Habib Bank AG Zurich

(Incorporated in Switzerland 1967)

Habib Bank AG Zurich

Capital adequacy and liquidity disclosure requirements

Disclosure as at 31 December 2018

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Habib Bank AG Zurich is providing this information as at 31 December 2018 in accordance with the provisions of the Capital Adequacy Ordinance (CAO) and the disclosure requirements set out in FINMA Circular 2016/1 "Disclosure - banks".

1. Scope of consolidation

Scope of consolidation for capital adequacy purposes

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

• Habib Bank AG Zurich	(hereafter referred to as "the Bank")
• Habib Canadian Bank, Canada	(100% ownership)
• HBZ Bank Limited, South Africa	(100% ownership)
• Habib Metropolitan Bank Ltd., Pakistan	(51% ownership)
• Habib Bank Zurich (Hong Kong) Ltd., Hong Kong	(51% ownership)
• Habib Bank Zurich Plc, UK	(100% ownership)
• Habib Metropolitan Financial Services Ltd., Pakistan	(51% ownership)
• Habib Metropolitan Modaraba Management Company Ltd., Pakistan	(51% ownership)
• First Habib Modaraba Ltd., Pakistan	(5% ownership)
• Habib Metro Modaraba, Pakistan	(36% ownership)

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

The Group's method of capital consolidation follows the purchase method. The scope of consolidation according to FINMA Circular 2015/1 "Accounting - banks" additionally includes the subsidiary HBZ Services FZ-LLC, United Arab Emirates (100% ownership), Habib Europe Limited, Isle of Man (100%) and HBZ Services AG, Switzerland (100%). HBZ Services FZ-LLC acts as a service provider for the Group and does not operate in the financial sector (please refer to the Annual Report 2018, page 41). Habib Europe Limited (former Habib European Bank Ltd.) is in liquidation.

2. Group risk principles

Risk & Control Framework

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

Risk organisation

The Board of Directors' responsibilities are the following:
- The Board of Directors is responsible for the strategic direction, supervision and control of the Group and for defining its overall risk tolerance by means of a risk appetite statement and overall risk limits;
- The Risk & Control Committee supports the Board of Directors in fulfilling its oversight responsibilities by providing guidance regarding risk governance and the Group's risk profile, including the regular review of major risk exposures and overall risk limits;

- The Audit Committee supports the Board of Directors in fulfilling its oversight responsibilities by monitoring General Management's approach with respect to financial reporting, internal controls and accounting. Additionally, the Audit Committee is responsible for ensuring independence and monitoring the performance of Group Internal Audit and the external auditors.

On an operational level, the Group operates with a three lines of defence model, whereby business and revenue generation, risk management oversight and risk control are performed by functions independent of one another.

Furthermore, a clear distinction is made between "risk owners", "risk managers" and "risk controllers":
- Risk owners keep oversight and bear the overall responsibility for the management of specific risk classes or risk types;
- Risk managers focus on the monitoring and proactive management of risk. They initiate risk management measures and can change the risk profile;
- Risk controllers independently monitor and assess risk as well as highlight deviations from target risk parameters and non-compliance with policies.

Risk management principles

The following general principles are applied to maintain an appropriate balance between risk and return to:
- Assure the financial strength of the Group by monitoring our risk exposures and avoiding potential risk concentrations at individual exposure levels, at specific portfolio levels and at an aggregate Group-wide level across all risk types;
- Protect our reputation through a sound risk culture characterised by a holistic and integrated view of risk, performance and reward, and through full compliance with our standards and principles;
- Systematically identify, classify and measure risks applying best practice;
- Ensure management accountability, whereby business line management owns all risks assumed and is responsible for the active management of all risk exposures to ensure that risk and return are balanced;
- Set up independent risk control functions or units, which monitor the effectiveness of risk management and oversee risk-taking activities;
- Disclose risks to the Board of Directors, regulators and other stakeholders in a comprehensive and transparent manner.

Internal controls

Internal controls are processes and instruments used to monitor and control operational and other business risks. In order to continuously enhance the Group's internal control system and the effectiveness of controls, results of actual control processes are reviewed and the outcome of the Group's operational risk management processes is taken into account. The organisational units responsible for internal controls work closely with other organisational units within the Group.

Credit risk

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

The Group Credit Management Committee is responsible for credit risks and credit decisions, which may be delegated to the respective Country Credit Management Committees. The Group manages its credit risk within a conservative framework by evaluating the creditworthiness of the borrowing counterparties, setting appropriate credit limits and obtaining collateral as deemed necessary. For each collateral type a minimum haircut is defined in order to account for the volatility in market values according to the nature and liquidity of the collateral. More than 44% of the Group's credit exposure is secured by property and only 12% is unsecured.

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

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

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

Bank counterparties, issuers and sovereigns are analysed according to their financial performance and their external rating. Over 64% of the credit exposure to financial institutions is of investment grade quality and the remaining 36% consists mainly of short-term trade finance exposure in emerging markets, to which the Group has close links, and monitors the portfolio with a set of country limits.

Regarding non-performing loans, the Group is in a comfortable position. After taking the collateral at market value and the specific value adjustments for default risks into account, the net unsecured and unprovided position at the end of December 2018 was only CHF 0.1 million.

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

Liquidity risk

The Group applies a prudent approach to liquidity risk management. The Group Asset & Liability Management Committee oversees liquidity and market risks regularly.

The Group grants advances and loans to clients both on a short-term basis and with tenors generally up to five years. Funding is primarily obtained through deposits, which are mainly at sight, or short-term deposits. Wholesale funding is not significant and deposits are well diversified. No single depositor accounts for more than 5% of the Group's total deposits. Excess liquidity is held as bank placements or financial investments. The latter primarily consist of bond portfolios of sovereign issuers or other issuers of high quality.

The contractual maturities of the Group's financial assets exceed the contractual maturities of the financial liabilities. However, when determining maturity gaps, the stickiness of deposits or economic maturities needs to be considered, which significantly reduces the contractual gaps. Furthermore, individual client groups in different countries will not act in the same way and at the same time.

In general, the Group is exposed to potential larger deposit outflows and sudden adverse market developments. Therefore, related scenarios have been analysed as part of three liquidity stress tests performed throughout the Group. The stress test results showed that the liquid assets available could absorb projected outflows in all cases.

The Group maintains a strong liquidity position, which is further supported by established repo functionalities. In addition, liquidity coverage ratio targets have been defined for all operating Group companies.

Both funding and liquidity management is performed on a decentralized basis. The short-term liquidity disposition and liquidity situation of individual countries are monitored by the respective country treasury functions. In addition, liquidity reserves are held both at the Group and at the country level, and contingency funding plans are in place for the Group as well as all branches and subsidiaries.

Market risk

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

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

The Group is exposed to interest rate risk due to interest periods set for advances made to clients exceeding the interest periods for client deposits taken. To limit interest rate risk, most client advances are agreed on a 3- or 6-month base rate plus a credit spread.

In addition, branches and subsidiaries have placed excess liquidity in bank placements or in financial investments with tenors usually up to 3-5 years. While the volume of financial investments is kept limited, the average duration of the fixed income portfolios creates interest rate risk exposure given the absence of long-term wholesale financing.

For foreign exchange transacion risks, the Group pursues a risk-adverse approach and aims to keep the potential foreign exchange losses to a minimum. The Group does not pursue proprietary foreign exchange trading activities.

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

Operational risk

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

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

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

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

The Group has developed a risk-based cyber risk strategy. The Chief Information Security Officer and his dedicated team of cyber specialists monitor cyber risk, perform risk assessments, vulnerability and penetration tests as well as run an information security campaign to raise employee awareness.

3. Disclosure

Table 1 (KM1): Key metrics

	in CHF 000's	31.12.18	31.12.17
	Eligible Capital		
1	Common equity Tier 1 (CET1)	1'078'713	1'189'049
2	Tier 1 capital	1'078'713	1'189'049
3	Total capital	1'138'240	1'189'049
	Risk weighted assets (RWA)		
4	Total risk-weighted assets (RWA)	5'822'666	6'140'335
4a	Minimum capital requirements	465'813	491'227
	Riskweighted capital quota (in % of RWA)		
5	Common Equity Tier 1 ratio (%)	18.5%	19.4%
6	Tier 1 ratio	18.5%	19.4%
7	Total capital quota	19.5%	19.4%
	CET1 buffer requirements as a percentage of RWA		
8	Capital conservation buffer requirement (%)	1.9%	1.3%
9	Countercyclical buffer requirement (%)	0.0%	0.0%
11	Total of bank CET1 specific buffer requirements (%)	1.9%	1.3%
12	CET1 available after meeting the bank's minimum capital requirements (%)	11.5%	11.4%
	Capital quota according to Appendix 8 Capital Ordinance (CAO) (in % of RWA)		
12a	Capital buffer according Appendix 8 CAO (%)	3.2%	3.2%
12b	Countercyclical buffer requirement (%)	0.0%	0.0%
12c	CET1 capital target (%)	7.4%	7.4%
12d	T1 capital target (%)	9.0%	9.0%
12e	Total capital target (%)	11.2%	11.2%
	Basel III Leverage Ratio		
13	Total Basel III leverage ratio exposure measure	11'139'447	12'632'745
14	Basel III leverage ratio (%)	9.7%	9.4%

	in CHF 000's	Quarter 4 2018 Weighted values	Quarter 3 2018 Weighted values	Quarter 2 2018 Weighted values	Quarter 1 2018 Weighted values	Quarter 4 2017 Weighted values
	Liquidity Coverage Ratio					
15	Total HQLA	2'133'338	2'805'614	3'217'738	3'108'954	3'707'424
16	Total net cash outflow	-2'772'600	-2'986'937	-3'203'814	-3'331'127	3'259'776
17	LCR ratio (%)	122.3%	119.4%	123.6%	116.1%	114.0%

As mentioned in the Directors' report on pages 13-14 of the annual report, the year 2018 was affected by unique developments, which left their mark in the capital adequacy reporting as well. The "Total capital" decreased by CHF 53.8 million, which is driven by a 20% devaluation of Pakistan Rupee and the respective impact on the "change in equity"*. On the other hand the Group introduced the "expected credit loss" (ECL) methodology in 2018, which resulted in adjustments in equity and in eligible tier 2 capital accordingly. Consequently, the "Tier 1 ratio" decreased from 19.4% to 18.5% but the "Total capital quota" increased by 0.1% to 19.5% for the year 2018.

*see page 24 of the Annual Report 2018

Table 2 (OV1): Overview of risk-weighted assets (partial disclosure)

			a	b	c
			RWA	RWA	Minimum capital requirements
	in CHF 000's		**31.12.2018**	**31.12.2017**	**31.12.2018**
1	Credit risk	SA-BIZ approach	4'843'858	4'973'083	387'509
20	Market risk	Standardised approach	260'594	370'738	20'848
24	Operational risk	Basic indicator approach	633'812	688'521	50'705
25	Amounts below the thresholds for deduction (subject to 250% risk weight)		84'403	107'993	6'752
27	**Total (1 + 20 + 24 + 25)**		**5'822'667**	**6'140'335**	**465'814**

Table 3 (LIQA): Liquidity: management of liquidity risks

Please find detailed information regarding the management of liquidity in the section "Liquidity risk" on page 3 of this document. As indicated the Group maintains a strong liquidity position, which results in a average liquidity coverage ratio over the year 2018 between 116% and 124%. The devaluation of Pakistan Rupee by 20% affected the total "High quality liquid assets" (HQLA) as well as the "Total net cash outflow" over the course of the year 2018. Consequently, the "HQLA" decreased by 36% in parallel to the decrease of the "Total net cash outflow" of 37% from December 2017 to December 2018.

The Group's total HQLA of CHF 2.1 billion in Quarter 4 2018 includes mainly balances with central banks in countries where the Group is active, investments in local government bonds in Pakistan and bond investments in Switzerland. Moreover, HQLA government bonds in Pakistan are only be considered up to the net cash outflow of the entity, which is in line with the FINMA Circular 2015/2 "Liquidity risks - banks", margin no. 161.

Table 4 (CR1): Credit risk: credit quality of assets

		a	b	c	d
	31.12.2018 in CHF 000's	Gross carrying values of defaulted exposures	Gross carrying values of non-defaulted exposures	Value adjustments/ impairments	"Net values (a + b - c)
1	Loans (excluding debt securities)	291'891	3'503'505	174'335	3'621'061
2	Debt securities		3'524'431	2'474	3'526'905
3	Off-balance-sheet exposures		1'431'862	2'283	1'429'579
4	**Total**	**291'891**	**8'459'798**	**179'092**	**8'577'545**

Value adjustments for default and latent credit risks:

Please refer for further information regarding "Value adjustments for default and latent credit risks" to the Annual Report 2018 page 27.

Table 5 (CR2): Credit risk: changes in stock of defaulted loan and debt securities

Under FINMA Circular 2016/1 “Disclosure – banks”, tables presenting a reconciliation between the figures of the previous reporting period and the reporting period need not be published if the figures of the previous reporting period refer to a time before the Circular was applied. Table 5 (CR2) will be compiled and published for the first time at 31 December 2019.

Table 6 (CRB): Credit risk: additional disclosures related to the credit quality of assets

31.12.18 in CHF 000's	Carrying values
Breakdown of exposures by geographical area	
Switzerland	391'957
Rest of Europe	1'002'953
Americas	380'283
Asia and Oceania	4'360'648
Africa	601'483
Total exposures	**6'737'324**

31.12.18 in CHF 000's	Carrying values
Breakdown of exposures by industry	
Agriculture	102'285
Manufactoring	1'152'062
Services	1'755'777
Individuals and others	3'727'200
Total exposures	**6'737'324**

31.12.18 in CHF 000's	Carrying values
Breakdown of exposures by residual maturity	
Due up to 3 months	2'697'066
Due between 3 and 12 months	1'783'961
Due between 1 and 3 years	813'951
Due between 3 and 5 years	1'160'667
Due after more than 5 years	281'679
Total exposures	**6'737'324**

31.12.18 in CHF 000's	Impaired exposures (gross debt)	Specific value adjustments
Breakdown of impaired exposures by geographical area		
Switzerland	11'569	9'330
Rest of Europe	17'736	5'036
Americas	6'356	664
Asia and Oceania	255'444	158'947
Africa	9'510	2'832
Total impaired exposures	**300'615**	**176'809**

31.12.18 in CHF 000's	Impaired exposures (gross debt)	Specific value adjustments
Breakdown of impaired exposures by industry		
Agriculture		
Manufacturing	120'668	64'936
Services	35'892	20'047
Individuals and others	144'055	91'826
Total impaired exposures	**300'615**	**176'809**

Non-performing loans / receivables:

Non-performance of a credit exposure is considered with regard to a particular obligor when either or both of the two following events have taken place:

- The Group considers that the obligor is unlikely to pay its credit obligations to the Group in full, without recourse by the Group to actions such as realizing collateral (if held)
- The obligor is 90 days or more past due on any material credit obligation to the Group. Overdrafts will be considered as being past due once the client has breached an advised limit or been advised of a limit smaller than current outstandings.

The assessment as to whether a credit exposure is non-performing is made on an entity level entailing all exposures of the respective entity.

31.12.18 in CHF 000's	Past due exposures (gross debt)	Specific value adjustments
Ageing analysis of accounting past-due exposures		
Past due for up to 3 months	64'393	2'827
Past due for 3 to 6 months	16'031	8'039
Past due for 6 to 9 months	1'477	76
Past due for 9 to 12 months	1'012	403
Due between 1 and 3 years	54'091	35'655
Due between 3 and 5 years	20'185	18'817
Due after more than 5 years	172'607	103'440
Total past due exposures	**329'796**	**169'257**

Restructured credits:

A restructuring of a credit agreement is generally defined to be a breach of contract under the initially agreed terms and conditions. Regardless of the interest and amortization payments, it is only possible in exceptional cases to keep restructured advances in the normal credit category and not to flag it as heightened or impaired credit risk.

A restructuring flag is set in the system showing the inability of the borrower to continue servicing its debt without relief in terms and conditions.

	Gross debt		
31.12.2018 in CHF 000's	Impaired	Not impaired	**Total**
Breakdown of restructured exposures			
Restructured exposures	45'277	103'106	**148'383**

Table 7 (CR3): Credit risk: overview of mitigation techniques

	a	c	e & g
31.12.2018 in CHF 000's	Unmitigated credit exposures	Exposures mitigated by collateral, of which: mitigated amount	Exposures mitigated by financial guarantees or credit derivatives, of which mitigated amount
Claims (including debt securities)	9'389'869	882'796	32'500
Off-balance sheet transactions	430'430	219'842	343
Total	**9'820'299**	**1'102'638**	**32'843**
of which defaulted	173'218		

Table 8 (CR5): Credit risk: exposures by exposure category and risk weights under the standardised approach

		a	b	c	d	e	f	g	h	i	j
	31.12.2018 in CHF 000's	0%	10%	20%	35%	50%	75%	100%	150%	Other	Total credit exposures amount (post-CCF and post-CRM)
1	Central governments and central banks	3'783'663		57'830		3'693		144'439			**3'989'625**
2	Banks and securities firms	22'111		1'150'145		851'593		168'237	30'165		**2'222'251**
3	Non-central government public sector entities and multilateral development banks	69'406		22'039				168'556			**160'001**
4	Corporates	264'762		100'249	65'396	127'295	33'516	2'788'395	41'351		**3'420'964**
5	Retail	133'992		12'308	177'497	122'327	488'945	72'869	12'195		**1'020'133**
6	Equity							29'610	3'970		**33'580**
7	Other exposures	16'481			546	548		58'806			**76'381**
8	**Total**	**4'290'415**		**1'342'571**	**243'439**	**1'105'456**	**522'461**	**3'330'912**	**87'681**		**10'922'935**
9	Of which, covered by mortgages						59'483				**59'483**
10	Of which, past-due loans							55'517	53'311		**108'828**

Table 9 (ORA): Operational risks: general duties

Please find detailed information regarding the management of operational risks in the section “operational risk” on page 4 in this document. Habib Bank AG Zurich applies the basic indicator approach for operational risks.

Interest rate risk disclosure

In accordance with the FINMA Circular 2016/1 "Disclosure - banks", the disclosure of the interest rate risks (Tables IRRBBA, IRRBBA1 and IRRBB1) is omitted within this document. There will be an extraordinary disclosure of the interest rate risks per 30 June 2019.