values and strategic intent of delivering sustainable growth.

The Bank's risk appetite is articulated in the Risk Appetite Statements set by the Board of Directors. The Bank takes a conservative view on the inherent risks and has zero tolerance for financial crime, compliance and regulatory risks. All risk types are measured and monitored through identification, measurement, mitigation and escalation processes from management to the Board level.

The table below highlights the key risks that the Bank is exposed to and provides details of the measures taken to mitigate these risks.

Risk type	Tolerance and mitigation
Credit risk	The Bank's mitigation of credit risk is based on a combination of focused strategy, defined target market, secured lending and quality of underwriting, ongoing monitoring and pre-set thresholds for single part exposure, industry concentration and type of collateral. The Bank has a well-defined and articulated credit risk management framework ("CRMF"), which comprises its credit risk appetite, credit policies, terms of reference of management and board level committees, target market analysis, collateral management, credit monitoring and other credit related policies. The Board Risk Committee ("BRC") has oversight responsibilities of the CRMF. The Country Credit Committee ("CCC") and Board Risk Committee review and approve credit exposures based on delegated authorities. The Bank has put in place detailed policies and guidance for the business and credit team to deal with impact of IFRS 9. Regular monitoring of credit portfolio is carried out by the analytics team which provides early warnings to the business team where customers start to show irregular repayments. Regular interaction between customers and relationship managers also helps in identifying any issues which might lead to significant increase in credit risk. Indicators if any, identified are closely monitored through a well-established watchlist process in place.
Concentration risk	The Bank has clearly articulated its risk appetite with respect to concentration risk. This is determined by taking into consideration concentration risk arising from single name, industry, product and geographical concentration. Concentration risk is discussed and managed at CCC, ALCO and BRC level. The Bank has put in place strong underwriting standards, portfolio monitoring process and early warning triggers to manage this risk.
Operational risk	The Bank manages operational risk through articulated risk appetite and ongoing monitoring with oversight at management and board level committees. The Bank has a fully operational risk assurance function, which monitors various operational risks. The Bank sets various tolerance trigger points in accordance with regulation and guidance from the UK Financial Conduct Authority ("FCA") and Prudential Regulation Authority ("PRA"). In the event of these tolerances being breached, reporting to the Operations and Technology Committee ("OTCO") is made. OTCO reviews the breaches and considers whether further escalation to Audit, Risk and Compliance Committee ("ARCC") and Executive Committee is required. Reporting is made together with confirmation of remediation plans.
Financial crime risk	The Bank has in place a robust anti-money laundering ("AML") governance process supported by three lines of defence. The Board Audit and Compliance Committee is primarily responsible for oversight of financial crime risk supported by the Executive Committee of the Bank. A compliance dashboard, which incorporates risk events and regulatory updates, is reviewed and reported to the committees for oversight. The Bank has a zero tolerance for financial crime and is vigilant to identify, report and take appropriate action to mitigate the inherent risk associated with financial crime. Risk identification and mitigation is undertaken through risk assessment, effective implementation of customers due diligence requirements and ongoing account and transaction monitoring process. The Bank has comprehensive AML policies and procedures in place, which are reviewed and updated regularly. The Bank provides continuous training to its staff in the areas of AML and compliance.

Risk type	Tolerance and mitigation
Conduct risk	The Bank is a service-orientated institution and therefore managing customer outcomes is central to the Bank's philosophy, business strategy and operations. The Bank has in place robust controls, adequate skill sets and appropriate decision- making arrangements to deliver its objectives of understanding customer needs, ensuring fair treatment and pro-actively preventing poor outcomes for its customers. The Bank has an articulated conduct risk appetite, which is driven by best customer outcome. The Audit, Risk and Compliance Committee and Board Audit and Compliance Committee monitor business performance against the risk appetite at management and board level respectively. The Bank has implemented the requirements under a senior managers and Certification Regime, assigning prescribed responsibilities and application of certification and conduct regime requirements. The Bank arranged adequate training for its employees, including senior management and members of the board, to ensure awareness and assist in implementing the requirements. Staff members meeting the certification requirements are identified through a robust process and undergo relevant training on an ongoing basis.
Capital risk	The Bank's capital structure has been built up to support the business over a long-term horizon and meet regulatory requirements. These include capital resources to cover Pillar 1, Pillar 2, Capital Requirement Directives ("CRD") Buffers and PRA Buffer. The Bank also maintains internal capital buffers over and above the minimum regulatory capital requirement. ALCO and Executive Committee monitor adequacy of capital with oversight from the Board Risk Committee.
Liquidity and funding risk	The Bank manages the maturities of its assets and liabilities and its cash flows on a daily basis. The Bank maintains substantial liquidity in a Bank of England Reserve account, high quality liquid assets and in short-term deposits. The Bank has early warning indicators in place, which are monitored at operational and management committee levels. The Bank's customer deposit base is stable and considered sticky based on long-term relationships. The Bank's depositor base mainly comprises relationship-based retail and SME deposits. The Bank also offers 6 and 12 months fixed-rate web-based deposits, which are mainly a rate-driven source of funding.
Interest rate risk	Interest rate risk at the Bank is well managed and contained under oversight from ALCO and BRC. The Bank has no significant or complex long-term interest rate positions. The Bank is part of a group-wide implementation plan to further strengthen and more effectively monitor interest rate risk in the banking book ("IRRBB"), which will be completed during 2019.
Cyber risk	The Bank recognises risk associated with cyber threats and is constantly taking proactive measures to strengthen its operating environment to provide a secure banking experience to internal as well as external stakeholders. The Bank takes risks associated with cyber security extremely seriously and is constantly engaged in not only improving and strengthening its transactional gateways but also its internal operating environment.
Foreign exchange risk	As the Bank does not maintain a trading book, it has minimal foreign exchange exposure risk. The foreign exchange exposures are managed by the treasury front office with defined levels of maximum allowable net open position in a single currency.

Emerging risks

Together with a strong governance process, the BRC receives regular information in respect of the risk profile of the Bank. Information received includes measures of risk profile against risk appetite as well as identification of new and emerging risks. We believe that our structure and governance supports us in managing risk in the changing economic, political and market environments.

The Bank considers the following as emerging risks:

Risk type	Tolerance and mitigation
Impact of Coronavirus (COVID-19)	Coronavirus has become a real threat to the global economy as it has been declared as a pandemic by the World Health Organisation (WHO). Like other governments, the UK has also taken serious steps to prohibit the gathering of large groups of people or otherwise advised against large congregations of people in an attempt to minimise the spread of the Coronavirus. These steps include closures of theatres, restaurants, cafes and other places of social gathering, which is likely to continue for months. All these will have a serious impact on all businesses across the country, the impact of which is very difficult to assess. The UK government has announced various unprecedented relief measures for individuals and businesses who are impacted by COVID-19. These include direct cash relief for small and medium size businesses, payment of salary for employees in private sector, low cost funding for businesses and protection for tenants of private landlords. These measures have been taken to keep the economy going till such time the impact of COVID-19 has subsided. The Bank is continuously monitoring the impact of COVID-19. It has formed a crises management team comprising of senior management staff to monitor and address various challenges, which have been broadly categorised in the areas of: • Human resources, to ensure employees around their well-being and address any of their concerns • Prevention measures, by informing employees and customers for taking steps to protect themselves by following Government advice • Contingency measures, for operational continuity by invoking business continuity plans and making additional arrangements to ensure minimum disruption to services • Business and financial impact of COVID-19 on the Bank's overall performance Daily meetings are held to discuss the areas of concern posed by the pandemic and measures to be put in place to mitigate any impact to the greatest extent possible. The Bank has also been following Government advice by implementing measures such as work from home for its employees, sending communications to customers keeping them informed of measures taken by the Bank. To ensure the Bank has the ability of meeting any stress on its liquidity, additional funds are being kept in Reserve Account with the Bank of England and with the clearing bank. The Bank is also taking steps to play its role by having continuous discussions with customers who are affected by the impact of COVID-19 due to supply chain issues, rental income from tenants, or loss of business. Such measures will also take into account relief measures provided by the Government for the SME sector such as Term Lending for SME scheme (TFSME) or mortgage holiday period for borrowers.

	The executive management team will continue to monitor the situation to assess potential risks to its customers, employees and suppliers to manage the impact in line with the Government guidance. The Bank is in the process of reviewing the impact of COVID-19 on credit portfolios and operations to help maintain continued business resilience.
Impact of no trade between EU and UK	The Bank's business is mainly concentrated in the UK with no presence in the EU. In case of no deal at the end of transition period the possible outcome could be a prolonged period of uncertainty, unstable economic conditions and market volatility, including fluctuations in interest rates and foreign exchange rates. As the Bank operates in the UK, the core risk is considered a deterioration in the UK economy that could impact the Bank's business in the form of less lending opportunities as investors will be cautious to make investments in the UK, margin compression due to competition among banks and an increase in operating cost due to higher inflation. Management prudently monitors the developments and their potential impact on Bank's overall performance and risks in various committees including ALCO, BRC and the Board.
Climate change	Climate Change is a much-discussed topic in recent times at a global level. Risks highlighted by scientific research and changes in natural phenomenon have played a significant role is attracting focus at governmental level across the globe. Various initiatives have been introduced in the UK including legislation and regulatory requirements. As per the regulatory guidance the two risk factors, that drive financials risks from climate change are Physical Risk and Transition Risk. Banks are expected to have an implementation plan which includes: **Governance** – embed the consideration of the financial risks from climate change in their governance arrangements; **Financial Risk Management Practice** – incorporate the financial risks from climate change into existing financial risk management practice; **Scenario Analysis** – use (long term) scenario analysis to inform strategy setting and risk assessment and identification; and **Disclosure** – develop an approach to disclosure on the financial risks from climate change Given that the climate change risks are evolving, and the legal/regulatory approach is relatively at an early stage, regulatory expectation is that "firm's response to the financial risks from climate change to be proportionate to the nature, scale, and complexity of its business" and to mature over time.

The notes to the financial statements and Pillar 3 Disclosures provide further information about most of these risks; the committees that have the relevant responsibility for these risks; and the policies to manage the key risks. The Directors are confident that the current risk management structure is sufficient for identification, monitoring and management of significant financial risks to the business.

Employee remuneration policy

The Bank's remuneration policy is in line with market practice and is weighted towards a performance-based compensation plan. The Bank does not have an incentivised compensation scheme for its staff. However, all staff members are included under a performance-based bonus scheme, which is paid out once a year.

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

Performance is reviewed annually against pre-defined measures and efforts are recognised through a combination of monetary and non-monetary benefits. The performance management framework is managed through the Bank's HR and senior executive teams. The Board is responsible for annual reviews to determine the remuneration of senior management with Senior Management Function ("SMF") roles.

Annual performance is a self-assessment process where employees assess their own performance against their job profile. It is an important time for an employee and their line manager to meet and share feedback, provide coaching, assess the goals, contributions and behaviours, and identify learning and development needs. It is also a time when future goals and clear expectations are set based on the SMART objectives. Compliance also provides its input on adherence to certification regime staff and their required competencies.

Future outlook

2019 was a very significant period for the Bank in terms of sustainable growth and having resolved major lending legacy problems. During the year we started to see the true earnings potential of the bank, as the strategy we have implemented began to deliver. This was evident in the strongly improved performance compared to 2018.

The Bank's overall results for 2019 were strong with continuous growth in lending, deposits and operating profit. The Bank exceeded its profit target despite a challenging and evolving economic and regulatory environment. There are more risks to global economic growth than this time last year mainly due to coronavirus and final outcome of trade talk with EU, and we remain alive and responsive to all possibilities. Our strong balance sheet and revenue base equip us to navigate these risks and, most importantly, enable us to help our customers negotiate their own paths.

The Bank in the year 2020 is also looking at Islamic Banking as a source of additional lending. Considering the Bank's current customer base and rise in ethical banking demand the Bank considers that Islamic Banking will add significant value to its growth strategy. We also see trade finance and lending through intermediary channels as value contributor to 2020 business growth.

We acknowledge that tougher times lie ahead for banks, which may go beyond 2020 as the real impact of COVID-19 unveils itself. As most of the world is impacted by Coronavirus we don't have to look far for economic and social impact as it's everywhere. We feel confident that the Bank will come out stronger to combat the impact of Coronavirus with the capital and liquidity buffers we have built post 2008 global financial crises.

Approved by the Board and signed on its behalf by:

Kamran Qazi
Chief Financial Officer

Directors' Report

On behalf of the Board of Directors of Habib Bank Zurich plc ("the Bank"), I am pleased to present the Directors Report on the Financial Statements of the Bank for the year ended 31 December 2019. The Bank is registered in England and Wales with number 08864609 and is authorised by the PRA and regulated by the FCA and PRA. The Bank is a wholly owned subsidiary of Habib Bank AG Zurich.

Results

The Bank posted a profit after taxation of £3.48 million (2018 (restated): £3.37 million). The Bank has continued to make steady progress during the year 2019, achieved solid results despite economic uncertainties throughout the year due to Brexit. The Bank remained focus on evolving its core business activities, real estate finance and commercial banking services. Bank successfully launched Islamic Banking business with brand name 'Sirat'. Trade finance business volumes also increased during the year as the Bank deployed resources to grow this area to diversify its revenue base.

Despite challenging business environment in 2019, the Bank was able to grow its lending business, which reflects the strength of its relationship-based banking. The Bank remained cautious all the time and prudently managed its investment and money market portfolio as a result of growing uncertainties about interest rate direction. The Bank has financial and operational capacity in place to expand its business activities and also explore new opportunities.

Share capital and dividend

The Directors do not recommend a final dividend on ordinary shares to be paid in respect of the year. (2018: £0.0299 per ordinary share).

The share capital of the bank remained unchanged at £60 million, which is divided into 60 million ordinary shares of £1 each.

Board of Directors

The following directors have been appointed to serve on the Board of the Bank:

Mr Muhammad H. Habib	Non-Executive Director (NED) and Chairman
Mr Carey Leonard	Independent NED
Mr Gerald Arthur Gregory	Independent NED
Mr Anjum Iqbal	Non-Executive Director
Mr Rajat Garg	Non-Executive Director
Mr Satyajeet Roy	CEO / Executive Director
Mr Masum Billah	COO / Executive Director

The Bank's Board membership represents a suitable mix of experience and knowledge relevant to the services offered.

Board meetings are held at least four times a year and additional meetings can be held at any time to discuss urgent issues.

Directors' representation

In the case of each of the persons who are Directors at the time the report is approved, so far as the director is aware, there is no relevant audit information of which the Bank's auditor is unaware, and the director has taken all the steps that he ought to have taken as a director in order to make himself aware of any relevant audit information and to establish that the Bank's auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

Independent Auditor

KPMG LLP has expressed an unqualified opinion on the 2019 financial statements.

Subject to satisfactory commercial agreement of terms, KPMG LLP has expressed its willingness to continue in office as Auditors and a resolution to reappoint the firm will be considered at the forthcoming annual general meeting.

Senior Management and Certification Regime

The Bank has established adequate documented processes over monitoring and governance of the Senior Management and Certification Regime ("SM&CR"), including the certified population. This includes adequate governance and oversight exercised by the Board, updating management responsibility and related business activities, and training staff in particular with Senior Management Function ("SMF") roles, as well as assessing the fitness and propriety of SM&CR staff.

Going concern

The Bank's operating model is simple, offering core lending and deposits products to its customers, who have a strong loyalty to the franchise. This is the bedrock of the value proposition for the Bank. Service is delivered through dedicated branch and relationship managers. The customer takes comfort in continuity with a relationship manager and quick turnaround on their requests as well as access to the decision makers at the Bank. The expertise of the Bank in understanding and dealing with SME customers and business owners has positioned the Bank very strongly among its peer banks. This has enabled longevity of customers relationships spreading over two to three generations.

The Bank has prepared these financial statements taking into account that it operates on a self-sufficient basis with minimum dependency on Habib Bank AG Zurich (the "Parent Bank"). The Bank also expects to grow its lending book in line with its strategy and improve its credit quality, which provides a steady stream of interest income from customers. In addition to net interest income the Bank has a flow of revenue from fees and commissions. In line with the Bank's strategy, there will also be an expected increase in flow of income from investments, which is likely to grow over the next two to three years.

The Bank has a sound governance structure in place, which comprises the Board of Directors, Committees of the Directors and Management Committees covering all key risk areas such as credit risk, liquidity risk, anti-money laundering, compliance risk and operational risk. The capital base of the Bank is sound with more than the required capital invested by the Parent Bank. The Bank's liquidity position is also very strong with more than adequate liquid assets to cover a stress over a 90-day survivability period.

Refinement made to the Bank's business strategy to target and maintain high value customers' accounts within its target market is progressing smoothly. The Bank has implemented a strategic shift by re-positioning its business towards financing commercial and residential buy-to-let, income generating properties. As part of the lending strategy the Bank is also focusing on loans secured by residential properties to make more effective use of available capital. The Bank also meets the commercial banking needs of its high value customers, which in most cases is also secured against properties. It signals the Bank's intention to target comparatively higher ticket size and an optimum cost base.

The Board fully understand the threat on the business and financial performance of the Bank due to the outbreak of Coronavirus, which has engulfed the whole World within few months. Businesses be they small or large have been forced to either close down or reduced operating capacity as like many other governments, UK also decided to lockdown to slow the spread of Coronavirus. The Bank with the help of a well-designed and tested business continuity plan is fully operational providing full services to its customers.

As seen in previous financial crises the Bank's high touch relationship-based business models allows it to keep in close contact with customers. It not only provides them the needed confidence on Bank's financial health but also addresses their business needs in the time of real crises like the one which we are in at the moment.

As explained in more detail in the Strategic Report the Bank has a strong capital base and liquidity position to meet business and financial uncertainties arising from wide spread effect of Coronavirus. The Bank continues to monitor the development and impacts of Coronavirus and is geared up to take necessary mitigating actions as needed.

Based on the above, the Directors are confident that the Bank has adequate resources to continue and grow the franchise for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and financial statements.

Post-balance sheet events

Coronavirus spread and its impact on businesses started in January 2020. There were no factors in 2019, which could have given any indication of such widespread impact of Coronavirus on the global economy. Therefore, no impact of Coronavirus has been taken as an adjustable reportable event in financial results for the year 2019.

There have been no other reportable events subsequent to the balance sheet date.

Acknowledgement

The Board of Directors takes the opportunity to express its gratitude to all stakeholders for their continued support.

The Board of Directors also records its appreciation to the EXCO and staff for their efforts, dedication, commitment and teamwork during 2019.

Approved by the Board and signed on its behalf by:

Satyajeet Roy
Chief Executive Officer

Directors' Responsibilities Statement

The Directors are responsible for preparing the Strategic Report, Directors' Report and the financial statements in accordance with the applicable law and regulations.

Company law requires the Directors to prepare the Bank's financial statements for each financial year. Under that law they have elected to prepare the Bank's financial statements in accordance with IFRS, as adopted by the EU and applicable law.

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Bank and of its profit or loss for that period. In preparing the Bank's financial statements, the Directors are required to:

- Select suitable accounting policies and then apply them consistently.
- Make judgements and estimates that are reasonable and prudent.
- State whether they have been prepared in accordance with IFRSs' as adopted by the EU.
- Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Bank will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Bank's transactions and disclose with reasonable accuracy at any time the financial position of the Bank and enable it to ensure that its financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as is reasonably open to them to safeguard the assets of the Bank and to prevent and detect fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Bank's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Satyajeet Roy
Chief Executive Officer

Tower of London

Corporate Governance Report

The Board of Directors

The Board of Directors ("the Board") is committed to follow best practice in Corporate Governance. The Financial Reporting Council updated the UK Corporate Governance Code ("the Code") in April 2016 and while the Code does not apply directly to the Bank, the Board agrees with and supports its general principles. This report sets out how the Bank has regard to the principles of the Code.

Board profile

Board of Directors
From left to right: Carey Leonard, Anjum Iqbal, Rajat Garg, Muhammad H. Habib, Masum Billah, Satyajeet Roy, Gerald Arthur Gregory.

Muhammad H. Habib

Chairman

Roles & Committees	Chairman & Non-Executive Director
Skills & Experience	Muhammad H. Habib became a member of the General Management at Habib Bank AG Zurich, Switzerland in 1992. He was appointed President & Chief Executive Officer in 2011. Muhammad H. Habib's career in banking comprises close to four decades of experience. He began his career in 1981 in Dubai, where he went through extensive training in order to gain the expertise, nuanced understanding, and enhanced knowledge of managing a bank and navigating the financial industry. This was an enriching journey spanning 11 years. In 1992, he joined the General Management team. His responsibilities encompassed UAE, Africa, UK, North America, and Switzerland. Under his leadership, the Bank has expanded into several new territories, including South Africa (1995) and Canada (2001). In 1996, he was promoted to the position of Joint President, and subsequently became the President of the Bank. Muhammad H. Habib completed his studies at the College de Leman in Geneva, Switzerland, and earned his degree in Business Administration from Babson College in Wellesley, Massachusetts (USA).
Principal external appointments	· Chairman, Habib Canadian Bank, Canada · Director, Habib Metropolitan Bank, Pakistan · Chairman, HBZ Bank Limited, South Africa · Vice Chairman, Gefan Finanz AG Zug, Switzerland · Member Board of Trustees, Habib University Foundation · Member Board of Trustees, Habib Public School, Karachi (Pakistan) · Member Global Advisory Board, Babson College

Carey Leonard

Independent
Non-Executive Director

Roles & Committees
- Independent Non-Executive Director
- Chair of the Board Risk Committee
- Member of the Board Audit and Compliance Committee

Skills and experience
Carey Leonard has over 46 years of banking experience in Asia, the Middle East, Africa and the UK. He has strong commercial banking disciplines in the areas of governance, strategy, business development, wholesale banking and risk management.

Principal external appointments
- Chairman, The Commonwealth Trade Bank Plc
- Trustee and Treasurer to the Council, Malvern College
- Governor and Chairman of the Commercial Committee, The Downs Malvern Preparatory School
- Justice of the Peace Worcestershire branch

Former appointments
Standard Chartered Bank
- Regional Head, Special Assets Management Africa
- Chief Executive Officer, South Africa
- Managing Director and CEO, Nigeria
- Chief Executive Officer, Sri Lanka
- Member of Business Leadership Team

Gerald Arthur Gregory

Independent
Non-Executive Director

Roles & Committees
- Independent Non-Executive Director
- Chair of the Board Audit and Compliance Committee
- Member of the Board Risk Committee

Skills and experience
Gerald Gregory brings extensive experience both in practice and in independent non-executive functions. His experience covers treasury, lending, strategy, marketing and risk management.

Principal external appointments
- Deputy Chairman and Independent Non-Executive Director, Chair of Risk Committee and member of Audit Committee, Gatehouse Bank Plc
- Chairman and Independent Non-Executive Director, Chair of Remuneration Committee, member of Audit committee and Risk Committee, Northern Bank Limited (t/a Danske Bank)

Former appointments
- Managing Director, Britannia Capital Investment Group
- Executive Director, Britannia Building Society
- Sales and Marketing Director, Britannia Building Society

Anjum Iqbal

Non-Executive Director

Roles & Committees

- Non-Executive Director
- Member of the Board Risk Committee
- Member of the Board Audit and Compliance Committee

Skills and experience

Anjum Iqbal has extensive management experience in various parts of the world in corporate and commercial banking. He has worked in several regions including Latin America, Europe, the Middle East, Africa and South Asia.

Principal external appointments

- Member of General Management and Regional CEO (Developing markets), Habib Bank AG Zurich (Switzerland)
- Non-Executive Director and member of Board Audit Committee, Board Risk Committee, HBZ Bank Ltd (South Africa)
- Chair of Risk and Compliance Committee, Chair of Board IT Committee, member of Board Audit Committee and Board Credit Committee, Habib Metropolitan Bank (Pakistan)

Former appointments

Habib Bank AG Zurich Group
- Chief Executive Officer, Habib Bank Zurich plc, UK
- President and Chief Executive Officer, Habib Metropolitan Bank, Pakistan

Citigroup
- Managing Director Commercial Banking Group (EMEA)
- Strategy and Business Development Head
- CEO Africa Division
- Regional CEO, Turkey and Central Asia

Rajat Garg

Non-Executive Director

Roles & Committees

- Non-Executive Director
- Member of the Board Risk Committee
- Member of the Board Audit & Compliance Committee

Skills and experience

Rajat Garg has 30 years of banking experience serving in senior executive roles across Asia, Europe and the Middle East. His professional background includes extensive experience in managing commercial banking and wealth management business.

Principal external appointments

- Member of General Management and Regional CEO (Developed markets), Habib Bank AG Zurich (Switzerland)
- Non-Executive Director, HBZ Bank (Hong Kong) Ltd
- Non-Executive Director, Habib Canadian Bank

Former appointments

Citigroup
- Head of Retail Banking and Wealth Management, EMEA
- Country Business Manager, Turkey
- Cards Business Manager, Saudi Arabia
- Regional CFO – Asia Pacific Cards, Singapore
- NRI Wealth Management Head, Singapore
- Financial Controller and Business Planning Head, India

Satyajeet Roy

Chief Executive Officer

Roles & Committees
- Executive Director
- Chief Executive Officer

Skills and experience
Satyajeet Roy is a seasoned executive with 25 years of international banking experience across the Middle East, UK, Europe and India spread over Commercial, SME and Retail segments. He brings cross-functional experience covering business strategy, risk, audit and operations.

Principal external appointments
none

Former appointments
Commercial Bank International, UAE
- Head of Business Banking

Citigroup
- Head of Commercial Banking for UAE & Bahrain
- Head of Business Development, Business Banking, EMEA (London UK)
- Audit and Risk Review, Lead Auditor, EMEA

Masum Billah

Chief Operations Officer

Roles & Committees
- Executive Director
- Chief Operations Officer

Skills and experience
Masum Billah has over 25 years of experience in financial services spread across operations, technology, operational risk, business development, compliance and risk management. During his various roles he has been based in Bangladesh and UK with coverage for Europe, Middle East and Africa markets.

Principal external appointments
none

Former appointments
Bank of America Merrill Lynch (London, UK)
- Director, Global Trade Service EMEA Compliance

Citigroup
- Senior Compliance Officer, TTS EMEA Compliance (London, UK)
- Risk and Control Programs Lead, TTS Global Operations (London, UK)
- EMEA Trade Deal Facilitation and FI Training Head (London, UK)
- Head of Operations and Technology (Dhaka, Bangladesh)

Executive Committee

Satyajeet Roy	CEO and Executive Director
Kamran Qazi	Chief Financial Officer
Syed Kausar Kazmi	Head of Commercial Banking
Nadia Saleem	Head of Compliance and MLRO
Masum Billah	Chief Operations Officer
Arif Mansoor	Head of Credit
Waqar Haider	Head of Governance and Risk Control and Board Secretary
Monika Poznar	Head of Human Resources

Satyajeet Roy

Chief Executive Officer

Kamran Qazi

Chief Financial Officer

Syed Kausar Kazmi

Head of Commercial Banking

Nadia Saleem

Head of Compliance and MLRO

Masum Billah

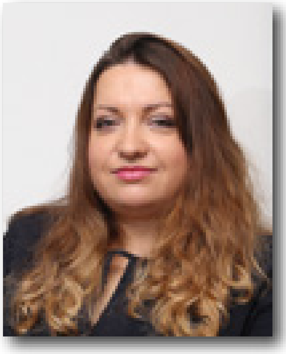
Chief Operations Officer

Arif Mansoor

Head of Credit

Waqar Haider

Head of Governance and Risk Control



Monika Poznar

Head of Human Resources

LEADERSHIP

The role of the Board

The primary role of the Board is to set the overall strategy for the Bank and to protect and enhance its long-term strategic value. The Board ensures that the business of the Bank is conducted in an efficient and effective manner to promote the success of the Bank within an established framework of effective systems of internal control, robust risk management process and compliance with regulatory requirements. The Board also ensures that good corporate governance policies and practices are implemented within the Bank. In the course of discharging its responsibilities, the Board acts in good faith, with due diligence and care, and in the best interests of the Bank and its shareholders.

The primary responsibilities, which the Board undertakes in this respect, are to:

- Consider changes to the structure, size and composition of the Board and board committees and approve terms of reference.
- Define, oversee and be accountable for the implementation of governance arrangements that ensure effective and prudent management of the Bank, including the segregation of duties in the organisation and the prevention of conflicts of interest.
- Set the Bank's strategic objectives and goals and reviewing the performance of the executive team.
- Review and approve the risk appetite statements of the Bank.
- Establish and maintain a framework for the overall sound and proper internal control and risk management processes.
- Review and challenge the business performance of the Bank, set the budget and financial forecasts, and ensure that the business of the Bank is managed to balance risk and reward.
- Ensure that adequate succession planning arrangements are in place related to senior management so as to maintain an appropriate balance of skills and experience within the Bank.

The responsibilities of the Board are clearly set out in its Terms of Reference ("TORs"), which is reviewed and approved annually by the members of the Board. The schedule of Board meetings along with recurring items is approved in advance with the permission of the Chairman and circulated to all members.

Division of responsibilities

The responsibilities of the Board members are set out in the Board TORs, which are aligned with a respective statement of responsibilities prepared under the senior management regime for each Board member. The Chairman is responsible for leading the development of and monitoring the effective implementation of policies and procedures for the induction, training and professional development of all members of the Board. The Chairman sets the Board's agenda primarily focusing on strategy, performance, value creation and accountability and ensures that adequate time is available for discussion on all agenda items, in particular strategic issues. Along with other Board members, the Chairman is also responsible for leading the development of the Bank's culture as a whole.

The two appointed independent non-executive directors ("INEDs") support the Board in the oversight functions on the basis of requisite skill sets and experience needed for effectively performing their respective SMF roles. Collectively and individually the INEDs provides adequate challenge to other members of the Board and the senior management team in the course of discharging their oversight responsibilities as board members.

The non-executive directors ("NEDs") along with INEDs are responsible for setting the Bank's strategic objectives and goals and reviewing the performance of the executive team. They approve and keep an oversight of the Bank's strategy and business plan prepared by the executive team. They also review and challenge the business performance of the Bank, approve the budget and financial forecasts, and ensure that the business of the bank is managed to balance risk and reward. They also scrutinise the delivery of the strategy within the risk and control framework set by the Board and satisfy themselves on the integrity of financial reporting.

The Chief Executive Officer ("Executive Director") is responsible for managing the Bank's business on a day-to-day basis on behalf of the Board. The business is managed within the strategy, risk appetite and control frameworks set and overseen by the Board. The Executive Director has specific management responsibilities for which he is accountable to the Board, such as executing the business plan, delivering planned results, managing risk, systems and the control framework, and delivering timely and accurate information to the Board.

EFFECTIVENESS

The composition of the Board

The size of the Board is aligned with the overall governance structure required for the effective oversight of the business, risk and control framework; operational, regulatory and compliance; and financial performance of the Bank. The composition of the Board has been established to ensure the availability of a pool of resource with relevant knowledge and experience to manage the strategic objective of the Bank.

The Board comprises seven directors – the Chairman, two INEDs, two NEDs and two Executive Directors. The relevant knowledge of Board members and diversity of their experience allows all directors to actively and effectively participate in the meetings.

The Board considers Carey Leonard and Gerald Arthur Gregory to be independent within the meaning of the UK Corporate Governance Code. They do not perform any executive or other role or have any relationship with the Bank that, in the Board's view, would affect their objectivity and judgement in performing their respective function.

Appointment to the board

Appointments to the Board are made by carrying out a formal and rigorous process of evaluating candidates by the Board members, selected on the skills and experience required for their particular appointment. The Bank usually uses an external executive search firm for shortlisting candidates.

Commitment

The Bank has a balanced combination of non-executive, independent non-executive and executive directors keeping in view the complexity and nature of the Bank's operations. All directors in accordance with their terms of appointment are required to allocate sufficient time to the Bank to discharge their responsibilities effectively and efficiently.

Development

The Bank provides a detailed overview of the business to all directors on their joining of the Board. The process includes a formal presentation conducted by senior executive management covering their respective areas including but not limited to strategy and risk management, business development, credit, AML and compliance, operations, treasury and finance and information technology. There is also continuous interaction between executive management and the Board members, which allows the new directors to gain further knowledge and insight about Bank's business.

All directors are required to complete in-house online courses, which comprehensively cover areas such as AML, information security, fraud prevention, anti-bribery and corruption, whistleblowing, complaints, data protection. In addition, directors are also provided face-to-face training related to emerging risks to keep them abreast of new challenges within financial services.

Information and support

The Chairman ensures that the Board members receive accurate, timely and clear information for effective decision-making processes and applies sufficient challenge to major proposals. The Directors keep close liaison with the executive management of the Bank for a better understanding of the business operations of the Bank. Furthermore, the Board has independent access to senior management and the Board Secretary at all times.

The Board Secretary ensures timely and accurate information flows within the Board and its committees and between senior management and the NEDs. Senior management of the Bank present information related to all key areas, such as risk management, credit, compliance, operations, finance and audit to the Board through its committees.

Evaluation

Each Board member undergoes an annual evaluation process by completing a self-assessment questionnaire, which is discussed with the Chairman of the Board. The assessment aims to assess the performance evaluation of each member by recognising strengths and addressing weaknesses.

To assess the overall performance of the Board, each member also completes a questionnaire on board effectiveness, which includes areas of strategic goals and objectives, governance, risk management, quality of information and leadership.

Re-election

In accordance with the provisions in the Articles of Association, all directors who have been appointed by the Board must stand for re-election every three years.

ACCOUNTABILITY

Board committees

To help carry out its responsibilities, the Board has also established the following committees with terms of reference setting out matters relevant to the committees' composition, responsibilities and administration.

Board Risk Committee

Membership	Carey Leonard	Chairman
	Gerald Arthur Gregory	Member
	Anjum Iqbal	Member
	Rajat Garg	Member

Board Audit and Compliance Committee

Membership	Gerald Arthur Gregory	Chairman
	Carey Leonard	Member
	Anjum Iqbal	Member
	Rajat Garg	Member

Board Risk Committee

Primary responsibilities are to:

- Review the overall approach of the Bank to risk, its management and reporting line framework to ensure the effective application of the risk management framework.
- Assess and regularly review the three lines of defence model implemented by the Bank for its effectiveness.
- Provide assurance on the Bank-wide risk management framework and monitor the overall risk profile of the Bank through effective control processes.
- Annually review the Risk Appetite Statement and consider the adequacy of risk limits and returns.
- Set guidelines for maintaining risk control parameters for all types of risk across the business, including policies, control standards, underwriting standards, risk exposure limits or other control levers.
- Receive information on any material breaches of risk limits, policies or procedures and agree proposed action as soon as practically possible.
- Consider and make recommendations to the Board regarding the appointment, removal and resignation of employees with SMF responsibilities under the Senior Management Regime (SMR) with the exception of Directors.
- Consider and make recommendations to the Board regarding the remuneration including increment and bonus of employees with SMF responsibilities with the exception of Directors.

Board Audit and Compliance Committee

An independent Audit and Compliance Committee is responsible for challenging executive management and the Bank's internal and external auditors as part of a good governance process. Primary responsibilities are:

- Review key internal control policies, processes and procedures and assess the effectiveness of those keeping in view the size, nature and complexities of Bank's operations.
- Review the effectiveness of the Bank's internal audit in the context of the Bank's overall risk management system.
- Review and assess independence of internal audit function.
- Make recommendations on the internal and external auditors' appointment, reappointment and removal.
- Review and monitor the independence of the external auditors.
- Discuss the financial statements and the quality of the underlying accounting processes with the member of management responsible for accounting and finance.
- Review and approve the non-audit services policy in respect of the external auditors.
- Review and approve accounting policies and changes therein.
- Review policies to ensure the Bank's ongoing compliance with relevant legal and regulatory requirements.
- Ensure that its recommendations to combat money laundering, terrorist financing and financial crime risks are incorporated into the Bank's ongoing procedures and monitoring infrastructure.
- Oversight of adequacy of processes put in place by the management to manage Conduct Risk.
- Oversight of the adequacy of the training and competency framework required fulfilling the Bank's obligations under the SMR and the Certification Regime.
- Review and ensure the implementation and compliance of EU audit legislation in liaison with external auditors.

Board meetings

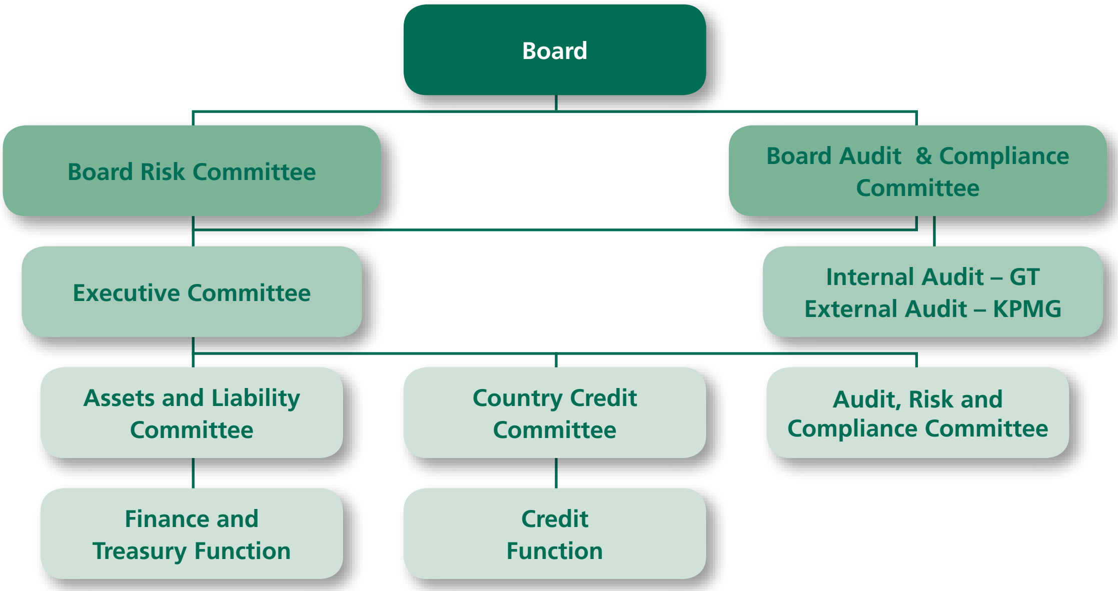
The Board meets regularly at least four times a year at quarterly intervals and holds additional meetings as and when the Board thinks appropriate. Four Board meetings were held during 2019. The agenda, together with Board papers, are sent in full to the directors not less than three business days before the intended date of the Board meeting. The Board Secretary prepared minutes of Board meetings, with details of decisions reached.

At each regular Board meeting, the executive management of the Bank made presentations to the Board on various aspects, including business performance, financial performance, corporate governance and outlook. Throughout 2019, Directors of the Bank also participated in the consideration and approval of matters of the Bank by way of written resolutions circulated to them. Supporting written materials were provided in the circulation and the Board Secretary when required gave verbal briefings.

All Directors attended the Board and its committee meetings held during the year.

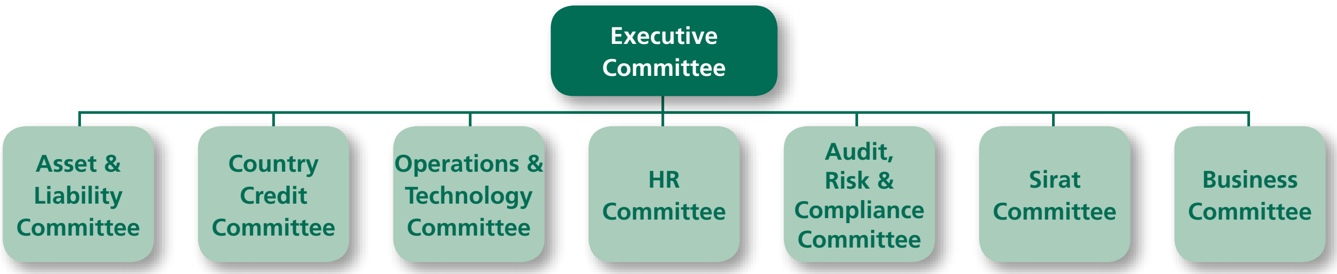
Interaction with management committees

There is a formal division of responsibilities matrix, which identifies the responsibilities of the Board and those of the management through its respective committees. Management committees are responsible for oversight of various operational processes through which the strategy and objectives set by the Board are achieved. These are clearly defined and approved in terms of reference of each management committee.



The CEO and EXCO represent the principal forum for conducting the day-to-day business of the Bank. The terms of reference of EXCO is approved by the Board. EXCO is represented in the Board through the CEO. While retaining the ultimate responsibility for the actions taken, the CEO and EXCO at its discretion has delegated certain responsibilities to the following standing sub-committees:

- Asset and Liability Committee
- Country Credit Committee
- Operations and Technology Committee
- Human Resource Committee
- Audit Risk and Compliance Committee
- Sirat Committee
- Business Committee



The Chairman of the respective committee presents key matters arising from each of the above committees to EXCO, which are also reported to the Board or its committees through various management information presented in Board or its committee meetings.

Financial and business reporting

The Board has put in place appropriate checks and controls to ensure that financial and business information presented in the financial statements provides a balanced and fair assessment of the Bank's performance, business model and strategy.

Risk management and internal control

The Board reviews and approves the overall risk appetite of the Bank. The Board has established and maintained a framework for the overall sound and proper internal control and risk management processes. The Board regularly receives reports on, and reviews the effectiveness of, the risk and control processes to support the strategy and objectives.

REMUNERATION

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

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

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

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

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

RELATIONS WITH SHAREHOLDERS

The Bank is a wholly owned subsidiary of Habib Bank AG Zurich ("the Parent Bank"). The Chairman discusses matters relating to governance and business strategy of the Bank with the other shareholders. He ensures that views of shareholders are shared with the Board.

Constructive use of annual general meeting

All members of the Board are encouraged to attend the annual general meeting of the Bank to be used as an opportunity to interact and communicate with the shareholders.

Buckingham Palace

Independent auditor's report

to the members of Habib Bank Zurich plc

1. Our opinion is unmodified

We have audited the financial statements of Habib Bank Zurich plc ("the Bank") for the year ended 31 December 2019 which comprise the Income statement, Statement of Comprehensive Income, Statement of Financial Position, Statement of Changes in Equity, Cash Flow Statement and the related notes, including the accounting policies in note 5.

In our opinion the financial statements:

— give a true and fair view of the state of Bank's affairs as at 31 December 2019 and of its profit for the year then ended;

— have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union; and

— have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion. Our audit opinion is consistent with our report to the audit committee.

We were first appointed as auditor by the directors for the period ended 31 December 2015. The period of total uninterrupted engagement is for the 5 financial years ended 31 December 2019. We have fulfilled our ethical responsibilities under, and we remain independent of the Bank in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to public interest entities. No non-audit services prohibited by that standard were provided.

Overview		
Materiality: Financial statements as a whole	£187k (2018: £218k) 5% (2018: 5%) of profit before tax	
Key audit matters		**vs 2018**
Recurring risks	The impact of uncertainties due to the United Kingdom exiting the European Union on our audit	◄►
	Provision for impairment on loans and advances	◄►
Event driven	Provision for impairment on loans and advances	▲

2. Key audit matters: our assessment of risks of material misstatement

Key audit matters are those matters that, in our professional judgment, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. We summarise below the key audit matters, in arriving at our audit opinion above, together with our key audit procedures to address those matters and, as required for public interest entities, our results from those procedures. These matters were addressed, and our results are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the financial statements as a whole, and in forming our opinion thereon, and consequently are incidental to that opinion, and we do not provide a separate opinion on these matters.

Key audit matter	The risk	Our response
The impact of uncertainties due to the United Kingdom exiting the European Union on our audit Refer to the Strategic report (page 6)	**Unprecedented levels of uncertainty** All audits assess and challenge the reasonableness of estimates, in particular as described in the provision for impairment of loans and advances (below) and related disclosures and the appropriateness of the going concern basis of preparation of the financial statements. All of these depend on assessments of the future economic environment and the Bank's future prospects and performance. In addition, we are required to consider the other information presented in the Annual Report including the principal risks disclosure and to consider the Directors' statement that the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Bank's position and performance, business model and strategy. Brexit is one of the most significant economic events for the UK and its effects are subject to unprecedented levels of uncertainty of consequences, with the full range of possible effects unknown.	We developed a standardised firm-wide approach to the consideration of the uncertainties arising from Brexit in planning and performing our audits. Our procedures included: — **Our Brexit knowledge** – We considered the directors' assessment of Brexit-related sources of risk for the Bank's business and financial resources compared with our own understanding of the risks. We considered the directors' plans to take action to mitigate the risks; — **Sensitivity analysis** – When addressing provision for impairment on loans and advances and other areas that depend on forecasts, we compared the Directors' analysis to our assessment of the full range of reasonably possible scenarios resulting from Brexit uncertainty and, where forecast cash flows are required to be discounted, considered adjustments to discount rates for the level of remaining uncertainty; and — **Assessing transparency** – As well as assessing individual disclosures as part of our procedures on provisions for impairment of loans and advances to customers, we considered all of the Brexit related disclosures together, including those in the strategic report, comparing the overall picture against our understanding of the risks. **Our results** As reported under provision for impairment on loans and advances,we found the resulting estimates and related disclosures of provision for impairment on loans and advances and disclosures in relation to going concern to be acceptable. However, no audit should be expected to predict the unknowable factors or all possible future implications for a Bank and this is particularly the case in relation to Brexit.

2. Key audit matters: our assessment of risks of material misstatement (continued)

Key audit matter	The risk	Our response
Provision for impairment on loans and advances (£5.0 million; 2018: £5.6) Refer to note 5 (accounting policy) and note 16 (financial disclosures).	**Subjective estimate:** Under IFRS 9, the Bank's loan loss provision is derived using forward-looking expected credit loss ('ECL') models. The measurement of ECLs depends on the change in credit quality of each loan since initial recognition. The Status of each loan is assessed to establish whether there is a 12 month ECL for performing loans or life time ECL for under performing / non performing loans. Key judgements and estimates in respect of the timing and measurement of ECLs include: — Allocation of assets to stage 1, 2, or 3 using criteria in accordance with the accounting standard; —Accounting interpretations and modelling assumptions used to build the models that calculate the ECL; —Inputs and assumptions used to estimate the impact of multiple economic scenarios; — Completeness and valuation of post model adjustments; The effect of these matters is that, as part of our risk assessment, we determined that the provision for impairment on loans and advances has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole.	Our procedures included: — **Controls testing:** We have tested the design and operating effectiveness of key controls of the processes relevant to the ECL estimate. This included the allocation of assets into stages, credit monitoring and management overlays. — **Our Financial Risk Modelling (FRM) expertise:** Our FRM specialists have evaluated the appropriateness of the Bank's IFRS 9 impairment methodologies. This includes challenging the reasonableness of management's assumptions, assessing the appropriateness of the model design and formulas used and recalculating the Probability of Default, Loss Given Default and Exposure at Default for a sample of models. — **Our economic scenario expertise:** Our KPMG economic specialists have challenged and assessed the appropriateness of the Bank's methodology for determining the macroeconomic variables, economic scenarios used and the probability weightings applied to them. They have assessed key economic variables used which includes agreeing the economic variables to external sources as well as checking overall reasonableness of the economic forecast. — **Tests of details:** We selected a sample of loans based on their risk characteristics and tested the appropriateness of their classification to stage 1, 2 and 3 based on quantitative and qualitative criteria established by the Bank; We have assessed the completeness and appropriateness of management overlays. This included assessment of the appropriateness of the scenarios used and calculation of the overlay. — **Assessing transparency:** We have assessed the adequacy of the Bank's disclosures in respect of the degree of estimation involved in arriving at the provision. **Our results** We found the resulting estimate of provision for impairment of loans and advances to customers to be acceptable (2018: acceptable)

KPMG

2. Key audit matters: our assessment of risks of material misstatement (continued)

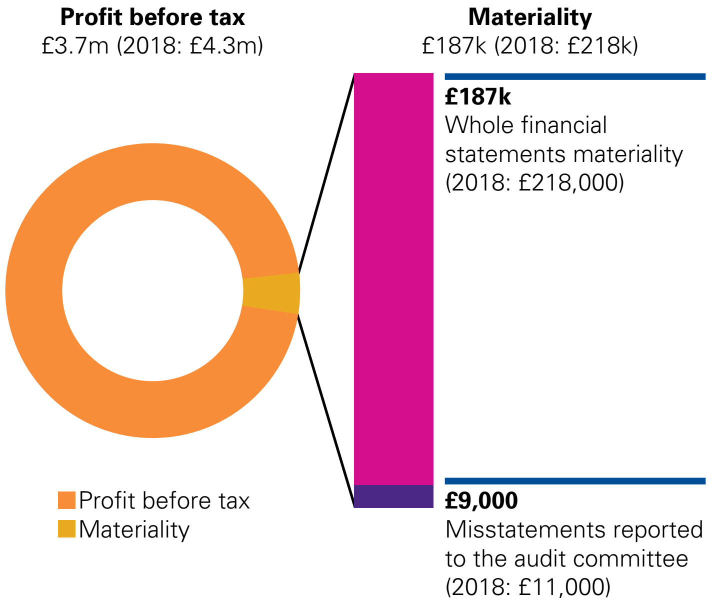
Key audit matter	The risk	Our response
Going concern – Impact of uncertainties due to Covid-19 on our audit Refer to the Strategic report (page 6), note 4 (Going concern)	**Unprecedented levels of uncertainty:** The financial statements explain how the Directors have formed a judgement that it is appropriate to adopt the going concern basis of preparation of the financial statements for the Bank. The judgement is based on an evaluation of the inherent risks to the Bank's business model and how those risks might affect the Bank's financial resources or ability to continue operations over a period of at least a year from the date of approval of the financial statements. The impact of Covid-19 is subject to unprecedented levels of uncertainty of outcomes, with the full range of possible effects unknown given the rapidly evolving nature of the situation on financial and operational performance. The risk most likely to adversely affect the Bank's available financial resources over this period was insufficient regulatory capital and liquidity to meet minimum regulatory levels over the course of the next 12 months. There are also less predictable but realistic second order impacts, arising from Covid-19, which could result in a rapid increase in the level of provision for impairment of loans and advances. The risk for our audit was whether or not those risks were such that they amounted to a material uncertainty that cast significant doubt about the ability to continue as a going concern. Had they been such, then that fact would have been required to have been disclosed. **Disclosure quality** Clear and full disclosure of the assessment undertaken by the Directors and the rationale for the use of the going concern assumption, represents a key financial statement disclosure requirement. There is a risk that insufficient details are disclosed to allow a full understanding of the assessment undertaken by the Directors.	Our procedures included: — **Key dependency assessment:** We assessed whether the assumptions made in the capital and liquidity forecast are realistic and achievable and consistent with the external and/or internal environment and other matters identified in the audit. — **Sensitivity analysis:** We considered sensitivities over the level of available financial resources indicated by the Bank's capital and liquidity forecast taking account of reasonably possible (but not unrealistic) adverse effects that could arise from these risks individually and collectively. — We challenged the stress testing and reverse stress testing undertaken by the Directors of the identified critical factors in their capital and liquidity forecast. — **Evaluating directors' intent:** We evaluated the achievability of the actions the Directors consider they would take to improve the position should the risks materialise. — **Assessing transparency:** We assessed the completeness and accuracy of the matters covered in the going concern disclosure, including those in the strategic report, by comparing the overall picture against our understanding of the risks. **Our results** We found the going concern disclosure without any material uncertainty to be acceptable (2018: acceptable). However, no audit should be expected to predict the unknowable factors or all possible future implications for a bank and this is particularly the case in relation to Covid-19.

3. Our application of materiality and an overview of the scope of our audit

Materiality for the financial statements as a whole was set at £187k (2018: £218), determined with reference to a benchmark of the Bank's profit before tax, of which it represents 5% (2018: 5%).

We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £9k (2018: £11k), in addition to other identified misstatements that warranted reporting on qualitative grounds.

Our audit of the Bank was undertaken to the materiality level specified above and was all performed at the Bank's head office in London.



4. We have nothing to report on going concern

The Directors have prepared the financial statements on the going concern basis as they do not intend to liquidate the Bank or to cease its operations, and as they have concluded that the Bank's financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over its ability to continue as a going concern for at least a year from the date of approval of the financial statements ("the going concern period").

Our responsibility is to conclude on the appropriateness of the Directors' conclusions and, had there been a material uncertainty related to going concern, to make reference to that in this audit report. However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the absence of reference to a material uncertainty in this auditor's report is not a guarantee that the Bank will continue in operation.

We identified going concern as a key audit matter (see section 2 of this report). Based on the work described in our response to that key audit matter, we are required to report to you if we have anything material to add or draw attention to in relation to the directors' statement in Note 4 to the financial statements on the use of the going concern basis of accounting with no material uncertainties that may cast significant doubt over the Bank's use of that basis for a period of at least twelve months from the date of approval of the financial statements.

We have nothing to report in these respects.

5. We have nothing to report on the other information in the Annual Report

The directors are responsible for the other information presented in the Annual Report together with the financial statements. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except as explicitly stated below, any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work we have not identified material misstatements in the other information.

Strategic report and directors' report

Based solely on our work on the other information:

- we have not identified material misstatements in the strategic report and the directors' report;
- in our opinion the information given in those reports for the financial year is consistent with the financial statements; and
- in our opinion those reports have been prepared in accordance with the Companies Act 2006.

6. We have nothing to report on the other matters on which we are required to report by exception

Under the Companies Act 2006, we are required to report to you if, in our opinion

- adequate accounting records have not been kept by the Bank, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in these respects.

7. Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out on page 24, the Directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Bank or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or other irregularities (see below), or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud, other irregularities or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A fuller description of our responsibilities is provided on the FRC's website at:

www.frc.org.uk/auditorsresponsibilities

Irregularities – ability to detect

We identified areas of laws and regulations that could reasonably be expected to have a material effect on the financial statements from our general commercial and sector experience, through discussion with the directors and other management (as required by auditing standards), and from inspection of the Bank's regulatory and legal correspondence and discussed with the directors and other management the policies and procedures regarding compliance with laws and regulations. We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit.

The potential effect of these laws and regulations on the financial statements varies considerably.

Firstly, the Bank is subject to laws and regulations that directly affect the financial statements including financial reporting legislation (including related companies legislation), distributable profits legislation and taxation legislation, and we assessed the extent of compliance with these laws and regulations as part of our procedures on the related financial statement items.

Secondly, the Bank is subject to many other laws and regulations where the consequences of non-compliance could have a material effect on amounts or disclosures in the financial statements, for instance through the imposition of fines or litigation or the loss of the Bank's licence to operate. We identified the following areas as those most likely to have such an effect: regulatory capital and liquidity, financial crime including money laundering, sanction list and market abuse regulations recognising the financial and regulated nature of the Bank's activities. Auditing standards limit the required audit procedures to identify non-compliance with these laws and regulations to enquiry of the directors and other management and inspection of regulatory and legal correspondence, if any. Through these procedures, we became aware of actual or suspected non-compliance and considered the effect as part of our procedures on the related financial statement items. The identified actual or suspected non-compliance was not sufficiently significant to our audit to result in our response being identified as a key audit matter.

Owing to the inherent limitations of an audit, there is an unavoidable risk that we may not have detected some material misstatements in the financial statements, even though we have properly planned and performed our audit in accordance with auditing standards. For example, the further removed non-compliance with laws and regulations (irregularities) is from the events and transactions reflected in the financial statements, the less likely the inherently limited procedures required by auditing standards would identify it. In addition, as with any audit, there remained a higher risk of non-detection of irregularities, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls. We are not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations.

8. The purpose of our audit work and to whom we owe our responsibilities

This report is made solely to the Bank's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Bank's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Bank and the Bank's members, as a body, for our audit work, for this report, or for the opinions we have formed.

M Davidson

Michael Davidson (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
15 Canada Square
London

23 April 2020

Income statement

For the year ended 31 December 2019

	Notes	2019 (£ 000')	2018 Restated (£ 000')
Interest income		23,079	20,979
Interest expense		(5,684)	(4,731)
Net interest income	6	**17,395**	**16,248**
Fee and commission income		1,438	1,581
Fee and commission expense		(128)	(305)
Net fee and commission income	7	**1,310**	**1,276**
Foreign exchange income		45	305
Fair value gain on derivative financial instruments		201	30
Gain on sale of financial investments		308	-
Other income	8	354	271
Net other income		**908**	**606**
Staff costs	9	(10,115)	(9,307)
Depreciation	19	(932)	(522)
Administrative and general expenses	10	(5,129)	(5,130)
Operating expenses		**(16,176)**	**(14,959)**
Operating profit before credit impairment losses		**3,437**	**3,171**
Reversal of credit impairment losses	11 & 31.14	303	926
Profit before tax		**3,740**	**4,097**
Tax charge	12	(256)	(731)
Profit after tax		**3,484**	**3,366**

Profit for the year arises from continuing operations.

The accompanying notes on pages 52 to 112 form an integral part of the financial statements.

The Bank adopted IFRS 9 with effect from 1 January 2018 and IFRS 16 applied from 1 January 2019. Due to the transition method applied, the comparative year amounts have not been restated.

The Financial Statements for the year 2018 were restated to account for the prior year's adjustment (Note 32)

These financial statements were approved by the Board of Directors and authorised for issue on 23 April 2020.

Statement of Other Comprehensive Income

For the year ended 31 December 2019

	Notes	2019 (£ 000')	2018 Restated (£ 000')
Profit after tax		**3,484**	**3,366**
Items that may be reclassified subsequently to income statement:			
Fair value through other comprehensive income reserve			
- Net losses from changes in fair value	27	308	(300)
- Deferred tax reversal / (charge)	27	(58)	56
		250	(244)
Net losses transferred to income statement due to impairment		30	7
Other comprehensive income for the year net of tax		**280**	**(237)**
Total comprehensive income for the year attributable to equity holders		**3,764**	**3,129**

Profit for the year arises from continuing operations.

The accompanying notes on pages 52 to 112 form an integral part of the financial statements.

The Bank adopted IFRS 9 with effect from 1 January 2018 and IFRS 16 applied from 1 January 2019. Due to the transition method applied, the comparative year amounts have not been restated.

The Financial Statements for the year 2018 were restated to account for the prior year's adjustment (Note 32)

These financial statements were approved by the Board of Directors and authorised for issue on 23 April 2020.

Statement of Financial Position

As at 31 December 2019

	Notes	2019 (£ 000')	2018 Restated (£ 000')
Assets			
Cash in hand and with central bank	14	58,964	66,810
Due from banks	15	98,298	58,931
Loans and advances to customers at amortised cost	16	430,736	398,977
Financial investments	17	84,586	103,385
Derivative assets held for risk management	18	357	167
Property and equipment	19	8,483	5,786
Other assets	20	1,070	881
Deferred tax assets	13	1,285	968
Total assets		**683,779**	**635,905**
Liabilities and Equity			
Liabilities			
Due to banks at amortised cost	21	6,722	17,399
Due to customers at amortised cost	22	577,013	523,493
Derivative liabilities held for risk management	18	312	137
Accruals, deferred income and other liabilities	23	7,542	4,560
Current tax liabilities	24	570	561
Deferred tax liabilities	27	48	-
Subordinated liabilities	25	20,098	20,104
Total liabilities		**612,305**	**566,254**
Equity			
Called up share capital	26	60,000	60,000
Retained earnings		11,226	9,683
Fair value through other comprehensive income reserve	27	248	(32)
Total equity		**71,474**	**69,651**
Total liabilities and equity		**683,779**	**635,905**

Signed on behalf of the Board of Directors

Chairman
(Muhammad H. Habib)

Director
(Satyajeet Roy)

The accompanying notes on pages 52 to 112 form an integral part of the financial statements.

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Statement of Changes in Equity

For the year ended 31 December 2019

	Called up share capital (£ 000')	Available for sale reserve (£ 000')	Fair value through other comprehensive income reserve (£ 000')	Retained earnings (£ 000')	Total (£ 000')
Balance as at 1 January 2017	**60,000**	**219**	**-**	**3,031**	**63,250**
Impact of prior year's adjustment	-	-	-	(136)	(136)
Restated balance as at 1 January 2017	**60,000**	**219**	**-**	**2,895**	**63,114**
Profit for the year as previously restated	-	-	-	4,401	4,401
Impact of prior year's adjustment	-	-	-	(187)	(187)
Available for sale (net gains during the year)	-	89	-	-	89
Restated balance as at 31 December 2017	**60,000**	**308**	**-**	**7,109**	**67,417**
Balance as at 1 January 2018 (restated)	**60,000**	**308**	**-**	**7,109**	**67,417**
- Change in accounting policy	-	(308)	308	(953)	(953)
- Deferred tax impact on change in accounting policy	-	-	-	162	162
	-	-	-	(791)	(791)
- Adjustment in fair value due to change in investment classification	-	-	(135)	-	(135)
- Deferred tax impact on fair value on change in investment classification	-	-	25	-	25
	-	-	(110)	-	(110)
Net losses transferred due to reclassification	-	-	7	-	7
Balance as at 1 January 2018 (restated)	**60,000**	**-**	**205**	**6,318**	**66,523**
Profit for the year as previously restated	-	-	-	3,588	3,588
Impact of prior year's adjustment	-	-	-	(223)	(223)
Fair value through other comprehensive income (net losses during the year)	-	-	(300)	-	(300)
Deferred tax	-	-	56	-	56
	-	-	(244)	-	(244)
Net losses transferred to OCI due to impairment	-	-	7	-	7
Balance as at 31 December 2018 (restated)	**60,000**	**-**	**(32)**	**9,683**	**69,651**

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	Called up share capital (£ 000')	Available for sale reserve (£ 000')	Fair value through other comprehensive income reserve (£ 000')	Retained earnings (£ 000')	Total (£ 000')
Balance as at 1 January 2019	**60,000**	**-**	**(32)**	**9,683**	**69,651**
Adjustment on initial application of IFRS 16					
- Change in accounting policy	-	-	-	(182)	(182)
- Deferred tax impact on change in accounting policy	-	-	-	35	35
	-	-	-	(147)	(147)
Balance as at 1 January 2019	**60,000**	**-**	**(32)**	**9,536**	**69,504**
Dividend paid	-	-	-	(1,794)	(1,794)
Profit after tax	-	-	-	3,484	3,484
Fair value through other comprehensive income (net gains during the year)	-	-	308	-	308
Deferred tax	-	-	(58)	-	(58)
			250	-	250
Net losses transferred to OCI due to impairment	-	-	30	-	30
Balance as at 31 December 2019	**60,000**	**-**	**248**	**11,226**	**71,474**

The accompanying notes on pages 52 to 112 form an integral part of the financial statements.

The Bank adopted IFRS 9 with effect from 1 January 2018 and IFRS 16 applied from 1 January 2019. Due to the transition method applied, the comparative year amounts have not been restated.

The Financial Statements for the year 2018 were restated to account for the prior year’s adjustment (Note 32)

These financial statements were approved by the Board of Directors and authorised for issue on 23 April 2020.

Cash Flow Statement

For the year ended 31 December 2019

	Notes	2019 (£ 000')	2018 Restated (£ 000')
Cash flows from operating activities			
Profit before tax		3,740	4,097
Adjusted for:			
- (Reversal) / Impairment losses on loans and advances at amortised cost	11	(303)	(926)
- Gain sale of financial assets at fair value through other comprehensive income		(308)	-
- Depreciation	19	932	522
		4,061	**3,693**
Net (increase)/decrease in operating assets			
Loans and advances to banks at amortised cost		(39,565)	663
Loans and advances to customers at amortised cost		(31,224)	(18,509)
Derivative financial instruments for risk management		(190)	112
Other assets		206	618
Net increase/(decrease) in operating liabilities			
Due to banks at amortised cost		(10,677)	1,534
Due to customers at amortised cost		53,520	26,641
Derivative financial instruments for risk management		175	(87)
Accruals, deferred income and other liabilities		65	1,333
Current tax liabilities		(561)	(773)
Leases paid		(436)	(486)
Tax paid		(372)	(350)
Net cash (outflow) / inflow from operating activities		**(24,998)**	**14,389**
Cash flows from investing activities			
Purchase of property and equipment		(457)	(303)
Purchase of financial investments		(13,163)	(38,137)
Maturity /sale of financial investments		32,572	25,229
Net cash inflow / (outflow) from investing activities		**18,952**	**(13,211)**
Cash flows from financing activities			
Payment of dividend		(1,794)	-
Subordinated liabilities		(6)	20
Net cash (outflow) / inflow from financing activities		**(1,800)**	**20**
Net increase / (decrease) in cash and cash equivalents		**(7,846)**	**1,198**
Cash and cash equivalents at the beginning of the year		66,810	65,612
Cash and cash equivalents at the end of the year		**58,964**	**66,810**

The accompanying notes on pages 52 to 112 form an integral part of the financial statements.

The Financial Statements for the year 2018 were restated to account for the prior year's adjustment (Note 32)

Notes to the Financial Statements

For the year ended 31 December 2019

1. The company and its operation

Habib Bank Zurich plc ("the Bank or HBZ UK") was incorporated in the United Kingdom on 28 January 2014 as a public limited company. The Bank is a wholly owned subsidiary of Habib Bank AG Zurich, Weinbergstrasse 59, PO Box 225, 8042 Zurich, Switzerland ("The Group). The Group's financial statements are available at www.habibbank.com.

2. Basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS).

The functional currency of the Bank is Pound Sterling, which is also the presentational currency of these financial statements.

3. Basis of measurement

The financial statements have been prepared on a historical cost basis, except for the following material items:

Items	Measurement basis
Financial assets at FVOCI (applicable from 1 January 2018)	Fair value
Derivative financial instruments	Fair value

4. Going concern

As detailed in the Directors' Report, the Directors believe that it remains appropriate to prepare the financial statements on a going concern basis for the foreseeable future from the reporting date. In making this assessment, the Directors have considered a wide range of information relating to present and future conditions, including the current state of the Bank's financial position, future projections of profitability, cash flows and capital and liquidity resources and the longer-term strategy of the business.

The Bank's capital and liquidity plans have been stress tested against a severe but plausible downside scenario used in the assessment of the ICAAP and ILAAP reviewed and approved by the Board of Directors. The Board concluded that both capital and liquidity remained within present regulatory requirements over the going concern period. The Directors also considered the subordinated debt which is repayable in 2021 subject to prior notification to PRA in their assessment with the expectation that this will be rolled over.

The Covid-19 impacts are not yet fully known and will depend on many factors including the length of the closure of certain businesses and social facilities, the social distancing measures and the success and continuity of the government and Bank of England measures put in place to support the economy and businesses. The Directors have considered and continue to actively monitor the financial implications of the risks associated with Covid-19, including the expected effect of Management actions taken in response to mitigate the impacts.

5. Accounting Policies

5.1 Compliance with international Financial Standards

The financial statements of the Bank have been prepared in accordance with the Companies Act 2006 and with International Financial Reporting Standards ("IFRS") as adopted by the European Union. IFRS comprise accounting standards issued by the International Accounting Standards Board ("IASB"), as well as interpretations issued by the International Financial Reporting Interpretation Committee ("IFRIC").

This is the first set of the Bank's annual financial statements in which IFRS 16 Leases has been applied.

Changes to significant accounting policies are described on Note 5.4.

5.2 Standards issued but not yet effective

New standards and amendments to standards have been issued by the International Accounting Standards Board, which are not yet effective for these financial statements. The key requirements are described below:

5.2.1 Other standards

The following amended standards are not expected to have a significant impact on the Bank's financial statements:

- Annual improvement to IFRS Standards 2015-2017 Cycle – various standards
- Long-term interests in associates and Joint Ventures (Amendments to IAS 28)
- Plan Amendment, Curtailment or Settlement (Amendment to IAS 19)
- IFRIC 23 Uncertainty over Income Tax Treatments
- Amendments to Reference to Conceptual Framework in IFRS Standards
- IFRS 17 Insurance Contracts

5.3 Critical accounting estimates and judgements

The preparation of the Bank's financial statements in accordance with IFRS requires management to make judgements, estimates and assumptions that affect the application of the Bank's and the reported amounts of revenues, expenses, assets and liabilities, and the accompanying disclosures. Actual results may differ from estimates.

Estimates and assumptions predominantly relate to ECL modelling, impairment of loans and advances and the determination of useful lives and residual values for property and equipment.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to estimates are recognised prospectively.

5.3.1 Judgement

Information about judgements made in applying accounting policies that have the most significant effects on the amounts recognised in the financial statements is included in the following notes:

- Note 5.5.3: classification of financial assets: assessment of business model within which the assets are held and assessment of whether the contractual terms of the financial assets are SPPI on the principal amount outstanding.

- Note 31.8: establishing the criteria for determining whether credit risk on the financial asset has increased significantly since initial recognition, determining methodology for incorporating forward-looking information into measurement of ECL and selection and approval of models used to measure ECL.

In determining the amount of the impairment loss, the Bank is required to exercise a degree of judgement.

The accuracy of the provision would therefore be affected by unexpected changes to these assumptions. The table below shows the estimated ECL impact on key principal portfolios for both a positive growth (Upward scenario) and a downturn (Downward scenario) of macroeconomic variables used by the Bank in estimating the Estimated Credit Loss (Loss).

The inputs have been modelled by replacing the Baseline macroeconomic variables with the Downside and Upside movement re-calibrating the PDs and LGDs.

Impact on ECL	2019	2018
Improvement in Debt to GDP Ratio and unemployment rate 5%	7% decrease	6% decrease
Improvement in Debt to GDP Ratio and unemployment rate 10%	14% decrease	11% decrease
Improvement in Debt to GDP Ratio and unemployment rate 20%	27% decrease	22% decrease
Deterioration in Debt to GDP Ratio and unemployment rate 5%	7% increase	6% increase
Deterioration in Debt to GDP Ratio and unemployment rate 10%	15% increase	12% increase
Deterioration in Debt to GDP Ratio and unemployment rate 20%	31% increase	24% increase

- *Effective interest rate:* Bank makes assumptions around the expected lives of mortgages and the collateral support to calculate the effective interest rate for specific customer. Management regularly reviews these assumptions and compares with actual results.

- *Tax position:* Recognition and measurement of deferred tax assets is based on business profit forecasts. Details on the recognition of deferred tax assets is provided in Note 13.

- *Fair value of derivatives and financial assets:* The Bank measures Fair Value through Other Comprehensive Income (FVOCI) at fair value using market prices and Derivative financial instruments based on observable market data. Note 30 provide the determination criteria of the fair value of financial instruments with significant unobservable inputs.

- Note 5.5.9 provides the recognition and measurement of provision and contingencies.

5.3.2 Assumptions and estimation uncertainties:

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment in the year ended 31 December 2018 is included in the following notes.

Impairment of financial instruments at Note 5.5.3 page 61 explains determining inputs into the ECL measurement model, including incorporation of forward-looking information. These estimates and assumptions are explained in the notes below.

5.4 Changes in accounting policies

The Bank has initially adopted IFRS 16 from 1 January 2019.

Due to the transition method applied, the comparative year amounts have not been restated.
The initial application of applying IFRS 16 did not have material impact except additional disclosure requirements.

Except for the changes below, the Bank has consistently applied the accounting policies as set out on Note 5.5 to all periods presented in these financial statements.

5.4.1 IFRS 16 Leases

IFRS 16 Leases replaces the requirements in IAS 17 Leases and related interpretations and is applicable for the first time for entities with an annual reporting period beginning on or after 1 January 2019.

IFRS 16 introduces a single, on-balance sheet lease accounting model for lessees. A lessee recognises a right-of-use (ROU) asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. There are optional exemptions for short-term leases and leases of low-value items. Lessor accounting remains a similar to the current standard-i.e. Lessors continue to classify leases as finance or operating leases.

IFRS 16 replaces existing leases guidance, including IAS 17 Leases, IFRIC 4 Determining whether an Arrangement contains a Lease, SIC-15 Operating Leases-Incentives and SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease.

The Bank applied IFRS 16 initially on 1 January 2019, using a modified retrospective approach. Therefore, the cumulative effect of adopting IFRS 16 has been recognised as an adjustment to the opening balance of the retained earnings as at 1 January 2019, with no restatement of comparative information.

The Bank recognised new assets and liabilities for its operating leases of branch and office premises. The nature of expenses related to these leases has now changed because IFRS 16 replaces the straight-line operating lease expense with a depreciation charge for right-of-use assets and interest expense on lease liabilities.

The Bank leases some branches and office premises that previously classified as operating leases under IAS 17 based on its assessment of whether the lease transferred substantially all of the risks and rewards incidental to ownership of the underlying asset to the Bank. Under IFRS 16, the Bank recognises right-of-use assets and lease liabilities for leases of branch and office premises – i.e. these leases are on-balance sheet. Further, the Bank has not entered into any new leases during the year ended 31 December 2019.

On transition, for these leases, lease liabilities were measured at the present value of the remaining lease payments, discounted at the Group's incremental borrowing rate as at 1 January 2019.

Right-of-use assets are measured at their carrying amount as if IFRS 16 had been applied since the commencement date, discounted using the lessee's incremental borrowing rate at the date of initial application.

The Bank initially applied IFRS 16 at 1 January 2019, which requires the recognition of right-of-use assets and lease liabilities for lease contracts that were previously classified as operating leases. The Bank used a number of practical expedients when applying IFRS 16 to leases previously classified as operating leases under IAS 17. In particular, the Bank did not recognise right-of-use assets and liabilities for leases for which the lease term ends within 12 months of the date of initial application.

As a result, the Bank has recognised £3.17 million of right-of-use assets and £3.36 million of liabilities from those lease contracts. The Bank has applied IFRS 16 using the modified retrospective approach, under which comparative information is not restated.

On transition to IFRS 16, the Bank recognised right-of-use assets and lease liabilities, recognising the difference in retained earnings. The impact on transition is summarised below.

	(£ 000')
Leased Assets – ROU	3,172
Leased Liabilities	(3,354)
	(182)
Deferred tax	35
Net impact adjusted in opening equity	**(147)**

When measuring lease liabilities, the Bank discounted lease payments using its incremental borrowing rate at 01 January 2019. The weighted average rate applied is 1.25%.

	(£ 000')
The operating lease commitments as at 31 Dec 2018 as disclosed under IAS17	3,630
Discounted using the incremental borrowing rate as at 1 January 2019	3,408
Recognition exemption for leases with less than 12 months term at transition	(54)
Lease liabilities recognized at 1 January 2019	**3,354**

5.5 Significant accounting policies

As a result of adoption of IFRS 16 effective 01 January 2019 the Bank has presented relevant significant accounting policies separately for the year 2018 and 2019 as the 2018 financial statements were prepared on the basis of IAS 17 "Leases and related interpretations."

The key changes to the Bank's accounting policies resulting from its adoption of IFRS 16 are summarised on Note 5.4.1 above.

Revenue recognition

5.5.1 Interest income and expense

Interest income and expense are recognised in profit or loss using the effective interest method, the 'effective interest rate' is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to:

- The gross carrying amount of the financial asset under stage 1 and stage 2 ; or
- The net amount (gross carrying amount less provisions held) under stage 3; or
- The amortised cost of the financial liability

When calculating the effective interest rate for financial instruments other than purchased or originated credit-impaired assets, the Bank estimates the future cash flows considering all contractual terms of the financial instruments but does not the assets' future credit losses.

The 'amortised cost' of a financial asset or financial liability is the amount at which the financial asset or financial liability measured on initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any expected credit loss.

The 'gross carrying of a financial asset' is the amortised cost of a financial asset before adjusting for any expected credit loss allowance.

5.5.2 Non-interest income: Fee and commission income

The Bank adopted IFRS 15 *Revenue from Contracts with Customers* effective 01 January 2018. The Bank provided banking services to personal and business customers, including account management, foreign currency transactions and servicing fees.

Fee and commission income is accounted for depending on the services to which the income relates:

- Revenue from account services and servicing fees is recognised over time as the services are provided.
- Commitment fees form an integral part of the effective interest rate of a financial instrument. These are recognised as an adjustment to the effective interest rate and recorded in interest income; and
- Loan termination represents fee paid by customers on early repayment of loans is recognised at the time loan is settled by the customer.
- Fees for ongoing account management are charged to the customer's account as per schedule of fee and charges. The Bank sets the rates separately for personal and business banking customers in each jurisdiction on monthly basis.
- Revenue earned on the execution of a significant act is recognised in fee income when the act is completed including trade finance income;
- Transaction-based fees for interchange and foreign currency transactions are charges to the customer's account when the transaction takes place.
- Bank provides locker services to the customers, the fee of which is charged upfront on annual basis and amortised monthly.
- Other fees charged to the customer's account when the transaction takes place.

5.5.3 Financial assets and liabilities

Recognition and initial measurement

The Bank initially recognises loan and advances, deposits, debt securities issued and subordinated liabilities on the date on which they are originated. All other financial instruments (including regular-way purchases and sales of financial assets) are recognised on the trade date, which is the date on which the Group becomes a party to the contractual provisions of the instrument.

A financial asset or financial liability is measured initially at fair value plus, for an item not at FVTPL, transaction costs that are directly attributable to its acquisition or issue. The fair value of a financial instrument at initial recognition is generally its transaction price.

Classification

IFRS 9 contains three principle classification categories for financial assets: measured at amortised cost (AC), fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL). IFRS 9 classification is generally based on the business model in which a financial asset is managed and its contractual cash flows. The standard eliminates the previous IAS 39 categories of held-to-maturity, loans and receivables and available-for-sale.

IFRS 9 largely retains the existing requirements of IAS 39 for the classification of financial liabilities. However, although under IAS 39 all fair value changes of liabilities designated under the fair value option were recognised in profit or loss, under IFRS 9 fair value changes are generally presented as follows:

- The amount of change in the fair value that is attributable to changes in the credit risk of the liability is presented in OCI; and
- The remaining amount of change in the fair value is presented in profit or loss.

Business model assessment

The Bank has considered the business model objective for each category of financial assets. For all loans and advances to banks and customers, the objective is to collect the contractual cash flows. The Bank maintains financial investments in (i) held to collect and (ii) held to collect and sell. For financial investments held to collect, the objective is to collect the contractual cash flows while for the financial investments held to collect and sell, the objective is to collect the contractual cash flows and sell the assets.

The Bank makes an assessment of the objectives of a business model in which as asset is held at a portfolio level as it best reflects the way the business is managed, and information is provided to management.

Assessment whether contractual cash flows are solely payment of principal and interest (SPPI Test)

For the purposes of this assessment, 'principal' is defined as the fair value of the financial asset on initial recognition. 'Interest' is defined as consideration of the time value of money and for the credit risk associated with the principal amount during a particular period of time and for basic lending risk and costs, as well as profit margin.

The Bank has made an assessment of the cash flow characteristics (SPPI test) of financial assets and concluded that loans and advances to banks and customers will continue to be recognized at amortized cost and financial investments at fair value through other comprehensive income and at amortised cost.

In assessing whether the contractual cash flows are SPPI, the Bank considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows that it would not meet its condition.

As a result of the assessments made, the Bank does not consider there is any material impact to the classification and measurement of its financial assets and liabilities.

Based on Bank's assessment it does not hold any financial assets, which fails to meet the SPPI test.

Financial Assets

As required by IFRS 9 classification and measurement of financial assets is based on the Bank's business model for managing the asset and the asset's contractual cash flow characteristics.

Amortised Cost

A financial asset is measured at amortised cost if it meets both the following conditions and is not designated as FVTPL:

- The asset is held with the business model whose objective is to hold assets to collect contractual cash flows; and
- The contractual terms of the financial asset give rise on specified basis to cash flows that are SPPI.

Fair value through other comprehensive income (FVOCI)

A debt instrument is measured at FVOCI only if it meets both the following conditions and is not designated as FVTPL:

- The asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- The contractual terms of the financial assets give rise on specific dates to cash flows that are SPPI.

Fair value through profit and loss (FVTPL)

- All other financial assets are classified as measured at FVTPL.

Financial liabilities

All financial liabilities are measured at amortised cost, except for financial liabilities at fair value through profit or loss. Such liabilities include derivatives (other than derivatives that are financial guarantee contracts or are designated and effective hedging instruments), other liabilities held for trading, and liabilities that an entity designates to be measured at fair value through profit or loss.

Derecognition

Financial Assets

The Bank derecognise a financial asset when the contractual rights to the cash flows from the financial asset expire, or it transfers the rights to receive the contractual flows in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred or in which the Bank neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset.

On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset derecognised) and the sum of (i) the consideration received (including new asset obtained less any liability assumed) and (ii) any cumulative gain or loss that had been recognised in OCI is recognised in profit or loss.

Financial Liabilities

The Bank derecognises a financial liability when its contractual obligations are discharged or cancelled or expire.

Modification of financial assets and financial liabilities

Financial Assets

If the terms of a financial asset were modified, then the Bank evaluated whether the cash flows of the modified assets were substantially different.

If the cash flows were substantially different, then the contractual rights to cash flows from the original financial asset were deemed to have expired. In this case, the original financial asset was derecognised, and a new financial asset was recognised at fair value plus any eligible transaction cost. Any fees received as part of the modification are accounted for as follows:

- Fees that are considered in determining the fair value of the new asset and fees that represent reimbursement of eligible transaction costs are included in the initial measurement of the asset; and
- Other fees are included in profit or loss as part of the gain or loss on derecognition.

If cash flows are modified when borrower is in financial difficulties, then the objective of the modification is usually to maximise recovery of the original contractual terms rather than to originate a new asset with substantially different term. If the Bank plans to modify a financial asset in a way that would result in forgiveness of cash flows, then it first considers whether a portion of the asset should be written off before the modification takes place.

Financial Liabilities

The Bank derecognises a financial liability when its terms were modified, and the cash flows of the modified liability were substantially different. The difference between the carrying amount of the financial liability derecognised and consideration paid is recognised in profit or loss.

Fair value measurement

'Fair value’ is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Bank has access at that date. The fair value of a liability reflects its non-performance risk.

When one is available, the Bank measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as ‘active’ if transactions for the asset or liability takes place with sufficient frequency and volume to provide pricing information on an ongoing basis.

If there is no quoted price in an active market, then the Bank uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction.

Impairment of financial assets

ECL are probability-weighted estimates of credit losses. They are measured as follows:

Financial assets that are not credit impaired at the reporting date: at the present value of all cash shortfalls i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Bank expects to receive.

Financial assets that are credit-impaired at the reporting date: at the difference between the gross carrying amount and the present value of the future cash flows.

IFRS 9 Impairment applies to financial instruments that are not measured at fair value through profit and loss (FVTPL). Financial assets falling within the scope of impairment are provided for by calculating their Expected Credit Loss (ECL). This requires considerable judgement regarding how changes in economic factors affect ECLs, which will be determined on a probability-weighted basis.

Estimated Credit Loss (ECL)

ECL is an estimate of present value of cash shortfalls over the life of the financial instrument and is computed as a product of probability of default (PD), loss given default (LGD) and exposure at default (EAD). The present value of cash shortfalls is calculated by taking into account the time value of money and forward-looking information.

Probability of default (PD)

The PD represents the expected point-in-time probability of a default over the next 12 months and remaining lifetime of the financial instrument, respectively, based on conditions existing at the balance sheet date and future economic conditions that affect credit risk.

Loss given default (LGD)

The LGD represents the expected loss conditional on default, taking into account the mitigating effect of collateral, its expected value when realized, and the time value of money.

Exposure at default (EAD)

The EAD represents the expected exposure at default, taking into account the repayment of principal and interest from the balance sheet date to the default event together with any expected drawdown of a facility.

Measurement of ECL

IFRS 9 requires an unbiased and probability weighted estimate of credit losses by evaluation of a range of possible outcomes that incorporates forecasts of future economic conditions. Measurement of ECLs at each reporting period should reflect reasonable and supportable information at the reporting date about past events, current conditions and forecasts of future economic conditions.

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

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

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

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

- *Where a financial instrument includes both a drawn and an undrawn component / off balance sheet items, and the Bank cannot identify the ECL on the loan commitment component separately for those on the drawn components:* The Bank presents a combined loss allowance for both components. The combined amount is presented as a deduction from gross carrying amount of the drawn component. Any excess of the loss allowance over the gross amount of the drawn component is presented as a provision; and

- *Debt instruments measured at FVOCI:* no loss allowance is recognised in the statement of financial position because the carrying amount of these assets is their fair value. However, the loss allowance is disclosed and recognised in the fair value reserves.

Significant increase in credit risk (SICR)

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

The Bank considers 30 days past due (DPD), marking the status of a loan as non-performing, a rating downgrade, restructure tag, or cross product defaults as being strong indicators of a significant increase in credit risk of an account. Hence, staging rules have been determined based on these criteria, as explained below:

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

Staging Criteria

Stage 1 – 12-month ECL

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

Stage 2 – Lifetime ECL

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

Stage 3 – Lifetime ECL

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

Write off

Loan and debt securities are written off (either partially or in full) where there is no reasonable expectation of recovering a financial asset in entirely or a portion thereof. This is generally the case when the Bank determines that the borrower does not have assets or source of income that could generate sufficient cash flows to repay the amounts subject to the write-off. This assessment is carried out at the individual asset level.

Recoveries of amount previously written off are included in 'impairment loss on financial instruments' in the statement of profit or loss or OCI.

Financial assets that are written off could still be subject to enforcement activities in order to comply with the Bank's procedures for recovery of amounts due.

Hedge accounting

IFRS 9 also incorporates hedge accounting rules that intend to align hedge accounting with risk management practices. There is also an accounting policy choice to defer the adoption of IFRS 9 hedge accounting and to continue with IAS 39 hedge accounting. As the Bank does not currently adopt hedge accounting, this part of the standard does not currently impact the Bank.

5.5.4 IFRS 15 Revenue from Contracts with Customers

IFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognised. It replaces IAS 18 Revenue, IAS 11 Construction Contracts and related interpretations.

The Bank initially applied IFRS 15 on 1 January 2018 without any practical expedients. The impact of transitioning to IFRS 15 did not materially change the basis of recognition of fee and commission in 2019 in comparison to the accounting policies applied in the previous accounting.

5.5.5 Derivative financial instruments

All derivative instruments are held at fair value through profit or loss. Derivatives are classified as assets when their fair value is positive or as liabilities when their fair value is negative. Derivative assets and liabilities arising from different transactions are only offset, if they meet the offsetting criteria under IAS 32.

5.5.6 Employee benefits

Short-term employee benefits, such as salaries, paid absences and other benefits, are accounted for on an accrual basis over the period which employees have provided services in the year. Bonuses are recognised to the extent that the Bank has a present obligation to its employees that can be measured reliably. All expenses related to employee benefits are recognised in the income statement in staff costs, which is included within operating expenses.

The Bank provides a defined contribution pension scheme for its staff. For this scheme, the Bank recognizes contributions due in respect of the accounting period in the income statement. Any contributions unpaid at the balance sheet date are included as a liability.

5.5.7 Cash and cash equivalents

Cash and cash equivalents represent Cash in bank in current account and balances held with the central bank.

For the purpose of the cash flow statement, cash and cash equivalents include highly liquid financial assets that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in their fair value.

Such financial assets are normally those with less than three months' maturity from the date of acquisition, and include cash and balances at central banks, loans and advances to banks and FVOCI investments.

5.5.8 Property and equipment

Property and equipment are initially recognised at acquisition cost, including any costs directly attributable to bringing the assets to the location and condition necessary for it to be capable of operating in the manner intended by the Bank’s management.

Property and equipment are subsequently measured using the cost model at cost less accumulated depreciation and impairment losses, if any. The Bank adheres to IAS 36, Impairment of Assets which, seeks to ensure that property and equipment assets are not carried at more than their recoverable amount (i.e. the higher of fair value less costs of disposal and value in use).

At the end of each reporting period, the Bank assesses whether there is any indication that a property and equipment may be impaired (i.e. its carrying amount may be higher than its recoverable amount). If there is an indication that a property and equipment may be impaired, then the asset's recoverable amount is calculated.

Depreciation is provided on a straight-line basis over estimated useful lives as follows:

Freehold improvements	25 Years
Leasehold improvements	Over the remaining period of the lease
Motor vehicles	5 years
Furniture, fixture and fittings	3 - 5 years
Computer hardware	4 years
Buildings	40 years

The assets’ useful lives are reviewed, and adjusted if appropriate, at the reporting date. Gains or losses arising on the disposal of property and equipment are determined as the difference between the disposal proceeds and the carrying amount of the assets and are recognised in profit or loss within other operating income.

5.5.9 Provisions and contingent liabilities

Provisions are recognised when it is probable that an outflow of economic benefits will be required to settle a current legal or constructive obligation as a result of past events, and a reliable estimate can be made of the amount of the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability.

Provisions are measured at the estimated expenditure required to settle the present obligation, based on the most reliable evidence available at the reporting date, including the risks and uncertainties associated with the present obligation.

Contingent liabilities are possible obligations whose existence depends on the outcome of uncertain future events or those present obligations where the outflows of resources are uncertain or cannot be measured reliably. Contingent liabilities are disclosed in the financial statements unless the probability of an outflow of resources is remote.

Contingent assets are not recognised. Contingent assets are disclosed in the financial statements when an inflow of economic benefits is probable.

5.5.10 Taxes

Income tax on the profit or loss for the year comprises current tax and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in other comprehensive income, in which case it is recognised in other comprehensive income.

Current tax is the tax expected to be payable on the taxable profit for the year, calculated using tax rates enacted or substantively enacted by the balance sheet date, and any adjustment to tax payable in respect of previous year.

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the balance sheet and the amounts attributed to such assets and liabilities for tax purposes. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent it is probable that future taxable profits will be available against which deductible temporary differences can be utilised. Deferred tax asset is recognised based on availability of future taxable profit against which carry-forward tax losses can be used. Future profits are based on financial projections prepared based on some key assumptions, which may vary in future due to internal and external factors such as projected growth, economic outlook, interest rates.

Deferred tax is determined using tax rates and legislation enacted, or substantively enacted, by the balance sheet date and is expected to apply when the deferred tax asset is realised, or the deferred tax liability is settled.

Deferred and current tax assets and liabilities are only offset when they arise in the same tax reporting group and where there is both the legal right and the intention to settle on a net basis or to realise the asset and settle the liability simultaneously.

5.5.11 Foreign currency translation

Transactions in foreign currencies are initially recorded at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated into the functional currency at the rate of exchange ruling at the reporting date.

5.5.12 Segment Reporting

The Bank undertakes commercial banking, which is carried on mainly within the United Kingdom and all other services are ancillary to commercial banking activities. The management information system and reporting to Board is also aligned to this business model.

The Bank currently manages its business activities on a centralised basis; as a result, the revenue and costs are not attributable to any one operating and geographic segment. No revenue transaction with a single external customer or counterparty amounted to 10% of total revenue for the year.

5.5.13 Accounting for operating leases

Applicable after 1 January 2019

The Bank has applied IFRS 16 using the modified retrospective approach and therefore the comparative information has not been restated and continues to be reported under IAS 17 and IFRIC 4.

At inception of a contract, the Bank assesses whether a contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. To assess whether a contract conveys the right to control the use of an identified asset, the Group uses the definition of a lease in IFRS 16.

This policy is applied to contracts entered into (or changed) on or after 1 January 2019.

At commencement or on modification of a contract that contains a lease component, the Bank allocates consideration in the contract to each lease component on the basis of its relative standalone price. However, for leases of branches and office premises the Bank has elected not to separate non-lease components and accounts for the lease and non-lease components as a single lease component.

The Bank recognises a right-of-use asset and a lease liability at the lease commencement date. The right-of-use asset is initially measured at cost, which comprises the initial amount of the lease liability adjusted for any lease payments made at or before the commencement date, plus any initial direct costs incurred and an estimate of costs to dismantle and remove any improvements made to branches or office premises.

The right-of-use asset is subsequently depreciated using the straight-line method from the commencement date to the end of the lease term. In addition, the right-of-use asset is periodically reduced by impairment losses, if any, and adjusted for certain remeasurements of the lease liability.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Bank's incremental borrowing rate. Generally, the Bank uses its incremental borrowing rate as the discount rate.

The lease liability is measured at amortised cost using the effective interest method.

Applicable before 1 January 2019

The Bank applies IAS 17 Leases, for operating leases. An operating lease is a lease where substantially all of the risks and rewards of the leased assets remain with the lessor where the Bank is the lessee, rentals payable are recognised as an expense in the income statement on a straight-line basis over the lease term unless another systematic basis is more appropriate.

On adoption of IFRS 16, Bank recognised lease liabilities in relation to leases that had previously been classified as 'operating leases' in accordance with IAS 17 'Leases'. These liabilities were recognised in 'other liabilities' and measured at the present value of the remaining lease payments, discounted at the lessee's incremental borrowing rate at 1 January 2019. The associated right of use ('ROU') assets were recognised in 'Fixed assets'.

Leases are recognised as a ROU asset and a corresponding liability at the date at which the leased asset is made available for use. Lease payments are allocated between the liability and finance cost. The finance cost is charged to profit or loss over the lease term so as to produce a constant period rate of interest on the remaining balance of the liability. The incremental borrowing rate is used that the Bank would have to pay to borrow the funds necessary to obtain an asset of a similar value in a similar economic environment with similar terms and conditions. The rates are determined for each economic environment in which Bank operates.

The incremental borrowing rate is the discount rate that Bank determines by analysing its borrowings from various external sources and makes certain adjustments to reflect the terms of the lease and type of asset leased.

The Bank discounted lease payments using its incremental borrowing rate. The weighted average rate applied is 1.25%.

Short-term leases and leases of low-value assets

The Bank has elected not to recognise right-of-use assets and lease liabilities for short-term leases, including lease of a rental premises. The Bank recognises the lease payments associated with these leases as an expense on a straight-line basis over the lease term.

6. Net interest income

	2019 (£ 000')	2018 (£ 000')
Interest income		
Funds held with central bank	402	406
Due from banks	1,458	1,156
Loans and advances to customers	19,421	17,881
Negative interest on due to customers (6.1)	105	58
Financial investments – FVOCI	1,387	1,082
Financial investments – Amortised cost	306	396
	1,693	1,478
Total interest Income	**23,079**	**20,979**
Interest expense		
Due to banks	(100)	(29)
Due to customers	(5,113)	(4,299)
Subordinated liabilities	(431)	(403)
Liability against leased assets (ROU) (6.2)	(40)	-
Total interest Expense	**(5,684)**	**(4,731)**
Net Interest Income	**17,395**	**16,248**

Interest income against loans and advances to customers included total of £469k (2018: £213k) relating to impaired financial assets and has been considered as part of the cash flows when assessing for individual impairment provisions.

6.1 This includes the interest charged by the Bank on the deposits maintained in the currencies of Euro and Swiss Franc.

6.2 This represents the interest expense charged during the year on lease liabilities following the adoption of IFRS 16.

Windsor Castle

7. Net fee and commission income

	2019 (£ 000')	2018 (£ 000')
Fee and commission income		
Loan termination fee	82	291
Customer transaction fees	329	367
Trade Finance	413	376
Other fees and commission on banking and credit products	614	547
Total fee and commission income	**1,438**	**1,581**
Fee and commission expense		
Bank charges	(90)	(253)
Commission on internet deposits	(1)	(12)
Other fees and commission	(37)	(40)
Total fee and commission expense	**(128)**	**(305)**
Net fee and commission income	**1,310**	**1,276**

7.1 Disaggregation of fee and commission income

In the above table, fee and commission income with customers in the scope of IFRS 15 is disaggregated by major type of services.

The following table provides information about receivables and contract liabilities from contacts with customers:

	2019 (£ 000')	2018 (£ 000')
Receivables included in other assets	27	31
Deferred income included in other liabilities	633	593

The fee and commission income with customers is measured based on the consideration specified in a contract with a customer. The Bank recognised revenue when it transfers control over a service to a customer.

8. Other income

	2019 (£ 000')	2018 (£ 000')
Right to light – Note 8.1	105	-
Other	249	271
Total other income	**354**	**271**

8.1 This represents the amount received by Bank being “right to light” compensation. A "right to light" is an easement that gives a landowner the right to receive light through defined apertures in buildings on his or her land. The Bank received the above compensation as a result of a third-party development near to its head office reducing light to the Bank’s building.

9. Staff costs, including Directors' emoluments

	2019 (£ 000')	2018 (£ 000')
Salaries and allowances	(8,116)	(7,344)
Social security costs	(1,413)	(1,442)
Pension costs – defined contribution plan	(586)	(521)
Total staff costs	**(10,115)**	**(9,307)**
Average number of employees (Nos)	150	142
Directors emoluments		
- Total emoluments of Directors – £ 000	928	573
- Salary and benefits paid to the highest paid Director – £ 000	573	428

The emoluments of Directors disclosed above include salary and social security cost. Pension contribution included in Directors emoluments is £26,000 (2018: £24,000).

The Parent bank paid emoluments of other Non-Executive directors' and has not recharged the Bank specifically for their services.

Key management personnel:

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Bank.

The key management personnel are the members of the Bank's Executive Committee together with its Directors. The table below details, on an aggregated basis, key management personnel compensation:

	2019 (£ 000')	2018 (£ 000')
Salaries and other short-term benefits	1,490	1,176
Post-employment benefits	81	69
Total staff costs	**1,571**	**1,245**
Loans outstanding – £ 000	154	166
No of persons	1	2

The loans are on secured basis and expected to be settled in cash. The loans attracted interest rate of 3%. No provisions have been recognised in respect of loans given to key management personnel.

Deposits placed – £ 000	13	32
No of persons – Nos	3	4

10. Other operating expenses

		2019 (£ 000')	2018 Restated (£ 000')
Premises running costs		(1,646)	(2,128)
Legal and Professional charges		(702)	(290)
Auditors remuneration	10.1	(188)	(140)
IT and communication costs		(453)	(406)
Branches operation charges		(414)	(587)
Group direct expenses		(1,496)	(1,310)
Travelling and conveyance		(103)	(187)
Marketing and advertisement		(40)	(3)
Miscellaneous		(87)	(79)
Total other operating expenses		**(5,129)**	**(5,130)**

10.1 Auditors remuneration

Statutory audit fee	(170)	(125)
Client Asset and Money audit fee	(11)	(8)
K-Helix Licence fee	(7)	(7)
Total Auditors remuneration	**(188)**	**(140)**

11. Impairment gains / (losses) on financial assets

	2019 (£ 000')	2018 (£ 000')
Loans and advances to customers		
Charged during the year		
- ECL Stage 1	218	192
- ECL Stage 2	86	284
- ECL Stage 3	694	962
	(998)	(1,438)
Recovered / settled during the year		
- ECL Stage 1	83	843
- ECL Stage 2	376	427
- ECL Stage 3	1,073	1,155
	1,532	2,425
	534	987
Financial investments		
- ECL Stage 1	(33)	(7)
Due from banks		
- ECL Stage 1	(198)	(54)
Impairment losses on financial assets	**303**	**926**

12. Taxation

	2019 (£ 000')	2018 (£ 000')
Corporate tax:		
Current year	(570)	(614)
Prior year	22	13
	(548)	(601)
Deferred tax:		
Current year	292	(130)
	(256)	**(731)**

		2019 (£ 000')		2018 (£ 000')
Tax reconciliation				
Profit before tax		3,740		4,097
Expected tax charge	(19.0)%	(711)	(19.0)%	(778)
Permanent disallowable expenses	(3.4)%	(126)	(0.4)%	15
Deferred tax not recognized	2.0%	75	(0.9)%	(35)
Deferred tax on losses not previously recognized	12.9%	484	2.1%	87
Impact of rate differences	-	-	0.1%	4
Prior year adjustment	0.6%	22	(0.6)%	(24)
Total tax charge	**(6.8%)**	**(256)**	**(17.8)%**	**(731)**

The Corporation Tax rate from 01 April 2017 to 31 March 2020 is set at 19%. The Corporation Tax main rate at 19% for the financial year beginning 1 April 2020. The charge to Corporation Tax and the main rate will also be set at 19% for the financial year beginning 1 April 2021.

13. Deferred tax assets

Deferred taxes are calculated on temporary differences under the liability method using the tax rates expected to apply when the liability is settled, or the asset is realised.

Deferred tax assets mainly relate to carry forward losses. The amount of carry forward losses available as at 31 December 2019 was £19.3 million (2018: £21.9 million) on which estimated amount of deferred tax not recognised amounted to £3.3 million (2018: £3.7 million). The Bank only accounts for deferred tax on the basis of future profits for a foreseeable period not exceeding four years. The Bank is of the view that assumptions used for preparing cash flow projections beyond such period are subject to significant change.

The table below shows the deferred tax assets including the movement in the deferred tax account during the year:

2019 £ 000'	Tax losses carried forward	IFRS 9 transitional arrangement	FV Loss on FVOCI investments	IFRS 16 transitional arrangement	Total
Opening balance as at 01 January 2019	810	148	10	-	968
Charged to Equity (Note 27 / 5.4.1)	-	-	(10)	35	25
Charged to statement of income	312	(18)	-	(2)	292
Balance as at 31 December 2019	**1,122**	**130**	**-**	**33**	**1,285**

2018 £ 000'	Tax losses carried forward	IFRS 9 transitional arrangement	FV Loss on FVOCI investments	Total
Opening balance as at 01 January 2018	926	-	-	926
Charged to Equity (Note 27)	-	162	10	172
Charged to statement of income	(116)	(14)	-	(130)
Balance as at 31 December 2018	**810**	**148**	**10**	**968**

14. Cash in hand and with central bank

		2019 (£ 000')	2018 (£ 000')
Balance with central bank	Note 14.1	58,190	65,847
Cash in hand		774	963
Total cash in hand and with central bank		**58,964**	**66,810**

14.1 This includes an amount of £3m (2018: £3m) held as a settlement cap for Image Clearing System.

14.2 No ECL was calculated on above as there is immaterial credit risk involved.

15. Due from banks

	2019 (£ 000')	2018 (£ 000')
Money market placements	74,904	43,499
Cash in current accounts	17,027	15,542
Bankers acceptances	6,383	27
Cash in margin accounts*	320	-
	98,634	**59,068**
Estimated credit loss (ECL – Stage 1)	(336)	(137)
Total due from banks	**98,298**	**58,931**

* This represents cash held with counterparties in accordance with collateral requirement under Credit Support Annex (CSA) agreements.

16. Loans and advances to customers at amortised cost

	2019 (£ 000')	2018 (£ 000')
Commercial loans	394,680	362,162
Overdraft	30,160	30,752
Discounted bills & trade finance loans	10,580	11,212
Other loans including staff loans	354	434
Gross loans and advances to customers	**435,774**	**404,560**
Less: Provision for impairment	(5,038)	(5,583)
Net loans and advances to customers	**430,736**	**398,977**

16.1 Provision for impairment

	2019 (£ 000')	2018 (£ 000')
Balance brought forward from previous year	5,583	12,876
Impairment on portfolio as at 1 Jan 2018 – Adoption of IFRS 9	-	862
Balance at the beginning of the year	5,583	13,738
Impairment charged to profit and loss	998	1,438
Reversals during the period	(1,532)	(2,425)
Net impairment charged to P&L	(534)	(987)
Write off	(11)	(7,168)
Total provision for impairment	**5,038**	**5,583**

17. Financial investments

	2019 (£ 000')	2018 (£ 000')
Debt Securities		
Investment securities measured at amortised cost	16,917	34,912
Investment securities measured at FVOCI	67,669	68,473
Total financial investments	**84,586**	**103,385**
Investment securities measured at amortised cost		
General government	-	-
Multilateral development banks	16,917	34,912
Financial institutions	-	-
Multilateral development banks	-	-
	16,917	34,912
Investment securities measured at FVOCI		
General government	519	517
Multilateral development banks	16,392	23,491
Financial institutions	46,910	44,465
Corporates	3,848	-
	67,669	68,473
Total financial investments*	**84,586**	**103,385**

17.1 * As at 31 December 2019 all financial investments were free of any encumbrance (2018: Nil).

18. Derivative financial instruments

The Bank transacts derivatives to manage and hedge its own risk and that of its customers.

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

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

Derivatives are measured at their fair value, which is calculated as the present value of the future expected net contracted cash flows at market related rates as of the balance sheet date.

The fair values and notional amounts of derivative instruments are as follows:

	2019 (£ 000')	2018 (£ 000')
Notional amount	22,830	19,969
Fair value asset	357	167
Fair value liability	312	137

19. Property and equipment

2019 £ 000'	Land	Leasehold Premises (ROU)	Freehold and leasehold improvements	Other equipment	Furniture, fixture and fittings	Motor vehicles	Total
Cost							
As at 1 January 2019	1,050	-	10,786	1,838	1,922	106	15,702
Application of IFRS 16*	-	4,806	-	-	-	-	4,806
Additions	-	-	251	176	30	-	457
As at 31 December 2019	**1,050**	**4,806**	**11,037**	**2,014**	**1,952**	**106**	**20,965**
Accumulated Depreciation							
As at 1 January 2019	-	-	6,632	1,491	1,687	106	9,916
Application of IFRS 16	-	1,634	-	-	-	-	1,634
Depreciation	-	376	387	102	67	-	932
As at 31 December 2019	**-**	**2,010**	**7,019**	**1,593**	**1,754**	**106**	**12,482**
Net book value as at 31 December 2019	**1,050**	**2,796**	**4,018**	**421**	**198**	**-**	**8,483**
Net book value as at 31 December 2018	**1,050**	**-**	**4,154**	**347**	**235**	**-**	**5,786**

* Following the adoption of IFRS 16, the Bank has presented right-of-use assets within 'property and equipment' – i.e. the line item in which it presents underlying assets of the same nature that it owns.

2018 £ 000'	Land	Freehold and leasehold improvements	Other equipment	Furniture, fixture and fittings	Motor vehicles	Total
Cost						
As at 1 January 2018	1,050	10,631	1,751	1,861	106	15,399
Additions	-	155	87	61	-	303
As at 31 December 2018	**1,050**	**10,786**	**1,838**	**1,922**	**106**	**15,702**
Accumulated Depreciation						
As at 1 January 2018	-	6,275	1,392	1,621	106	9,394
Depreciation	-	357	99	66	-	522
As at 31 December 2018	**-**	**6,632**	**1,491**	**1,687**	**106**	**9,916**
Net book value as at 31 December 2018	**1,050**	**4,154**	**347**	**235**	**-**	**5,786**

20. Other assets

	2019 (£ 000')	2018 (£ 000')
Corporation tax	372	363
Prepayments	254	289
Receivable from Parent bank	7	-
Value added tax refundable	336	81
Customer transaction fee receivable	27	31
Other	74	117
Total other assets	**1,070**	**881**

21. Due to banks at amortised cost

Due to Parent bank (Habib Bank AG Zurich, Switzerland)	4,047	10,869
Due to associates (fellow subsidiaries)	2,274	5,980
Other deposits	401	208
Margin held	-	342
Total due to banks	**6,722**	**17,399**

22. Due to customers at amortised cost

	2019 (£ 000')	2018 (£ 000')
Time deposits	358,477	341,945
Current and demand accounts	218,028	180,954
Margin accounts	-	20
Call deposits	508	574
Total due to customers	**577,013**	**523,493**

23. Accrual, deferred income and other liabilities

	2019 (£ 000')	2018 Restated* (£ 000')
Bills payable	1,198	1,326
Lease Liability (23.1)	2,973	-
Staff costs payable	611	812
Accrued expenses	915	801
Deferred income	633	593
VAT reverse charge payable to HMRC	636	636
Other	576	392
Total accrual, deferred income and other liabilities	**7,542**	**4,560**

* The Financial Statements for the year 2018 were restated to account for the prior year's adjustment (Note 32)

23.1 The Bank leases a number of branch and office premises. The leases typically run for a period of 10 to 12 years, with an option to renew the lease after that date. Following the adoption of IFRS 16, the Bank has presented lease liabilities with the other liabilities.

The Bank also has short term lease of premises with contract terms of 12 months. The Bank has elected not to recognise right-of-use assets and lease liabilities for that lease.

Previously these leases were classified as operating leases under IAS 17.

Information about leases for which the Bank is lessee is presented below:

Right-of-use assets

Right-of-use assets relate to leased branch and office premises that are presented within property and equipment.

	2019 (£ 000')
Balance at 1 January	3,172
Depreciation charge for the year	(376)
Balance at 31 December	2,796

At 31 December 2018, the future minimum lease payments under non-cancellable operating leases were payable as follows.

Maturity analysis – Contractual undiscounted cash flows	2018 (£ 000')
Less than one year	421
Between one and five years	1,611
More than five years	1,598
Balance at 31 December	3,630

Amount recognised in profit & loss	2019 (£ 000')
Lease under IFRS 16	
Interest on lease liabilities	40
Expense related to short term lease	53
	93

	2018 (£ 000')
Operating lease under IAS 17	
Lease expense	486
	486

Amount recognised in statement of cash flows	2019 (£ 000')
Total cash outflows for leases	436
	436

24. Current tax liabilities

	2019 (£ 000')	2018* Restated (£ 000')
Provision for corporation tax	570	651
Prior year adjustment (Note 32)	-	(90)
Total current tax liabilities	**570**	**561**

* The Financial Statements for the year 2018 were restated to account for the prior year's adjustment (Note 32).

25. Subordinated liabilities

The Parent bank, Habib Bank AG Zurich, issued a subordinated loan of £20m in 2016, providing T-2 capital to the Bank. The loan carries interest at a rate of 6-month Libor plus 125 bps per annum to be paid semi-annually. The initial term of the loan is five years. The term of loan can be extended for one additional year on each anniversary with the mutual consent of both lender and borrower after the expiry of the initial term. Subordinated liabilities are measured at amortised cost using the effective interest method under IFRS 9.

26. Share capital

	2019 (£ 000')	2018 (£ 000')
Called up and fully paid		
60 million authorised and fully paid ordinary shares of £1 each (2018: 60 million ordinary shares of £1 each)	60,000	60,000
Share Capital	**60,000**	**60,000**

27. Fair value gain/(loss) on financial assets at fair value through other comprehensive income

	2019 (£ 000')	2018 (£ 000')
Fair value movement		
FV gain at the beginning of the year	(56)	379
Movement in FV due to change in classification	-	(135)
FV movement during the year	308	(300)
FV (loss) / gain at the end of the year	252	(56)
Deferred tax movement		
Deferred tax liability at the beginning of the year	10	(72)
Liability reversed due to change in investment classification	-	26
Net movement during the year	(58)	56
	(48)	10
	204	(46)
Net losses of FVOCI transferred due to impairment		
- Transferred on initial application of IFRS 9	14	7
- FV loss during the year	30	7
	44	14
FV gain/(loss) on financial assets at FVOCI	**248**	**(32)**

28. Contingent liabilities and commitments

The Bank enters into transactions, which exposes it to tax, legal and business risks in the ordinary course of business. Provisions are made for known liabilities, which are expected to materialise. Contingent obligations and banking commitments, which the Bank has entered into on behalf of customers and for which there are corresponding obligations from customers, are not included in assets and liabilities.

	2019 (£ 000')	2018 (£ 000')
Direct credit substitutes		
- Guarantees	5,868	6,084
Trade related contingent liabilities		
- Letters of credit	656	455
- Acceptances	36	96
Unused credit facilities	15,216	19,462

Unused credit facilities refer to commitments to make loans and revolving credits.

Commitments generally have fixed expiry dates, or other termination clauses. Since commitments may expire without being drawn upon, the total contract amounts do not necessarily represent future cash requirements. The potential credit loss is less than the total commitments since most commitments to extend credit are contingent upon customers maintaining specific standards. The Bank monitors the term to maturity of credit commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments.

29. Related party disclosure

Details of transactions between the Bank and related parties are summarized below.

	2019 (£ 000')	2018 (£ 000')
Banking transactions:		
- Interest earned from Parent bank	364	30
- Interest and expenses paid to Parent bank*	1,955	1,722
- Transactions with parent bank and fellow subsidiaries	9,878	11,727
Outstanding balance:		
- Due to Parent bank including subordinated loan	24,145	30,973
- Due to fellow subsidiaries	2,274	5,980
- Due from related parties	5,760	11,419

The Bank's related parties include Parent bank and fellow subsidiaries.

* Interest and expenses represent interest of £460k (2018: £412k) charged on borrowings and allocation of group expenses of £1,495k (2018: £1,310k).

The transactions arose from the ordinary course of business and on the same terms and conditions as for comparable transactions with third party counterparties.

Key management personnel information is disclosed in note 9.

30. Fair value of financial instruments

30.1 Fair value measurement:

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It is a measure as at a specific date and may be significantly different from the amount, which will actually be paid or received on maturity or settlement date. Fair values of financial assets and liabilities measured at fair value are determined on the basis of their gross exposures. The carrying amount of the financial instruments is a reasonable approximation of fair values as illustrated in the table below.

30.2 Valuation of financial assets and liabilities

Assets and liabilities carried at fair value or for which fair values are disclosed has been classified into three levels based on significance and observability of inputs to determine the fair values.

Level 1 fair value measurements are those derived from unadjusted quoted prices in active markets for identical assets or liabilities. Products classified as level 1 predominantly comprise debt securities where observable prices are available in the market.

Level 2 This category comprises forward currency contracts, valued using external exchange rates.

Level 3 portfolios are those where the valuation technique includes input not based on observable data and the unobservable inputs have a significant effect on the instruments' valuation. Where the fair value cannot be reliably determined for an investment, the instrument is measured at cost.

The Bank had no level 3 financial instruments.

30.3 Financial instruments carried at fair value and basis of valuation

£ 000'	2019 Level 1	2019 Level 2	2019 Level 3	2019 Total
Financial investments				
- Fair value through other comprehensive income	67,669	-	-	67,669
Derivative financial instruments-assets	-	357	-	357
Total financial assets carried at fair value	**67,669**	**357**	**-**	**68,026**
Derivative financial instruments-liabilities	**-**	**312**	**-**	**312**
Total financial liabilities carried at fair value	**-**	**312**	**-**	**312**

£ 000'	2018 Level 1	2018 Level 2	2018 Level 3	2018 Total
Financial investments				
- Fair value through other comprehensive income	68,473	-	-	68,473
Derivative financial instruments-assets	-	167	-	167
Total financial assets carried at fair value	**68,473**	**167**	**-**	**68,640**
Derivative financial instruments-liabilities	**-**	**137**	**-**	**137**
Total financial liabilities carried at fair value	**-**	**137**	**-**	**137**

30.4 Financial instruments not measured at fair value

The following table sets out the fair value of financial instruments not measured at fair value and analyse them by the level in the fair value hierarchy into which each fair value measurement is categorised.

£ 000'	Level 1 2019	Level 2 2019	Level 3 2019	Total fair value 2019	Total carrying amount 2019
Assets					
Cash in hand and with central bank	58,964	-	-	58,964	58,964
Due from banks	-	-	98,298	98,298	98,298
Loans and advances to customers	-	-	390,606	390,606	430,736
Financial investments	16,065	-	-	16,065	16,917
Liabilities					
Due to banks	-	-	6,722	6,722	6,722
Due to customers	-	-	575,188	575,188	577,013
Subordinated liabilities	-	-	19,571	19,571	20,098

£ 000'	Level 1 2018	Level 2 2018	Level 3 2018	Total fair value 2018	Total carrying amount 2018
Assets					
Cash in hand and with central bank	66,810	-	-	66,810	66,810
Due from banks	-	-	58,931	58,931	58,931
Loans and advances to customers	-	-	377,181	377,181	398,977
Financial investments	32,512	-	-	32,512	34,912
Liabilities					
Due to banks	-	-	17,399	17,399	17,399
Due to customers	-	-	520,057	520,057	523,493
Subordinated liabilities	-	-	19,164	19,164	20,104

The fair value of cash in hand and with central bank, due from banks and due to banks approximate to their carrying amount due to their short-dated nature of less than 1-year maturity.

The fair value of loans and advances to customers, due to customers and subordinated liabilities is estimated using valuation models, such as discounted cash flow techniques. Inputs into the valuation techniques include interest rates and outstanding maturities.

The fair value of other financial instruments is estimated using valuation models, such as discounted cash flow techniques. Input into the valuation techniques includes expected lifetime credit losses, interest rates and outstanding maturities.

31. Risk management

The Bank has an overall risk management framework set out in line with its risk appetite, documented within a set of risk management policies approved by the Board. Risk appetite defines the types and amounts of risk that the Bank is willing to take in pursuit of its business strategy. This is reviewed regularly and provides qualitative statements and quantitative measures to assist with the monitoring of various risk types. This process is underpinned by disclosure of risk exposures to Board, its committees and the senior management.

The Bank's approach to Risk Management is built on the principle of low to medium risk appetite and Investment return horizon, which is medium to long term. In order to achieve this, the Bank offers conventional products where the focus is on personalised customer service.

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

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

31.1 Board Committees

The Board of Directors has established Committees of the Board for effective oversight of business strategy and key risks. To implement an effective governance, process the Board established "Board Risk Committee" (BRC) and "Board Audit and Compliance Committee" (BACC).

The Board Risk Committee (BRC) oversees and challenges the risk management function to ensure that governance arrangements, risk framework and systems and controls are evaluated and managed properly. BRC periodically review the risk framework to evaluate its adequacy and appropriateness under the prevailing business environment and in light of major changes in internal or external factors. It provides assurance on the Bank-wide risk framework and monitors the overall risk profile of bank through effective control processes. BRC annually review the Risk Appetite Statement and consider the adequacy of risk limits and returns.

The independent internal audit function reports into BACC and conduct reviews of all key risk areas including the risk management framework. Reports are presented to BACC and the Board.

31.2 Management responsibilities

At an operational level the Risk Management Framework is managed through a management committee structure with delegated authorities from the Board. The Executive Committee presides over the committees and is responsible for implementing the Bank's strategic objectives and managing the business with adequate controls within the risk appetite of the Bank.

The management of the Bank through committee structure allows for Enterprise Wide Risk Management through the consideration of different aspects and challenge at decision-making levels. Significant and relevant decisions and issues at other committees are escalated to EXCO for information and consideration as appropriate. This structure ensures that management of the Bank's operations, strategic decision-making and risk management are undertaken on a consultative basis at committee level by experienced functional and business personnel.

The ALCO is the committee responsible to review and recommend to the EXCO the capital and liquidity related matters. The EXCO reviews and further recommend the same to the BRC and Board for its consideration, review and approval.

31.3 Credit risk

Credit Risk is defined as loss of principal or a loss of a financial reward stemming from a borrower's failure to repay a loan or otherwise meet a contractual obligation resulting in financial loss to the Bank. It is also measured in terms of credit losses or provisions charged to the profit and loss account. Qualitative information also used to assess issues related to the effectiveness of the risk appetite.

The Bank manages its credit risk through documented Credit Risk Management Framework ("CRMF"), which is part of the overall Risk management framework. CRMF serves as a collection of tools, processes and methodologies that support the Bank in identifying, assessing, monitoring and controlling the credit risk.

The CRMF also provides a sound basis for more informed risk-based decision-making across the business areas. The CRMF includes the credit risk appetite, which defines the bank's target customer segment, industries and products, risk acceptance. CRMF reflects regulatory requirements and guidelines in the UK while also referencing the overall credit risk framework and guidelines of the Group.

Through CRMF the Board ensure that the Bank has a clear and measurable statement of its credit risk appetite against which the strategy to achieve the credit related aspects of its business plan can be actively assessed. In order to measure its achievements against this goal, the Board and management of the Bank are provided with robust, well calibrated and sufficiently granular management information so that they can provide an effective challenge to management's actions.

Balmoral Castle

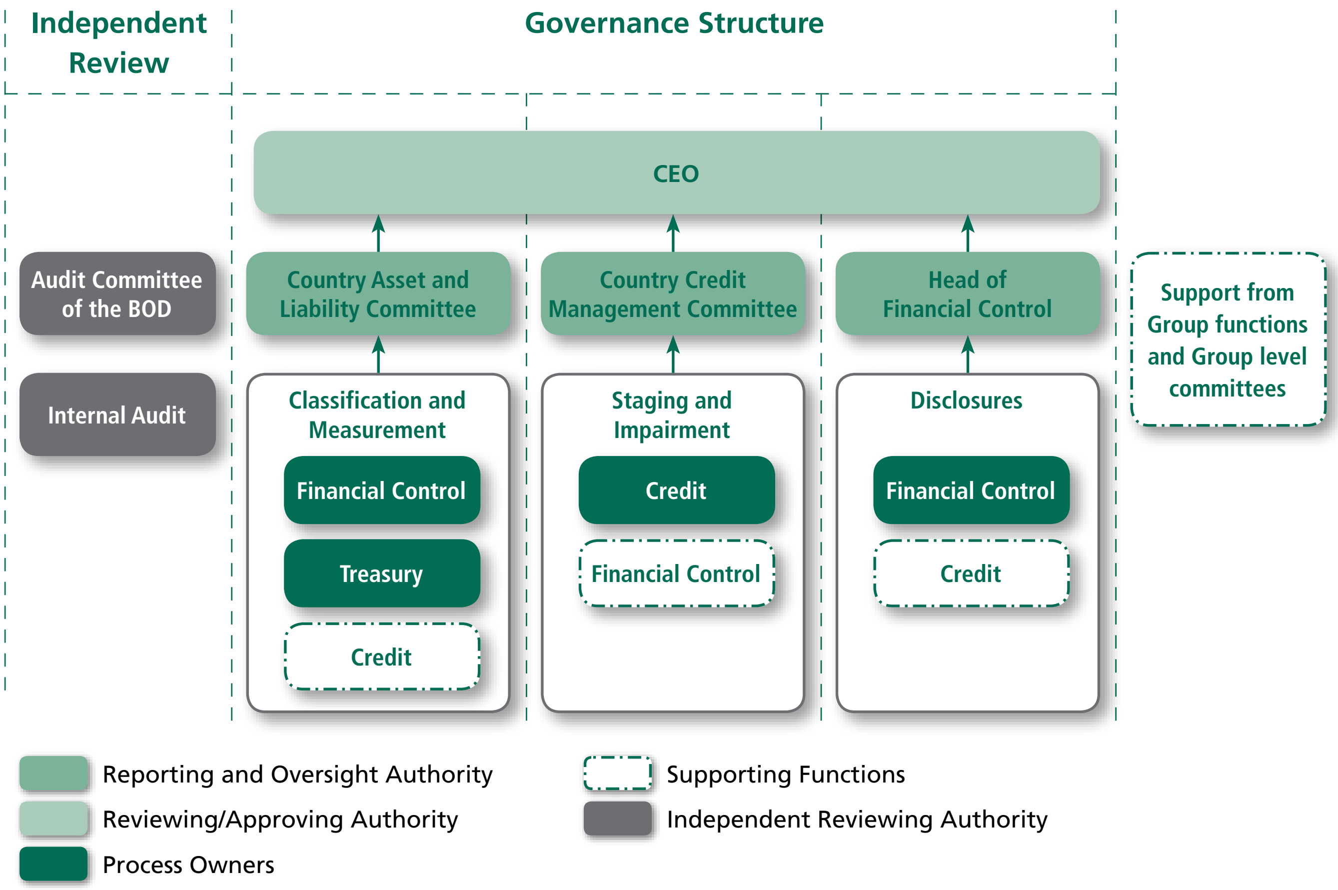
31.4 IFRS 9 Implementation and Model Validation

The Bank implemented IFRS 9 from 01 January 2018 by implementing suitably developed models with the assistance of external consultants. Details in respect of changes business model, classification and measurement and impairment are explained in Notes 5.5.3 above. In this section the Bank has provided governance and risk management applied on adoption of IFRS 9.

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

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

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



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

The purpose of these controls is to set out in particular the principles and requirements for effective governance of the Bank's Expected Credit Loss (ECL) models and methodologies used for estimating the respective risk components. The main statistical models in scope of these controls include the following:

- credit risk rating model for rating of obligors belonging to the Corporate / SME portfolios
- probability of default ("PD") models (and /or methodologies)
- loss given default ("LGD") models (and /or methodologies)
- exposure at default ("EAD") models (and /or methodologies)
- credit conversion factor ("CCF") models (and /or methodologies), and
- macroeconomic models.

For the purpose of calculating ECL Bank has developed models for types of financial assets

- Customer Lending – separate models for property lending and other lending
- Investments and Financial Institutions

31.5 Probability of Default – model methodology

The Bank collects performance and default information about its credit risk exposures analysed by type of product and borrower or region as well as by credit risk grading. For some portfolios, information from external credit reference agencies is also used.

The Bank employs statistical models to analyse the data collected and generate estimates of the remaining lifetime PD of exposures and how these are expected to change as a result of the passage of time.

Probability of Default is one of the three risk components needed to estimate ECL under IFRS 9. PD is defined as probability that a borrower will be unable to meet his/her debt obligations over a stipulated time period. IFRS 9 requires PD to be a Point in Time ("PiT") as opposed to a Through the Cycle (TTC) estimate, implying that the PD associated with each internal rating grade should reflect current economic conditions rather than the long-term average.

For ECL calculation, Bank segregates 'Loans and advances to customers' in two categories i.e. lending secured against property and other lending.

The methodology used to estimate the IFRS 9 calibrated PD for the Bank's Other Lending portfolio involves developing a macroeconomic model incorporating relevant macroeconomic variables for the portfolio to estimate the forward-looking default rates for a period of 5 years ranging from 2018-2022. The default rates obtained from the macroeconomic model are further calibrated for each rating grade based on the portfolio distribution.

The PD was computed for the Property Lending portfolio using flow rate analysis, where migration matrices were built to track the historical performance of customers into default status over a twelve-month performance period in order to arrive at the default rate.

While developing the model, an 'ever default' definition was employed in order to capture all accounts obtaining default status over a twelve-month period, regardless of whether the customer ceased to be in default at the end of the period. The default rate obtained from this calculation is considered to be a point-in-time estimate of the PD.

31.6 Loss Given Default – model methodology

The LGD for the Other Lending portfolio is computed at an account level and leverages the Basel F-IRB LGD. The main drivers of Basel F-IRB LGD framework are seniority of the facility, facility type (secured / unsecured), security (collateral type) and security coverage of the facility (level of collateralization). The LGD computed using the Basel LGD framework is adjusted using a beta-regression. The methodology utilizes macroeconomic data and facility level collateral coverage to predict LGD estimates based on Basel LGD estimates. The adjustment is performed to reflect potential dependency on macroeconomic factors and to remove the element of conservatism (floors) included in the Basel LGD estimates.

As the Bank's Property Lending exposures essentially follow the 'Held to Collect' business model, a workout LGD approach to measurement was adopted to estimate potential losses. This approach involves use of contracts which have defaulted over a period of time to calculate internal recovery and loss cash flows to compute the 'Net Present Value' (NPV) of the loss as percentage of the EAD.

The final loss on the exposure was arrived at by adding the loss estimates for the cure, restructure and recovery nodes, weighted by the probability of the account flowing into either of the three nodes. This was divided by the Exposure at Default to derive the LGD %. The final LGD takes into account the cost of recovery and also includes a discount rate to discount the recovered amounts to the point of default.

31.7 Exposure at Default

For amortising facilities, cash flows are used to determine the principal outstanding as of a given reporting date, while for non-amortising facilities, such as bonds where only coupon payments are made periodically (with the principal falling due on the bond's maturity date), the principal outstanding will remain unchanged on each reporting date. Since the Bank has a low amortising portfolio 100% EAD as on the reporting date is representative of the expected exposure at default.

31.8 Determining whether credit risk has increased significantly (Significate increase in credit risk – SICR)

The Bank assesses whether credit risk has increased significantly since initial recognition at each reporting date. Determining whether an increase in credit risk is significant depends on the characteristics of the financial instrument and the borrower, and the geographical region. What is considered significant differs for different types of lending, in particular between wholesale and retail. As a general indicator, credit risk of a particular exposure is deemed to have increased significantly since initial recognition if, based on the Bank's quantitative modelling.

The credit risk may also be deemed to have increased significantly since initial recognition based on qualitative factors linked to the Bank's credit risk management processes that may not otherwise be fully reflected in its quantitative analysis on a timely basis. This will be the case for exposures that meet certain heightened risk criteria, such as placement on a watch list. Such qualitative factors are based on its expert judgment and relevant historical experiences.

As a backstop, the Bank considers that a significant increase in credit risk occurs no later than when an asset is more than 30 days past due. Days past due are determined by counting the number of days since the earliest elapsed due date in respect of which full payment has not been received. Due dates are determined without considering any grace period that might be available to the borrower

31.9 Curing policy

If there is evidence that there is no longer a significant increase in credit risk relative to initial recognition, then the loss allowance on an instrument returns to being measured as 12-month ECL. Some qualitative indicators of an increase in credit risk, such as delinquency or forbearance, may be indicative of an increased risk of default that persists after the indicator itself has ceased to exist. In these cases, the Bank determines a probation period during which the financial asset is required to demonstrate good behaviour to provide evidence that its credit risk has declined sufficiently. When contractual terms of a loan have been modified, evidence that the criteria for recognising lifetime ECL are no longer met includes a history of up-to-date payment performance against the modified contractual terms.

Under IFRS 9, exposures transferred into Stage 2 and Stage 3 are deemed to be significantly riskier than those falling within Stage 1. Hence the Bank seeks objective evidence of an improvement in customer credit worthiness prior to relegating a Stage 2 or Stage 3 account back to Stage 1.

The Bank follows a three-month time period or payment of three consecutive instalments for movements from Stage 3 to Stage 2 and three-month time period or payment of three consecutive instalments for movement from Stage 2 to Stage 1, implying that once the triggers for movement to Stage 2 or Stage 3 cease to exist, the exposure would still remain in Stage 2/Stage 3 for the duration of the cool-off period. Once the cool-off period is over, the exposure may be transferred out of Stage 2/Stage 3. The table below illustrates the minimum requirements for backward movement across stages. The Bank may choose to adopt a stricter cool off period in line with updates to its credit policy.

Movement	Time Period	Instalments
Stage 2 to Stage 1	3 months	3
Stage 3 to Stage 2	3 months	3

The Bank monitors the effectiveness of the criteria used to identify significant increases in credit risk by regular reviews to confirm that:

- the criteria are capable of identifying significant increases in credit risk before an exposure is in default;
- the criteria do not align with the point in time when an asset becomes 30 days past due;
- the average time between the identification of a significant increase in credit risk and default appears reasonable;
- exposures are not generally transferred directly from 12-month ECL measurement to credit- impaired; and
- there is no unwarranted volatility in loss allowance from transfers between 12-month PD (Stage 1) and lifetime PD (Stage 2).

31.10 Definition of default

The classification is consistent with the 90 DPD definition of default adopted by the Bank for the portfolio and the 30 & 90 DPD rebuttable presumptions provided under IFRS 9 for classification of financial instruments into Stage 2 and Stage 3.

In order to maintain a default definition consistent with both regulatory guidelines and the Bank's business practices for management of credit risk, an exposure has been considered non-performing if:

- The account is 90 or more days overdue on contractual payments; or
- Based on observed payment delays or early warning indicators detected as a result of the Country Credit function's portfolio monitoring activities, the account has been tagged as Default. The management takes such decision when the borrower is unlikely to pay its credit obligations to the Bank in full, without recourse by the Bank to actions such as realising security (if any is held). Further, it is becoming probable that the borrower will restructure the asset as a result of bankruptcy due to borrower's inability to pay its credit obligations.

While developing the model, an 'ever default' definition has been employed by the Bank in order to capture all accounts obtaining default status over a twelve-month period, regardless of whether the account ceases to be in default at the end of the period.

31.11 Impairment

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

IFRS 9 requires an unbiased and probability weighted estimate of credit losses by evaluation of a range of possible outcomes that incorporates forecasts of future economic conditions. Measurement of ECLs at each reporting period should reflect reasonable and supportable information at the reporting date about past events, current conditions and forecasts of future economic conditions.

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

31.12 Incorporation of forward-looking information

The estimation and application of forward-looking information requires significant judgement and are subject to appropriate internal governance and scrutiny. The Bank incorporates forward-looking information into both the assessment of whether the credit risk of an instrument has increased significantly since its initial recognition and the measurement of ECL.

In order to comply with the requirements of IFRS 9, the ECL estimates must be forward looking. Hence, a macroeconomic adjustment was applied to the Point in Time PD estimates for each segment.

The macroeconomic model built for Lending products contains the following exogenous variables capable of explaining the Property Lending default rates:

- Unemployment Rate
- Debt to GDP Ratio

On account of low data points, the macroeconomic model forecasts the raw default rates based on the assumption that the macroeconomic cycle repeats itself every five years.

Base, Upturn and Downturn scenario forecasts for the exogenous macroeconomic variable (i.e. Unemployment Rate) were multiplied with their respective scenario probabilities in order to arrive at a probability weighted forecast value for each year.

The inputs have been modelled by replacing the Baseline macroeconomic variables with the Downside and Upside movement re-calibrating the PDs and LGDs.

Impact on ECL	2019	2018
Improvement in Debt to GDP Ratio and unemployment rate 5%	7% decrease	6% decrease
Improvement in Debt to GDP Ratio and unemployment rate 10%	14% decrease	11% decrease
Improvement in Debt to GDP Ratio and unemployment rate 20%	27% decrease	22% decrease
Deterioration in Debt to GDP Ratio and unemployment rate 5%	7% increase	6% increase
Deterioration in Debt to GDP Ratio and unemployment rate 10%	15% increase	12% increase
Deterioration in Debt to GDP Ratio and unemployment rate 20%	31% increase	24% increase

31.13 Modified financial assets and forbearance

The contractual terms of a loan may be modified for a number of reasons, including changing market conditions, customer retention and other factors not related to a current or potential credit deterioration of the customer.

When the terms of a financial asset are modified and the modification does not result in de-recognition, the determination of whether the asset's credit risk has increased significantly reflects comparison of:

- its remaining lifetime PD at the reporting date based on the modified terms; with
- the remaining lifetime PD estimated based on data on initial recognition and the original contractual terms.

When modification results in de-recognition, a new loan is recognised and allocated to Stage 1 (assuming it is not credit-impaired at that time).

The Bank renegotiates loans to customers in financial difficulties (referred to as 'forbearance activities) to maximise collection opportunities and minimise the risk of default. Under the Bank's forbearance policy, loan forbearance is granted on a selective basis if the debtor is currently in default on its debt or if there is a high risk of default, there is evidence that the debtor made all reasonable efforts to pay under the original contractual terms and the debtor is expected to be able to meet the revised terms.

The revised terms usually include extending the maturity, changing the timing of interest payments and amending the terms of loan covenants. Both retail and corporate loans are subject to the forbearance policy.

All such situations are discussed and approved as per the credit sanction process by the Country Credit Committee. The Bank accommodates the forbearance situations by deferring the principal repayments, providing an Interest moratorium, converting the overdraft into an amortising loan, or by using a letter of credit to finance trade finance rather than an Overdraft.

All customers assessed under a forbearance process with revised repayment terms are kept under a close monitoring process. Once the circumstances leading to a forbearance process related to a loan no longer exists, and customers demonstrate continuous repayment history, the loan is no longer considered as forborne.

During the year, loans amounting to £3.1 million (2018: £4.0 million) were considered as forborne of which £0.3 million (2018: £3.0 million) were classified as impaired. A provision of £0.02 million (2018: £0.2 million) was made against forborne loans.

31.14 Loss allowance

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

					Amount in £ 000'
Due from banks at amortised cost	2019 Stage 1	2019 Stage 2	2019 Stage 3	2019 Total	2018 Total
Balances at the beginning of the year	137	-	-	137	83
New provisions	74	-	-	74	35
Increased provisions	163	-	-	163	19
Uncollectable recovered / settled	(38)	-	-	(38)	-
Net measurement of loss allowance	199	-	-	199	54
Transferred to 12 month's ECL Stage 1	-	-	-	-	-
Transferred to lifetime ECL stage 2 Credit not impaired	-	-	-	-	-
Transferred to lifetime ECL stage 3 Credit impaired	-	-	-	-	-
Balances at the closing of the year	**336**	**-**	**-**	**336**	**137**

					Amount in £ 000'
Loans and advances to customers at amortised cost	2019 Stage 1	2019 Stage 2	2019 Stage 3	2019 Total	2018 Total
Balances at the beginning of the year	1,057	458	4,068	5,583	13,738
New provisions	215	-	-	215	192
Increased provisions	3	86	694	783	1,246
Recovered / settled / reduced	(83)	(376)	(1,073)	(1,532)	(2,425)
Net measurement of loss allowance	135	(290)	(379)	(534)	(987)
Transferred to 12 month's ECL Stage 1	54	(52)	(2)	-	-
Transferred to lifetime ECL stage 2 Credit not impaired	(13)	83	(70)	-	-
Transferred to lifetime ECL stage 3 Credit impaired	-	(6)	6	-	-
Uncollectable written off	-	-	(11)	(11)	(7,168)
Balances at the closing of the year	**1,233**	**193**	**3,612**	**5,038**	**5,583**

The contractual amounts outstanding on financial assets that were written off during the year ended 31 December 2019 are subject to enforcement activity.

Amount in £ 000'

Financial investments	2019 Stage 1	2019 Stage 2	2019 Stage 3	2019 TOTAL	2018 TOTAL
Balances at the beginning of the year	2	-	-	2	8
New provisions	2	-	-	2	2
Increased provisions	31	-	-	31	5
Net measurement of loss allowance	33	-	-	33	7
Other movement	(4)	-	-	(4)	1
Impairment of FVOCI investment shown under OCI	(30)	-	-	(30)	(14)
Balances at the closing of the year	**1**	**-**	**-**	**1**	**2**

The following table provides reconciliation between:

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

Amount in £ 000'

	Due from banks at amortised cost	Loans and advances to customers at amortised cost	Financial investments	Total
New provisions	75	215	2	292
Increased provisions	162	783	31	976
Uncollectable recovered / settled	(39)	(1,532)	-	(1,571)
Total - 2019	**198**	**(534)**	**33**	**(303)**
Total - 2018	**54**	**(987)**	**7**	**(926)**

31.15 Credit quality analysis

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

Amount in £ 000'

	2019 Stage 1	2019 Stage 2	2019 Stage 3	2019 TOTAL	2018 TOTAL
Cash in hand and with central bank	58,964	-	-	58,964	66,810
Due from banks	98,634	-	-	98,634	59,068
Loans and advances to customers	417,199	8,045	10,530	435,774	404,560
Financial investments - amortised cost	16,918	-	-	16,918	34,914
Financial investments - FVOCI debt instruments	67,669	-	-	67,669	68,473
	84,587	-	-	84,587	103,387
	659,384	8,045	10,530	677,959	633,825
Loss allowance	(1,570)	(193)	(3,612)	(5,375)	(5,722)
Net exposure	**657,814**	**7,852**	**6,918**	**672,584**	**628,103**

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

Amount in £ 000'

2019	Cash and balances with central bank	Due from banks	Loans and advances to customers	Financial investments	Derivatives	Total
Current & past due up to 1 month	58,964	98,634	430,247	84,587	357	672,789
Past due 1 to 3 months	-	-	3,173	-	-	3,173
Past due over 3 months	-	-	2,354	-	-	2,354
Gross exposure	58,964	98,634	435,774	84,587	357	678,316
Less: impairment	-	(336)	(5,038)	(1)	-	(5,375)
Net exposure	**58,964**	**98,298**	**430,736**	**84,586**	**357**	**672,941**

Amount in £ 000'

2018	Cash and balances with central bank	Due from banks	Loans and advances to customers	Financial investments	Derivatives	Total
Current & past due up to 1 month	66,810	59,068	401,207	103,387	167	630,639
Past due 1 to 3 months	-	-	1,340	-	-	1,340
Past due over 3 months	-	-	2,013	-	-	2,013
Gross exposure	66,810	59,068	404,560	103,387	167	633,992
Less: impairment	-	(137)	(5,583)	(2)	-	(5,722)
Net exposure	**66,810**	**58,931**	**398,977**	**103,385**	**167**	**628,270**

The following table sets out information about the overdue status of loans and advances to customers in Stage 1, 2 and 3:

Amount in £ 000'

Age bracket	2019 Stage 1	2019 Stage 2	2019 Stage 3	2019 Total	2018 Total
< 30 days	20,357	3,212	803	24,372	28,519
> 30 days to 60 days	25	1,467	1,070	2,562	531
> 60 days to 90 days	-	-	611	611	810
> 90 days to 180 days	-	619	35	654	-
> 180 days	-	-	1,700	1,700	2,012
Total overdue	20,382	5,298	4,219	29,899	31,872
Not overdue	396,817	2,747	6,311	405,875	372,688
Gross loans and advances to customers	417,199	8,045	10,530	435,774	404,560
Less: Impairment allowance	(1,233)	(193)	(3,612)	(5,038)	(5,583)
Net loans and advances to customers	**415,966**	**7,852**	**6,918**	**430,736**	**398,977**

31.16 Credit Risk Ratings

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

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

The Bank regards a loan and advance or a debt security as impaired if there is objective evidence that a loss event has an impact on future estimated cash flows from the asset.

The following table sets out the credit quality of non-trading Financial assets split by external rating, where applicable:

Amount in £ 000'

2019	Cash and balances with central bank	Due from banks	Loans and advances to customers	Financial investments	Derivatives	Contingent liabilities and commitments	Total
AAA to AA-	58,203	84	-	52,302	-	-	110,589
A+ to A-	-	11,576	-	32,284	4	2,711	46,575
BBB+ to B-	-	77,765	-	-	5	9,215	86,985
Unrated	761	8,873	430,736	-	348	39,067	479,785
	58,964	**98,298**	**430,736**	**84,586**	**357**	**50,993**	**723,934**

The above numbers represent the carrying values of the financial assets

Amount in £ 000'

2018	Cash and balances with central bank	Due from banks	Loans and advances to customers	Financial investments	Derivatives	Contingent liabilities and commitments	Total
AAA to AA-	65,847	14,255	-	77,351	-	-	157,453
A+ to A-	-	202	-	26,034	31	3,754	30,021
BBB+ to B-	-	32,444	-	-	136	7,855	40,435
Unrated	963	12,030	398,977	-	-	34,458	446,428
	66,810	**58,931**	**398,977**	**103,385**	**167**	**46,067**	**674,337**

The following table shows an analysis of counterparty credit exposures arising from derivative transactions. Derivative transactions of the Bank are fully collateralised by cash.

Amount in £ 000'

	Total Notional amount	Total Fair value	Over-the-counter Other bilateral collateralized Notional amount	Over-the-counter Other bilateral collateralized Fair value
2019				
Derivative assets	22,570	357	22,570	357
Derivative liabilities	22,492	(312)	22,492	(312)
2018				
Derivative assets	20,200	167	20,200	167
Derivative liabilities	19,953	(137)	19,953	(137)

31.17 Concentration of Risk

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

Concentration of financial assets and credit related contingent liabilities:

Amount in £ 000'

2019	Cash and balances with central bank	Due from banks	Loans and advances to customers	Financial investments	Derivatives	Contingent liabilities and commitments	Total
Supernationals	58,203	-	-	33,828	-	-	92,031
Financial Institutions	-	98,298	-	46,910	9	18,334	163,551
Industrial & commercial	-	-	371,132	3,848	348	32,292	407,620
Individual	-	-	59,604	-	-	367	59,971
Other	761	-	-	-	-	-	761
	58,964	**98,298**	**430,736**	**84,586**	**357**	**50,993**	**723,934**

Amount in £ 000'

2018	Cash and balances with central bank	Due from banks	Loans and advances to customers	Financial investments	Derivatives	Contingent liabilities and commitments	Total
Supernationals	65,847	-	-	58,920	-	-	124,767
Financial Institutions	-	58,931	-	44,465	167	11,778	115,341
Industrial & commercial	-	-	335,789	-	-	33,374	369,163
Individual	-	-	63,188	-	-	915	64,103
Other	963	-	-	-	-	-	963
	66,810	**58,931**	**398,977**	**103,385**	**167**	**46,067**	**674,337**

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

Geographical concentration of financial assets and credit related contingent liabilities:

Amount in £ 000'

2019	Cash and balances with central bank	Due from banks	Loans and advances to customers	Financial investments	Derivatives	Contingent liabilities and commitments	Total
UK	58,964	63,058	385,639	12,447	353	44,817	565,278
Europe excl UK	-	442	10,428	42,852	4	3,037	56,763
Asia	-	16,376	4,713	14,099	-	21	35,209
North America	-	122	25,481	3,002	-	-	28,605
Africa	-	17,084	4,475	-	-	3,118	24,677
USA	-	1,145	-	6,936	-	-	8,081
Australia	-	71	-	5,250	-	-	5,321
	58,964	**98,298**	**430,736**	**84,586**	**357**	**50,993**	**723,934**

Amount in £ 000'

2018	Cash and balances with central bank	Due from banks	Loans and advances to customers	Financial investments	Derivatives	Contingent liabilities and commitments	Total
UK	66,810	25,730	369,427	7,535	126	38,260	507,888
Europe excl UK	-	7,846	4,425	66,927	41	4,698	83,937
USA	-	14,251	5,182	11,264	-	33	30,730
Africa	-	240	14,386	3,000	-	-	17,626
Asia	-	9,739	5,557	-	-	3,076	18,372
North America	-	1,125	-	10,161	-	-	11,286
Australia	-	-	-	4,498	-	-	4,498
	66,810	**58,931**	**398,977**	**103,385**	**167**	**46,067**	**674,337**

The Bank held cash and cash equivalents of £58.2 million as at 31 December 2019 (2018: £65.8 million) with central bank that is rated at least AA- to AA+ as per approved external credit rating agencies.

31.18 Collateral Management

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

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

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

Collateral Risk	Controls & Mitigation in Place
Risk arising from reduction in collateral values	• Generally acceptable collateral – Cash, Residential & Commercial Property, Bank Guarantees, Shares & Bonds & life insurance with surrender value. • Lien is marked against cash taken as collateral • Charge is recorded in Bank's name in land registry relating to residential and commercial properties taken as collateral. • Other collateral like Bank Debenture, Stocks, Receivables, Personal Guarantees also available but discounted for lending and provision decisions. • Well defined haircuts for all collateral with Property haircuts arrived at on the basis of type of property, location and market conditions • Property Stress tests conducted every six months
Risk arising from inadequate perfection of Security for Customer Borrowing	• Credit Administration unit centralised • Standardisation of documents and processes for Risk mitigation • Duly reviewed & approved panel of solicitors & valuation firms

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

The carrying amount of financial assets recorded in the balance sheet, net of any allowances for losses, represents the Bank's maximum exposure to credit risk without taking account of any collateral obtained. The fair value of collateral and security enhancements held against loans or advances to customers is shown below:

Amount in £ 000'

Collateral Type	2019 Collateral Value	2019 Advances	2018 Collateral Value	2018 Advances
Commercial real estate	618,715	301,720	585,575	282,820
Residential real estate	227,686	109,949	217,984	98,448
Cash collateral	29,021	20,991	30,929	20,145
Other collateral	-	-	-	-
Guarantees	-	-	-	-
Unsecured	-	3,114	-	3,147
Total	**875,422**	**435,774**	**834,488**	**404,560**

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

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

Loans and Advances

Amount in £ 000'

LTV Bracket	2019 Stage 1	2019 Stage 2	2019 Stage 3	2019 Total	2018 Stage 1	2018 Stage 2	2018 Stage 3	2018 Total
Less than 50%	90,210	7,863	2,251	100,324	102,315	13,294	2,027	117,636
51-70%	274,798	-	-	274,798	219,440	2,337	3,798	225,575
71-90%	39,381	-	464	39,845	38,091	-	477	38,568
91-100%	1,957	182	-	2,139	1,454	-	-	1,454
More than 100%	10,853	-	7,815	18,668	8,603	4,106	8,618	21,327
Grand Total	**417,199**	**8,045**	**10,530**	**435,774**	**369,903**	**19,737**	**14,920**	**404,560**
Collateral	**842,086**	**21,568**	**11,768**	**875,422**	**761,635**	**50,817**	**22,036**	**834,488**

31.19 Market risk

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

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

31.20 Interest Rate Risk Management

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

The Bank uses its own base rate for pricing of products, which can be changed with 60 days' notice to the customers. Therefore, any significant fluctuation in interest rate is unlikely to have a material impact on the Bank as it can re-price its lending and customer deposit books. The Bank is exposed to interest rate risk on its fixed rate investment portfolio maintained to meet the Liquidity Coverage Ratio (LCR) requirement. However, this is only limited to a portion, which is monitored in ALCO.

Customers' deposits are mostly short tenors (<1year) and priced in accordance with market conditions and the Bank's cost of funds. Hence the interest rate risk on the same is limited.

The following table provides a summary of the interest rate re-pricing profile of the Bank's financial assets and liabilities. Items have been allocated to time bands by reference to the earlier of the next interest rate reset date and the contractual maturity date.

Amount in £ 000'

2019	Within 3 months	<3 to 6 months	<6 months to 1 year	<1 to 2 years	<2 to 3 years	< 3 to 4 years	<4 to 5 years	No specific re-pricing	Total
Assets									
Cash in hand & with central bank	58,190	-	-	-	-	-	-	774	58,964
Due from banks	45,162	29,850	-	-	-	-	-	23,286	98,298
Loans & advances to customers	61	429,891	670	114	-	-	-	-	430,736
Financial investments									
- fair value through other comprehensive income	55,416	1,002	6,481	3,091	1,679	-	-	-	67,669
- Amortised cost	-	-	-	-	16,917	-	-	-	16,917
Derivative financial instruments	287	65	5	-	-	-	-	-	357
Total assets	**159,116**	**460,808**	**7,156**	**3,205**	**18,596**	**-**	**-**	**24,060**	**672,941**
Liabilities									
Due to banks	6,722	-	-	-	-	-	-	-	6,722
Due to customers	193,190	62,789	95,870	7,138	-	-	-	218,026	577,013
Derivative financial instruments	263	49	-	-	-	-	-	-	312
Subordinated liabilities	-	-	-	20,098	-	-	-	-	20,098
Total Liabilities	**200,175**	**62,838**	**95,870**	**27,236**	**-**	**-**	**-**	**218,026**	**604,145**
Net Gap (Assets - Liabilities)	**(41,059)**	**397,970**	**(88,714)**	**(24,031)**	**18,596**	**-**	**-**	**(193,966)**	**68,796**

Amount in £ 000'

2018	Within 3 months	<3 to 6 months	<6 months to 1 year	<1 to 2 years	<2 to 3 years	< 3 to 4 years	<4 to 5 years	No specific re-pricing	Total
Assets									
Cash in hand & with central bank	65,847	-	-	-	-	-	-	963	66,810
Due from banks	37,922	5,525	-	-	-	-	-	15,484	58,931
Loans & advances to customers	1,470	397,067	-	70	29	-	341	-	398,977
Financial investments									
- fair value through other comprehensive income	63,725	-	-	2,660	1,569	520	-	-	68,473
- Amortised cost	-	-	-	-	-	27,440	7,472	-	34,912
Derivative financial instruments	130	37	-	-	-	-	-	-	167
Total assets	**169,094**	**402,629**	**-**	**2,730**	**1,598**	**27,960**	**7,813**	**16,447**	**628,270**
Liabilities									
Due to banks	17,399	-	-	-	-	-	-	-	17,399
Due to customers	168,044	94,080	80,124	271	-	-	-	180,974	523,493
Derivative financial instruments	108	29	-	-	-	-	-	-	137
Subordinated liabilities	-	-	-	-	20,104	-	-	-	20,104
Total Liabilities	**185,551**	**94,109**	**80,124**	**271**	**20,104**	**-**	**-**	**180,974**	**561,133**
Net Gap (Assets - Liabilities)	**(16,457)**	**308,520**	**(80,124)**	**2,459**	**(18,506)**	**27,960**	**7,813**	**(164,527)**	**67,137**

Interest Rate Sensitivity Analysis

The sensitivity to the income statement to various interest risk variables is considered on daily basis. An analysis of sensitivity to an increase or decrease in market interest rates, assuming no asymmetrical movement in yield curves and a constant financial position, is as follows at the financial year end.

	2019 Impact on P&L (£ 000')	2018 Impact on P&L (£ 000')
25bps increase in interest rate	17	68
25bps decrease in interest rate	17	(86)
50bps increase in interest rate	16	138
50bps decrease in interest rate	16	(198)

31.21 Foreign Currency (FX) Risk Management

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

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

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

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

The Bank's net open position (NOP) as at 31 December 2019 was £0.06m (2018: £0.04m)

Currency	2019 (£ 000')	2018 (£ 000')
USD	17	10
EUR	16	(9)
PKR	3	10
ZAR	(3)	(7)
CAD	2	1
INR	11	24
Others	18	11

31.22 Liquidity Risk Management

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

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

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

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

In order to achieve the above, the Bank has identified several risk factors, which form components of the Bank's overall liquidity risk profile. These include but are not limited to:

- Wholesale secured and unsecured funding risk
- Retail funding risk
- Intra-day liquidity risk
- Intra-group liquidity risk
- Cross-currency liquidity risk
- Off-balance sheet liquidity risk
- Franchise viability risk
- Marketable assets risk
- Non-marketable assets risk
- Funding concentration risk

The Treasury Department is responsible for the day-to-day management of funding and liquidity with particular attention to the level of mismatch between assets and liabilities as well as currency exposure. The Finance Department provides daily monitoring reports against the regulatory and MI requirements, with a clear escalation process for reporting adverse outcomes. The ALCO coordinates and provides direct oversight on the whole process of liquidity risk management in accordance with their terms of reference approved by the Board.

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

Amount in £ 000'

2019	Carrying amount	Gross nominal inflow/ (outflow)	Within 1 month	1-3 months	3 months -1 year	1-5 years	>5 years
Financial asset by type							
Non-derivative assets							
Cash in hand & with central bank	58,964	59,001	59,001	-	-	-	-
Due from banks	98,298	98,469	40,152	28,283	30,034	-	-
Loans & advances to customers	430,736	502,816	31,188	9,579	20,586	70,901	370,562
Financial investments							
- fair value through other comprehensive income	67,669	67,951	2,505	6,124	13,628	45,694	-
- Amortised cost	16,917	17,120	-	-	-	17,120	-
	672,584	**745,357**	**132,846**	**43,986**	**64,248**	**133,715**	**370,562**
Derivative assets							
Risk management	357	-	-	-	-	-	-
Outflow		13,643	2,878	3,513	7,252	-	-
Inflow	-	(13,305)	(2,765)	(3,358)	(7,182)	-	-
	357	**338**	**113**	**155**	**70**	**-**	**-**
Financial liability by type							
Non-derivative liabilities							
Due to banks	6,722	(6,723)	(6,723)	-	-	-	-
Due to customers	577,013	(578,977)	(285,889)	(124,878)	(160,789)	(7,421)	-
Subordinated liabilities	20,098	(20,299)	-	-	-	(20,299)	-
Lease liability	2,973	(3,129)	(76)	(294)	(1,478)	(1,281)	
	606,806	**(609,128)**	**(292,688)**	**(125,172)**	**(162,267)**	**(29,001)**	**-**
Derivative liabilities							
Risk management	312	-	-	-	-	-	-
Outflow	-	8,080	1,893	3,283	2,904	-	-
Inflow	-	(8,373)	(1,986)	(3,424)	(2,963)	-	-
	312	**(293)**	**(93)**	**(141)**	**(59)**	**-**	**-**

Amount in £ 000'

2018	Carrying amount	Gross nominal inflow/ (outflow)	Within 1 month	1-3 months	3 months -1 year	1-5 years	>5 years
Financial asset by type							
Non-derivative assets							
Cash in hand & with central bank	66,810	66,852	66,852	-	-	-	-
Due from banks	58,931	59,045	40,424	13,061	5,560	-	-
Loans & advances to customers	398,977	476,976	48,749	6,946	17,170	68,434	335,677
Financial investments							
- fair value through other comprehensive income	68,473	68,581	1,577	-	12,082	54,922	-
- Amortised cost	34,912	35,548	-	-	-	35,548	-
	628,103	**707,002**	**157,602**	**20,007**	**34,812**	**158,904**	**335,677**
Derivative assets							
Risk management	167	-	-	-	-	-	-
Outflow	-	9,510	2,415	5,397	1,698	-	-
Inflow	-	(9,315)	(2,372)	(5,295)	(1,648)	-	-
	167	**195**	**43**	**102**	**50**	**-**	**-**
Financial liability by type							
Non-derivative liabilities							
Due to banks	17,399	(17,381)	(17,381)	-	-	-	-
Due to customers	523,493	(526,954)	(280,166)	(70,300)	(176,207)	(281)	-
Subordinated liabilities	20,104	(20,320)	-	-	-	(20,320)	-
	560,996	**(564,655)**	**(297,547)**	**(70,300)**	**(176,207)**	**(20,601)**	**-**
Derivative liabilities							
Risk management	137	-	-	-	-	-	-
Outflow	-	10,635	5,235	3,743	1,657	-	-
Inflow	-	(10,885)	(5,368)	(3,819)	(1,698)	-	-
	137	**(250)**	**(133)**	**(76)**	**(41)**	**-**	**-**

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

Exposure to Liquidity risk

The key measure used by the Bank for managing liquidity risk is the ratio of high-quality liquid assets (HQLA) to deposits from customers and short-term funding. For this purpose, HQLA divided by deposits from customers and banks. Bank also considers the liquidity coverage ratio (LCR) being another strong tool for liquidity Risk. Details of the reported ratios at the reporting date and during the reporting period were as follows:

	2019 Liquidity coverage %	2019 HQLA to deposits %	2018 Liquidity coverage %	2018 HQLA to deposits %
As at 31 December	160%	16%	198%	23%
Average for the period	178%	17%	267%	25%
Maximum for the period	220%	23%	345%	28%
Minimum for the period	131%	12%	198%	22%

Liquidity Reserves	2019 Carrying amount	2019 HQLA	2018 Carrying amount	2018 HQLA
Balance with central bank	58,190	55,173	65,847	62,831
Cash in hand	774	774	963	963
Unencumbered debt securities issued by sovereigns and supernational	33,788	33,788	58,761	58,761
Other assets	3,800	1,900	-	-
	96,552	**91,635**	**125,571**	**122,555**

31.23 Financial assets and financial liabilities

Classification of financial assets and financial liabilities

The following table provides a reconciliation between line items in the statement of financial position of categories of financial instruments.

Amount in £ 000'

31 December 2019	Mandatorily at FVPTL	FVOCI - debt instruments	Amortised cost	Estimated credit loss	Total carrying amount
Cash in hand and with central bank	-	-	58,964	-	58,964
Due from banks	-	-	98,634	(336)	98,298
Loans and advances to customers	-	-	435,774	(5,038)	430,736
Financial investments	-	67,669	16,918	(1)	84,586
Derivative assets held for risk management	357	-	-	-	357
Total financial assets	**357**	**67,669**	**610,290**	**(5,375)**	**672,941**
Due to banks	-	-	6,722	-	6,722
Due to customers	-	-	577,013	-	577,013
Derivative liabilities held for risk management	312	-	-	-	312
Current tax liabilities			570		570
Subordinated liabilities	-	-	20,098	-	20,098
Other liabilities	-	-	1,198	-	1,198
Total financial liabilities	**312**	**-**	**605,601**	**-**	**605,913**

31 December 2018 Amount in £ 000'	Mandatorily at FVPTL	FVOCI - debt instruments	Amortised cost	Estimated credit loss	Total carrying amount
Cash in hand and with central bank	-	-	66,810	-	66,810
Due from banks	-	-	59,068	(137)	58,931
Loans and advances to customers	-	-	404,560	(5,583)	398,977
Financial investments	-	68,473	34,914	(2)	103,385
Derivative assets held for risk management	167	-	-	-	167
Total financial assets	**167**	**68,473**	**565,352**	**(5,722)**	**628,270**
Due to banks	-	-	17,399	-	17,399
Due to customers	-	-	523,493	-	523,493
Derivative liabilities held for risk management	137	-	-	-	137
Current tax liabilities	-	-	561	-	561
Subordinated liabilities	-	-	20,104	-	20,104
Other liabilities	-	-	1,326	-	1,326
Total financial liabilities	**137**	**-**	**562,883**	**-**	**563,020**

31.24 Encumbered assets

Certain assets are pledged as collateral to secure liabilities under Credit Support Annex (“CSA”) for derivative liabilities and as security deposits relating to FX forward transactions. The holders of these securities do not have the right to sell or re-pledge the asset except where specifically disclosed. The aggregate amount of collateral pledged under CSAs is £0.32 million as on 31 December 2019 (2018: £ nil) as mentioned at note 15.

31.25 Operational Risk Management

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

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

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

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

31.26 Capital Management and Risk

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

The Bank's capital has been invested by the Parent bank to support long-term business growth of the Bank, which includes capital resources to meet Total Capital Requirement (Pillar 1 and Pillar 2), CRD Buffers and PRA Buffer. The Bank also maintains an internal capital buffer over and above the minimum regulatory capital requirement. The Bank also takes into account changes in economic conditions; risk characteristics of its activities and regulatory requirement in managing its capital structure and make adjustments to it in the light of such changes. The bank has put in place processes and controls to monitor and manage its own funds and no breaches were reported to the PRA during the period.

The Bank's regulatory capital consists of the sum of the following elements:

- Common equity Tier 1 (CET 1) capital, which includes ordinary share capital and retained earnings, and Tier 2 capital which includes qualifying subordinated liabilities.

	2019 (£ 000')	2018 (£ 000')
Share capital	60,000	60,000
Retained earnings	11,226	9,683
Tier 1 capital	**71,226**	**69,683**
Subordinated liability	20,000	20,000
IFRS 9 (ECL) impact of regulatory capital	426	350
Tier 2 capital	20,426	20,350
Own funds	**91,652**	**90,033**

32. Prior year's adjustment

In the current the year 2019, Bank initiated to undertake a review of its VAT arrangements and obtained the services of an external consultant for VAT health check.

During the review it was identified that certain payments from April 2016 to December 2018 that include payments to Group companies against outsourcing / management charges and other offshore suppliers should have attracted a VAT reverse charge. In preparing these financial statements, the element of the VAT due under the reverse charge has been accounted for in the financial statements by adjusting the Equity of the relevant years and also restating the Profit & Loss and Balance Sheet of 2018.

Following table shows the yearly impact in Income Statements and Statement of Changes in Financial Position:

Amount in £ 000'

Income Statement	Previously Disclosed	Adjustment	Restated
For the Year 2016			
Administrative and general expenses	(3,031)	(158)	(3,189)
Profit before taxation	2,482	(158)	2,324
Tax credit	549	22	571
Profit after tax	**3,031**	**(136)**	**2,895**
For the Year 2017			
Administrative and general expenses	(4,997)	(218)	(5,215)
Profit before taxation	4,992	(218)	4,774
Tax charge	(591)	31	(560)
Profit after tax	**4,401**	**(187)**	**4,214**
For the Year 2018			
Administrative and general expenses	(4,871)	(259)	(5,130)
Profit before taxation	4,356	(259)	4,097
Tax charge	(768)	36	(732)
Profit after tax	**3,588**	**(223)**	**3,365**

Statement of Financial position	Disclosed	Adjustment	Amount in £ 000' Restated
As at 2016			
Assets	**593,146**	**-**	**593,146**
Liabilities			
Accruals, deferred income and other liabilities	4,400	158	4,558
Current tax liability	400	(22)	378
Total liabilities	**529,896**	**136**	**530,032**
Total equity	63,250	(136)	63,114
Total liabilities and equity	**593,146**	**-**	**593,146**
As at 2017			
Assets	**604,948**	**-**	**604,948**
Liabilities			
Accruals, deferred income and other liabilities	3,336	376	3,712
Current tax liability	400	(53)	347
Total liabilities	**537,208**	**323**	**537,531**
Total equity	67,740	(323)	67,417
Total liabilities and equity	**604,948**	**-**	**604,948**
As at 2018			
Assets	**635,905**	**-**	**635,905**
Liabilities			
Accruals, deferred income and other liabilities	3,925	635	4,560
Current tax liability	651	(90)	561
Total liabilities	**565,709**	**545**	**566,254**
Total equity	70,196	(545)	69,651
Total liabilities and equity	**635,905**	**-**	**635,905**

33. Ultimate Parent Company

The Bank is a wholly owned subsidiary undertaking of Habib Bank AG Zurich, which is the ultimate controlling parent, incorporated in Switzerland. The largest group in which the results of the company are consolidated is Habib Bank AG Zurich, Switzerland.

34. Significant Events after the Balance Sheet Date

The Directors confirm that there have been no significant events since the reporting date that require to be disclosed.

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Leeds Castle

Branch Network

Moorgate		Habib House
		42 Moorgate
		London EC2R 6JJ
	Telephone:	020 7452 0200
West End		142 Wigmore Street
		London W1U 3SH
	Telephone:	020 7487 4571
Harrow		377 Station Road
		Harrow on the Hill
		Middlesex HA1 2AW
	Telephone:	020 8515 1380
Southall		5-7 High Street
		Southall
		Middlesex UB1 3HA
	Telephone:	020 8893 5059
Tooting		264 Upper Tooting Road
		London SW17 0DP
	Telephone:	020 8767 5555
Manchester		Showroom 5, The Point
		173-175 Cheethamhill Road
		Manchester M8 8LG
	Telephone:	0161 832 2166
Leicester		160 Belgrave Road
		Leicester LE4 5AU
	Telephone:	0116 261 3300
Birmingham		Ground Floor Pinnacle House,
		8 Harborne Road
		Edgbaston
		Birmingham B15 3AA
	Telephone:	0121 455 6213

International Network

1 Switzerland	Habib Bank AG Zurich	1 Branch
2 United Kingdom	Habib Bank Zurich plc	8 Branches
3 United Arab Emirates	Habib Bank AG Zurich	8 Branches
4 Pakistan	Habib Metropolitan Bank Ltd	392 Branches
5 United Arab Emirates	HBZ Services FZ LLC	1 Branch
6 Kenya	Habib Bank AG Zurich	4 Branches
7 South Africa	HBZ Bank Ltd	10 Branches
8 Canada	Habib Canadian Bank	3 Branches
9 Hong Kong	Habib Bank Zurich (Hong Kong) Ltd	5 Branches
10 Pakistan	Habib Bank AG Zurich	Representative Office
11 Hong Kong	Habib Bank AG Zurich	Representative Office
12 Bangladesh	Habib Bank AG Zurich	Representative Office
13 China	Habib Bank AG Zurich	Representative Office