Pillar 3 Disclosures as at December 31st 2017

Contents

1 Background, Scope and Purpose

1.1 Background

This Pillar 3 Statement is designed to comply with:

- the requirements of the Capital Requirements Regulations (CRR) at *Part 8: Disclosure by Institutions* and
- the European Banking Authority (EBA) Guidelines on Disclosure effective under Prudential Regulation Authority (PRA) rules as of October 15th 2015

…in both cases as applicable and relevant to Sonali Bank (UK) Limited (SBUK and the Bank), at December 31st 2017 (the data date).

The Bank is a stand-alone, solo entity and this document relates solely to that entity.

1.2 Statement of adequacy

This document, in the SBUK Board's opinion, conveys adequately and comprehensively the risk profile of SBUK in accordance with the Bank's documented Disclosures Policy. No applicable material disclosures have been omitted on the grounds of being proprietary or confidential, or for any other reason.

This Pillar 3 Statement will be made available and remain on the Bank's website until superseded by its successor document. Pillar 3 Statements are supplementary to the Bank's contemporary financial statements but may contain data also made available in those financial statements.

1.3 Document ownership and control

This Statement is drafted and maintained by the Chief Risk Officer (CRO). It is the responsibility of the SBUK Board Risk Committee to review, challenge and ultimately approve the Pillar 3 Statement, at least annually, and more often in the event of a material change in the Bank's risk profile.

1.4 Related Documents

Document	Description	Location
SBUK Risk Policy	Overarching risk framework policy covering the Banks risk management process and procedures and governance.	Shared
SBUK Credit Risk Policy	Establishes and implements procedure that set out the Bank's credit risk management policy.	Shared

SBUK IFRS9 Policy Annex 1	Appendix 1 to the SBUK IFRS 9 Policy *SBUK ECL Modelling YYMMDD.docx*	Shared
SBUK ECL Model	Excel workbook containing source documents, references and research links *SBUK ECL Model YYMMDD.xlsx*	Shared
Operational Risk Policy BDO Update 170616	Operational risk management policy	Shared
Market Risk Policy 21.5.18	Market risk management policy	Shared
Treasury IRR Policy 2018	Interest rate risk in the banking book policy	Shared

2 Definitions

Definitions	
EBA	European Banking Authority
CRR	EU Capital Requirements Regulations
PRA	Prudential Regulation Authority
CRO	Chief Risk Officer
IRRBB	Interest rate risk in the banking book
ICAAP	Internal Capital Adequacy Assessment Process
ILAAP	Internal Liquidity Adequacy Assessment Process
CEO	Chief Executive Officer
ALCO	Asset and Liability Committee
BRCC	Board Risk and Compliance Committee
LCR	Liquidity coverage ratio
NSFR	Net stable funding ratio
R&CC	Board Risk and Compliance Committee
MLRO	Money Laundering Reporting Officer
ToR	Terms of Reference
KPI	Key Performance Indicator
KYC	Know Your Customer
IFRS	International Financial Reporting Standard
ECL	Expected Credit Losses
EAD	Exposure at default
PD	Probability of default
CCF	Credit conversion factor
LGD	Loss given default

CRM	Credit risk mitigation
SME	Small/medium-sized entity
ECAI	External Credit Assessment Institution
ECA	Export Credit Agency
RemCo	Board Remuneration Committee
FCA	Financial Conduct Authority
B/S	Balance Sheet

3 Risk management objectives and policies

3.1 Risk Management Objective and Policies

The Bank's risk management objective is the accurate assessment of SBUK's risk profile, as required for the fulfilment of its business plan over the planning cycle, and the establishment of effective controls and mitigations of resultant material risk including, but not limited to, holding capital and liquidity reserves such that the Bank is resilient to all foreseeable events and circumstances.

A comprehensive suite of risk management policies is maintained by the CRO and reviewed at minimum annually by the Board via its Risk Committee. Those policies give rise to documented procedures and management information designed to give assurance that policies are complied with or, where not, that non-compliance is brought to the attention of the senior management team for action.

During the year the Bank received additional funds from its shareholders, in proportion to their respective shareholdings, of £17.1m (51%) from the Government of Bangladesh and £16.4m (49%) from Sonali Bank Limited, a Bangladesh banking corporation wholly-owned by the Government of Bangladesh. These funds have increased the Banks' share capital from £28m to £61.5m. At the data date the Bank had a surplus capital of £45.7m over its regulatory capital requirement[1]. A portion of this capital will support graduated future growth in credit exposures, in line with the Bank's existing conservative credit policies and while maintaining a surplus above regulatory requirements.

While capital and liquidity reserves may be effective in mitigating the adverse effects of some risk categories, the Bank's risk management infrastructure, meaning its policies, processes and assurance mechanisms, is the preferred and primary methodology deployed by the Bank in order to control and mitigate risk.

[1] Figures to the nearest £100,000

The Bank utilises the Standardised Approaches for measuring Pillar 1 capital requirements for Credit and Operational Risks. SBUK does not hold tradeable assets and is therefore not exposed to market risk other than in respect of:

- overnight FX positions, upon which there is a firm and conservative limit, which limit is in any event rarely approached. The Bank does not currently deal in derivative instruments for speculative purposes, however it holds foreign exchange currency swaps to manage its operational exposure to foreign currency risk arising on certain transactions. At the data date the resultant exposure was £142,664 against a notional position of £3m.

- interest rate risk in the banking book (IRRBB), in which respect the Bank effectively runs a matched book, allocating loans on a transaction-by-transaction basis and funding from either a fixed or notice 90/180/365-day account. The hypothetical sensitivity of the Bank's reported profit to a 1% increase or decrease in the respective interest rates to which the Bank is exposed would be £603,380.

The Bank re-assesses its overall exposure to risk at least annually (and more often if dictated by changes to its business model) via its Internal Capital Adequacy Assessment Process (ICAAP) and Internal Liquidity Adequacy Assessment Process (ILAAP). These assessments and documents incorporate detailed Risk Appetite Statements which describe quantitative and qualitative triggers and limits against all risks assessed as material (ranked Medium or High). Those triggers and limits are transposed into monitoring metrics which are generated daily by the finance department of the Bank and reported to the CRO and to the Chief Executive Officer (CEO) or, in their absence, their deputies.

Summary metrics are also reviewed periodically by the Bank's Credit Committee, its Asset and Liability Committee (ALCO) and the Board Risk and Compliance Committee (BRCC).

3.2 Material risk categories

The Bank's business model is that of a wholesale lending bank, focussing on trade-based services and related lending to Bangladeshi banks. Funding is provided by the Bank's shareholders and deposits from Bangladeshi banks. SBUK does not currently, and has no present plans to, use speculative derivative instruments or undertake repurchase transactions, securities or commodities lending or borrowing transactions, long settlement transactions or margin lending.

The material risks to which SBUK is exposed, as determined in the latest versions of its ICAAP and ILAAP, are described in the following sections.

3.3 Group Risk

The ultimate shareholder is the Government of Bangladesh, both directly and via the Government's ownership of Sonali Bank Limited, a Bangladesh-incorporated institution. It is therefore implausible that the shareholders would wilfully or neglectfully cause or permit harm to the net assets of the Bank – this would directly impact the value of their shareholdings.

However, the Bank's continued existence is inarguably subject to the strategic aims of the ultimate shareholder, as those aims may change from time to time. This risk is managed and mitigated by the Bank's Board-level relationships with its shareholders, and by the holding of Pillar 2 capital reserves sufficient to provide for the continuing orderly management and run-down of the Bank's business and portfolios over a defined period of one year maximum (the Bank's assets are predominantly short-term and where not short-term are cash-collateralised).

3.4 Credit Risk and Credit Concentration Risk

While a significant proportion of the Bank's lending is cash-collateralised by monies held under the Bank's control and under legally binding set-off agreements, a material part of its credit risk exposure is unsecured, primarily to Bangladeshi institutions and corporates, but also to other institutions. This latter category is comprises predominantly investment-grade banks holding SBUKs Nostro accounts in diverse currencies, and 2 'designated' money-market funds, i.e. qualifying as eligible for liquidity buffer purposes under CRR rules.

As regards the lending and off-balance sheet exposures (such as Letter of Credit confirmations) to Bangladeshi institutions which are not cash-collateralised, all facilities are short-term (maximum tenor 12 months), trade-related, and self-liquidating under normal business circumstances, and are granted only after due credit committee process including assessment under the Bank's internal credit rating system. This results in use of the same rating label system as two of the major agencies (i.e. AA, B-, etc.) and there is a hard lower rating boundary below which the Bank will not expose itself.

Similarly the Bank may be aware of adverse intelligence, regarding existing or potential counterparties, which might result in facilities being withdrawn or declined, irrespective of the rating.

The Bank has never experienced any incidents of default or loss from this portfolio. Nevertheless, in addition to maintaining its Pillar 1 credit risk capital, in recognition of the concentration risk inherent in its business model, SBUK reserves a Pillar 2 capital amount equivalent to the greater of

- its largest 100%-risk-weighted, uncollateralised exposure and
- the amount determined by application of the PRA-mandated HHI[1] methodology for assessing single-name obligor, sector and geographic concentration risks.

3.5 Business Risk

Also sometimes called 'strategic risk', this is the risk that revenues are materially lower, and/or costs materially higher, than forecast in our Business Plan, which projects modest but consistently-growing profits. The Bank calculates a capital planning reserve based on both significantly lower revenues and coinciding significantly higher costs.

[1] The Herfindahl-Hirschman Index is a commonly accepted measure of concentration.

However, Business Risk and Group Risk (as defined at 3.3 above) are mutually exclusive, in the sense that were an orderly wind-down to take place as under the Group Risk scenario, Business Risk would by definition no longer exist; equally, if the business continues as a going concern, albeit under stress as in this Business Risk scenario, wind-down costs would not additionally apply. Therefore the capital held against Group Risk is offset against the (much larger) Business Risk Pillar 2 capital reserve.

3.6 Operational Risk

The Bank recognises the existence of both Conduct and non-Conduct operational risk inherent in its business activities.

In respect of Conduct Risk, the Bank has invested significantly over recent years in both people and systems in order to upgrade its defences against money laundering, terrorist financing and breach of sanctions. The Bank has also fully implemented the UK PRA/FCA Senior Manager and Certification regimes. In any event SBUK does not regard capital as an effective mitigation of this risk.

As regards non-Conduct operational risk, the Bank's mandatory minimum Pillar 1 capital reserve is much higher than is required by the Bank's recorded operational risk loss history. The Pillar 1 operational risk capital requirement was £1.4m at the effective date of this Statement.

3.7 Liquidity Risk

SBUK monitors and manages liquidity risk on a daily basis taking into account its liquidity risk appetite statement, which incorporates minimum compliance tolerances for the Bank's liquidity coverage ratio (LCR), net stable funding ratio (NSFR) and its survival under severe liquidity stress scenarios, specific to the Bank's business model and operations but also coinciding with adverse market events.

The Bank's activities and operations are such that through its Treasury it is able to accurately predict, and satisfy beforehand, all intraday requirements – this is in any event an operational necessity, as SBUK has no intraday credit facilities.

The Bank monitors future cash flow mismatch risk using regulatory returns populated on a daily basis. At the data date the Bank's minimum cumulative daily inflows for the next 3 months were £39.1m (maximum £81.2m).

4 Governance

4.1 SBUK Board Risk & Compliance Committee and risk management function

The Bank has a Board Risk and Compliance Committee (BRCC) comprising at least 3 non-Executive Directors (NEDs) as voting members, including the Chair, and with a standing invitation to the CEO, CRO, Money Laundering Reporting Officer (MLRO) and Head of Compliance (HC).

The BRCC must be convened at least bi-monthly and met on 6 occasions in 2017.

Under its Terms of Reference (ToR) the BRCC is authorised by the Board to obtain, at the Bank's expense, outside legal or other professional advice on any matters within its terms of reference, which include risk management (risk management strategy, risk appetite, the risk register and dashboards, KPIs etc.), internal controls and risk management systems, compliance, whistleblowing and fraud.

The standing agenda items include the review of trends, and of current and forward-looking metrics on all material risks present in the Bank's operations and activities.

The CRO is an Executive Member of the Bank's Board and reports directly to the CEO. The MLRO, HC and Head of Client Data and KYC Controls each reports to the CRO, and those officers are supported by additional, dedicated risk and compliance personnel.

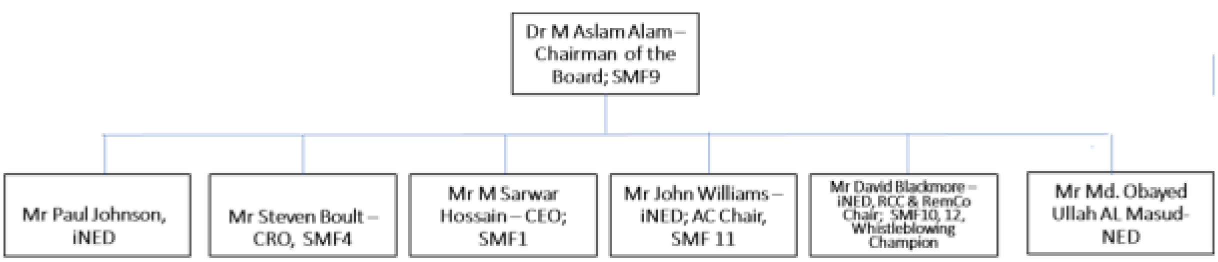
The Board is satisfied with the Bank's ability to continue as a going concern and that it has the financial resources to continue in business for the foreseeable future. This includes surplus capital at December 31st 2017, over regulatory thresholds, of £45.7m, a liquidity coverage ratio of 211% against a requirement of 100%, and positive profit and cash flow projections following the recent reorganisation of the business (the cessation of all retail borrowing activities).

4.2 Declaration

The Bank's Board has reviewed the adequacy of the risk management arrangements of SBUK and assured itself that the risk management systems put in place are adequate, having regard to the Bank's risk profile and strategy.

4.3 Directorships

The SBUK Board as at January 1st 2017 is represented below:



Mr. Alam resigned on December 21st 2017 and was on the same date replaced as Chair by Mr Mahmud Hussain.

A Conflict of Interests register is maintained recording other directorships of Board members. At December 31st 2017 the seven Directors held in total fifteen other board positions, none of which was deemed to conflict with membership of the SBUK Board.

The Bank's Senior Management Regime Procedures incorporate:

- the Criteria for Director Appointments
- a Directors Independence Assessment process and
- a Directors Skills Assessment process

…all of which were retrospectively applied to the Board upon adoption by the Bank of the UK Senior Managers and Certification regimes, and have since been applied to joining members.

4.4 Diversity

The Bank's Equality and Diversity Policy is generically applicable to all customers, staff (including the Board) and third parties and protects the following characteristics from discrimination:

(a) age

(b) disability

(c) gender reassignment

(d) race

(e) religion or belief

(f) gender

(g) sexual orientation

(h) marriage or civil partnership status

(i) pregnancy and maternity or

(j) caring responsibility.

The Policy endorses positive measures to seek a balance between representations in the body of staff; this includes the Board. No quantitative targets have been set in this respect.

5 Own Funds and Countercyclical Capital Buffer (CCyB)

The Bank's Common Equity Tier 1 capital comprises ordinary share capital of £61.5m and retained earnings of £0.3m, a total of £61.8m[1]. No other capital resources are held.

The following table shows gross and risk-weighted assets (after credit risk mitigation) per CRR Exposure Class:

[1] To the nearest £100,000

Total Exposures	Gross	Risk-weighted	x8%
Institutions	129.2	20.6	1.6
Corporates	95.5	34.8	2.8
Money Market Funds - CIUs	13.1	2.6	0.2
Retail	-	-	-
Other Assets	2.3	1.5	0.1
Off-B/S	5.8	1.2	0.1
	245.9	**60.7**	**4.9**

There is no exposure to counterparty credit risk.

As to the CCyB, the UK rate was zero at the effective date (it will be 1% effective November 2018). The Bank had no exposure to those other jurisdictions where the CCyB had been implemented (Lithuania, Denmark, the USA, the Czech Republic, Sweden, Slovakia and Iceland).

6 Credit Risk Adjustments

The Bank's definition of past due is any exposure where any obligor is more than 90 days past due on any material credit obligation. The Bank's definition of impairment is consistent with that in International Financial Reporting Standard 9 (IFRS 9).

SBUK has adopted, with effect from January 1st 2018, and deems itself compliant in all applicable respects with, IFRS 9. The Bank carried no credit loss provisions under the previous accounting standard. Under IFRS 9 the Bank has approved a policy approach and built a model in order to ascertain Expected Credit Losses (ECL) and accordingly would hold an initial provision of slightly less than £706,000. This is less than one third of one percent of gross (i.e. on- and off-balance sheet) credit risk exposures, and just 1.53% of the Bank's *excess* capital held at December 31st 2017.

Nevertheless it is a material amount in the context of the Bank's ongoing profitability, and the Bank intends to take advantage of the transitional provisions finally approved by the EU on May 31st 2017[i] (and endorsed by the UK PRA in its 'clarification' statement), under which the full impact to the Bank's P&L account is phased-in over 5 years, on a straight-line basis (and the Bank will advise its PRA Supervisor accordingly, as per PRA instructions).

The ECL model is based on the Bank's internal rating system, described at 3.4 above. Actual ECAI ratings and proxy ratings, derived for unrated entities via researched comparison, are converted into lifetime probabilities of default (PD) based on a 10-year time series. Lifetime PD is converted to 12-month PD using a scalar.

Exposure at default (EAD) for on-balance sheet exposures is generally taken as the current balance - the Bank does not typically offer overdraft-type facilities. Off-balance sheet exposures are converted into on-balance sheet equivalents using the same credit conversion factors (CCF) used in calculating the Pillar 1 credit risk capital requirement.

Loss given default (LGD) is necessarily a primarily judgment-based assessment, given that the Bank has no history of loss and that its counterparties are overwhelmingly financial institutions where, in many jurisdictions, there is still significant implicit state support for banks and, in any event, little empirical input on how to derive LGD.

Given the methodology outlined above we regard all ECLs as specific provisions.

7 Credit Risk

As at the effective date of this Statement gross credit risk exposures totalled £245.9m (including off-balance sheet items of £5.8m), however as a result of (i) cash collateralisation and (ii) significant short-term exposures to Institutions of Credit Quality Steps 1, 2 or3, the Bank's credit risk weighted assets were just £57.0m, of which 61% were to Corporates and the remainder to Institutions. (There was also an immaterial retail exposure.) These figures are representative of the averages for 2017.

£135.0m (55%) of exposures were domiciled in Bangladesh and £71.2m (29%) in the UK and other EU countries, with the remainder divided principally between North America and China.

No assets were in default or impaired, and none were risk weighted in excess of 100%.

All credit risk exposures were of under 1 year's duration with the exception of one fully cash-collateralised long-term corporate loan.

8 Use of External Credit Assessment Institutions (ECAIs)

The Bank uses Fitch ratings, where available, accessed from that agency's website. The exposure classes, for which such ratings are used, where available, are Institutions.

9 Exposure to market risk

The Bank's market risk exposure at the effective date of this Statement was £78,710 generating a Pillar 1 capital requirement of c. £6,300.

10 Remuneration

The Bank's Remuneration Policy is generated and maintained by the CEO, for challenge and review by the Remuneration Committee of the Board (RemCo), before commendation to the Board itself.

The Policy is designed to provide total compensation that is in line with market rates, and structured and calibrated so as to attract, retain, motivate and reward its employees to deliver enhanced performance in the eyes of customers and shareholders, and to comply with the UK Financial Conduct Authority's (FCA) revised Remuneration Code (the Code) issued in June 2015. Under the Code the Bank must ensure that its Remuneration Policy, practices and procedures are clear and documented. To assess compliance with the Code the Bank is required to complete a Remuneration Policy Statement which is maintained by SBUK's Human Resources Manager, in conjunction with the Compliance function.

The SBUK remuneration scheme includes both fixed and variable components. These are appropriately balanced so that the fixed or guaranteed component represents a sufficiently high proportion of the total remuneration to avoid employees being overly dependent on the variable components. This allows SBUK to operate a fully flexible bonus policy, including the option to pay no variable component.

Any awards in respect of that proportion of variable pay relating to the Bank's performance may be subject to downward adjustment, where RemCo has evidence that the performance was achieved through risk-taking in excess of SBUK's risk appetite. The scope and scale of any such downward adjustment is at the sole discretion of RemCo.

RemCo approval is required for all and any termination payments.

The key management personnel are considered to be the Directors. The highest paid Director received remuneration of £150,000 and a contribution of £8,000 to that Director's money purchase pension scheme.

11 Leverage

At the relevant date the Bank's leverage ratio, whether or not using a fully phased-in definition of Tier 1 capital, was 25.6%, based on a total exposure value of £240.1m. This is partly accounted for by the capital inflow referenced at 3.1 above, nevertheless given the Bank's cautious risk appetite and modest planned growth, the Bank does not consider the risk of excessive leverage to be a material threat.