

# **NATIONAL BANK OF EGYPT (UK) LIMITED**

Basel II, Pillar 3 disclosures for the year ended 30<sup>th</sup> June 2016

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## 1. OVERVIEW

### *Introduction*

National Bank of Egypt (UK) Limited (“NBEUK” or “the Bank”) was incorporated in the UK as a company limited by shares under the Companies Acts 1985 to 1989 on 28<sup>th</sup> August 1992 under Company Number 2743734. NBEUK took over the operations of the two former London branches, (re-opened in London 1982) of National Bank of Egypt (“NBE”), and incorporated as a wholly owned subsidiary of NBE. The Bank’s name was changed to National Bank of Egypt (UK) Limited (“NBEUK”) from National Bank of Egypt International Limited (“NBEI”) with effect from 1<sup>st</sup> October 2004.

The Bank’s current product portfolio comprises a number of activity areas set out in the paragraphs that follow:

- The Bank operates a **wholesale money market business** which essentially focuses on money market placements and foreign exchange (Forex).
- **A commercial lending business.** This includes syndicated lending facilities working mainly with financial institutions, corporates and sovereign entities world-wide.
- **Debt securities and investments.** These include government treasury bills, Fixed income Products (FI) and corporate FRN’s (Fixed/Floating Rate Notes), bonds and notes.
- **Trade finance.** In the main, this business provides a facility to Egyptian banks to cover letters of credit, letters of guarantee and bills discounted. In addition, trade finance is also extended to a number of banks and corporates globally.
- **Customer/Retail Services** to Egyptian nationals in the UK and to staff of Egyptian Embassies and of Egypt Air world-wide.

### *Background*

Since 1<sup>st</sup> January 2008, the Bank has been operating under the Basel II Framework (“the Framework”), as adopted by the European Union via the implementation of the Capital Requirements Directive (“the Directive”). In the UK, the Directive is being implemented by our regulator the Prudential Regulatory Authority and the Financial Conduct Authority (the PRA and FCA). The Basel II Framework is structured around three pillars: Pillar 1 (minimum capital requirements), Pillar 2 (supervisory review) and Pillar 3 (market discipline).

The disclosure requirements (Pillar 3) aim to complement the minimum capital requirements (Pillar 1) and the supervisory review process (Pillar 2). It aims to encourage market discipline by allowing market participants to assess key pieces of information on risk exposures and the risk assessment processes and capital adequacy of the Bank.

### *Basis of Disclosures*

These disclosures cover the Pillar 3 qualitative and quantitative disclosure requirements and have been prepared by NBEUK in accordance with the Pillar 3 requirements laid out in the FCA handbook BIPRU Chapter 11. They provide information on the capital adequacy and risk management of NBEUK. NBEUK does not have any subsidiary undertaking and prepares its prudential returns on an unconsolidated basis only. All figures within this document are as at 30<sup>th</sup> June 2016 unless stated otherwise.

**Frequency**

This report will be made on an annual basis. The disclosures will be as at the Accounting Reference Date (ARD), i.e. as at 30<sup>th</sup> June, and will be published within six months of the ARD. The Bank will aim, however, to make the disclosure shortly after the publication of the Annual Report & Accounts.

**Media and Location**

The report will be published on the NBEUK corporate website ([www.nbeuk.com](http://www.nbeuk.com)).

**Verification**

The Pillar 3 disclosures have been subject to internal review procedures broadly consistent with those undertaken for unaudited information published in the Annual Report and Accounts. The Pillar 3 information has not been audited by NBEUK's External Auditors.

The Pillar 3 disclosures have been prepared purely for explaining the basis on which the Bank has prepared and disclosed certain capital requirements and information about the management of certain risks and for no other purpose. They do not constitute any form of financial statement but are supplementary to the information contained in the Bank's financial statements.

**2. RISK MANAGEMENT OBJECTIVES AND POLICIES****2.1 Introduction**

The primary objectives of risk management are to protect the financial strength of NBEUK while looking to ensure that capital is well deployed to support business activities and grow shareholder value. The Bank's risk management framework is based on the following principles, which apply across all Business Units.

- The Board of Directors ("the Board") in providing leadership, approving risk policies, setting risk appetite (risk limits), strategy, geographical risk profile, delegating the necessary discretion to the Board's Committees and remaining responsible for the Internal Capital Adequacy Assessment Process (ICAAP), Individual Liquidity Adequacy Assessment Process (ILAAP), recovery plan and resolution pack and risk management framework.
- Protection of financial strength: NBEUK controls risk in order to limit the impact of potentially adverse events on the Bank's capital and income levels. The maximum amount of risk the Bank can take is limited by the capital it is required to hold against all types of risks (risk appetite) The Bank's risk appetite is to be consistent with its financial resources.
- Risk transparency: Risk transparency is essential so that risks are well understood by Business Units, senior management and the Board of Directors, in alignment with the Bank's strategy.
- Distributed Risk Management: Each Business Unit is responsible for the ongoing identification, measurement, reporting and management of their respective risk exposure.
- Independent oversight to ensure Business Units compliance with risk policies, regulations and to provide regular evaluation and reporting.

Risk management at NBEUK is a structured process that identifies, measures, monitors and reports risk. All Business Units report their identified risks to the Risk Management Officer who is responsible for the aggregation of all material risks and reporting directly to Senior Management and to the Supervisory Regulatory Body as the case may be. Also, to oversee the implementation of all relevant risk policies, developing tools to assist Senior Management to determine risk appetite and assessing the overall risk profile of the Bank.

NBEUK has strategies and processes in place for continuously assessing and maintaining the adequacy of its capital resources, liquid asset buffer and also to carry out regular internal reviews of these strategies and processes. The Board is responsible for reviewing the effectiveness of its internal controls in containing risk as laid down within acceptable parameters, and for ensuring that corrective action is taken in the event that control weaknesses are identified.

## **2.2 Risk Management Organisation And Internal Governance**

NBEUK's Board of Directors are responsible to shareholders for the strategic direction, supervision and control of the Bank and for defining the Bank's overall tolerance for risk. The Board has established its committees including the Management Committee chaired by the Chairman of the Board, with credit risk authorities in line with the approved credit policy, Audit and Risk Committee, Asset and Liabilities Management Committee (ALCO), Credit Committee, Investment Committee and Business Continuity Committee. The Board is responsible for approving all risk policies and their annual review.

In this context, the Board and the Senior Management of the Bank are ultimately responsible for the Bank's risk management arrangements which encompass the risk profile, risk appetite, management of capital, management of liquidity, recovery plan and resolution pack as per the approved Internal Capital Adequacy Assessment Process (ICAAP), Individual Liquidity Assessment Process (ILAAP) and risk policies and its pertaining procedure manuals.

NBEUK's risk management oversight is performed at several levels of the Bank based on a distributed risk management structure. This entails a two tier risk management function, with a central risk management function responsible for risk policy and a distributed risk management function located in each business unit responsible for day-to-day risk management.

The distributed risk management structure of NBEUK is generally characterised by the following features:

- The focus of the distributed risk structure is purely on risk (generating risk information, monitoring compliance with limits, ensuring compliance with regulatory risk capital requirements, reviewing risk adjusted performance, generating risk information for the risk officer).
- The distributed risk function has matrix reporting responsibilities whereby every business unit identifies the risk and report directly to the risk officer.
- The central risk management function (conducted by the Risk Management Officer) reports to the Deputy Managing Director or the CEO and Managing Director in his absence (establishing Board risk policies with Senior Management including tolerance of risk expressed in terms of quantum of capital which is placed at risk, establishment of risk valuation methodologies, updating and reviewing risk limits and policies, recommending new products, establishment of risk reporting framework, development and implementation of capital allocation policies).

- Under the approved ICAAP and its pertaining risk policies and procedures, the selected approach for risk management framework is distributed risk management whereby each business unit (the first line of defence) is responsible for ongoing identification, assessment, control, monitoring, reporting and mitigation of risks of their respective risk exposures. Oversight and governance is provided through dedicated Board Committees and risk support function from the Risk Management Officer and Senior Management (second line of defence). Finally independent assurance is provided by Internal Audit and the Audit and Risk Committee (third line of defence).

This process is applied to all risks which could have a significant impact on the Bank if they were to materialise. Such material risk represents the bank's risk profile and is reviewed and reassessed at least annually as part of the internal capital adequacy assessment process (ICAAP) and Individual Liquidity Adequacy Assessment (ILAA). The most significant risks categories the Bank is exposed to are: credit risk, market risk (currency risk), interest rate risk in non-trading book, liquidity risk and operational risk. For each risk the following risk management practices have been adopted in line with the bank's risk management framework:

• Risk Policies/Procedures	• Risk Mitigation
• Risk Measurement / ICAAP/ILAAP approaches Basel II	• Risk monitoring & reporting
• Risk Control	• Stress Testing including capital, liquidity and reverse stress scenarios
• Contingency Funding Plan (CFP)	• Recovery Plan and Resolution Pack

- Responsibility for risk management (first line of defence) lies with business units. Responsibility for risk governance and oversight (second line of defence) lies with the Board's Committees, Risk Management Officer (RMO) and Senior Management. Independent challenge is provided by Internal Audit (third line of defence).

KEY RISKS	FIRST LINE OF DEFENCE	SECOND LINE OF DEFENCE	THIRD LINE OF DEFENCE
	Risk Management	Risk Oversight/ Governance	Independent Oversight
Credit Risk	Credit Department	Credit Committee RMO Senior Management	Internal Audit
Market Risk (Currency risk)	Treasury/Back Office	ALCO Committee RMO Senior Management	Internal Audit
Interest rate risk	Treasury/Back Office	ALCO Committee RMO Senior Management	Internal Audit
Liquidity risk	Treasury/Back Office	ALCO Committee RMO Senior Management	Internal Audit
Operational Risk	Financial Control / Customer Services / MLRO / IT/ Others	ALCO Committee RMO Senior Management	Internal Audit

## 2.3 Risk Management Committees

Risk management oversight at the Board committees and Senior Management is as follows:

- *Management Committee*: responsible for assisting the Board of Directors in fulfilling their oversight responsibilities by providing guidance regarding risk governance and the development of the risk profile and capital structure including the regular review of risk exposures, policies and the approval of risk limits within its delegated discretions.
- *Bank Executive Management*: responsible for implementing the Bank's strategy and activity, managing its portfolios and its risk profile to ensure risk and return are balanced and appropriate for current market conditions.
- *Audit and Risk Committee*: responsible for assisting the Board of Directors in fulfilling their oversight responsibilities by monitoring Management's approach with respect to financial reporting, internal control, accounting, and legal and regulatory compliance. Additionally, the Audit and Risk Committee is responsible for monitoring the independence and the performance of the internal and external auditors.
- *Credit Committee*: responsible for approving credit limits within its delegated discretions or recommending risk limits outside its discretions to the Management Committee for approval or for ultimate recommendation of board approval. Also, the Committee is focusing on monitoring and managing individual exposures and assessing the quality of the credit portfolio and the adequacy of provisions.
- *ALCO Committee*: responsible for supervising and directing the Bank's risk profile with immediate focus on asset and liability management, liquidity market and credit risk and operational risk compliance.
- *Internal Auditors*: responsible for assisting the Audit and Risk Committee and Management by providing an objective and independent challenge, evaluation of the effectiveness of control, risk management and governance process.
- *Risk Management Officer*: responsible for assessing the overall risk profile on a Bank wide, portfolio level and for individual businesses and recommending corrective action to executive management under advice to internal audit.

## 2.4 RISK MANAGEMENT ARRANGEMENTS RELATING TO SPECIFIC RISKS

The Bank is exposed to the following main categories of risks:

- Credit risk
- Operational risk
- Liquidity risk
- Interest rate risk
- Currency risk (market risk)

### 2.4.1 Credit Risk

Credit risk is defined as the possibility of a loss arising from a credit event, such as deterioration in the credit ratings or the financial conditions of a counterparty or a group of closely related counterparties, that causes an asset (including off-balance sheet transactions) to lose value or become worthless. Credit risk is the largest single risk that NBEUK is exposed to.

NBEUK's risk management distinguishes between four kinds of credit risk:

- Counterparty/default risk is the risk that counterparties fail to meet contractual payment obligations.
- Country risk is the risk that NBEUK suffers a loss in any given country because of any of the following reasons: a possible deterioration of economic conditions, political and social upheaval, nationalisation or expropriation of assets, government repudiation of indebtedness, exchange control and disruptive currency depreciation or devaluation. Country risk includes transfer risk which arises when debtors are unable to meet their obligations owing to an inability to transfer assets to non-residents due to direct sovereign intervention.
- Settlement risk is the risk that the settlement or clearance of a transaction will fail. It arises whenever the exchange of cash, securities and other assets is not undertaken simultaneously.
- Concentration risk is the additional risk that arises where there are large exposures or concentrations in the credit portfolio to certain regions, sector or industries.

In accordance with the provisions of the Bank's approved Large Exposure Policy Statement (the Credit Policy), Provisioning Policy Statement, Credit Procedures and other pertaining policies and Board's guidelines which are issued from time to time, NBEUK's credit risk management processes covers all businesses which are exposed to credit risk and are regularly refined.

Central to NBEUK's risk management philosophy is a sound system of risk limits, which defines the Bank's risk appetite and control of the range of risks inherent in its business activities. Every extension of credit or material change to a credit facility (such as its tenor, collateral structure or major covenants) to any counterparty or a member of closely related counterparties requires credit approval at the appropriate authority level. Credit risk limits establish the maximum amount of credit risk assumed by the Bank through normal operations, given the business strategy and the financial resources available to absorb losses.

Credit assessment of an individual obligor is a structured process to assess, identify, quantify, monitor and manage credit risk on a consistent basis.

NBEUK's Board of Directors agree the credit risk limits and delegate approval authorities to Credit Committee and Management Committee as stated in the Credit Policy Guide. Credit risk limits are always subject to annual review taking into consideration regulatory requirements for large exposure treatments and pre-notification of limits agreed with the PRA and FCA from time to time. Credit limits for both countries and counterparties include sub-limits for particular products.

In addition to individual obligor and group assessments and limits, concentration limits are set and monitored in respect of:

- Country risk
- Sector exposures
- Large exposures

NBEUK monitors all credit exposures on a continuing basis and has procedures in place in accordance with the Bank's policies to identify at an early stage credit exposures for which there may be an increased risk of loss. Counterparties that on the basis of the application of our risk management tools, demonstrate the likelihood of problems, are identified well in advance so that we can effectively manage the credit exposure and maximise the recovery. This monitoring process includes:

- Limit monitoring – A comprehensive daily reporting process is in place covering all relevant exposures by country, by counterparty and by group exposures.

- Limit violations – Procedures to be followed in terms of action to be taken when a breach occurs.
- Limit allocations – the necessary authorities for limit allocations or powers to switch between sub-limits of various business lines or activities to maximise efficient use of credit risk limits are embedded in the Large Exposure Policy Statement and are delegated to Credit Committee under advice to Management Committee and Board of Directors.

NBEUK carries out regular loan reviews, enabling it to swiftly implement measures to prevent deterioration of borrowers' business situations, support business recoveries, and enhance loan security and recovery. It defines and grades non-performing loans (NPLs) as set out in the Provisioning Policy Statement. The Credit Department is responsible for monitoring the performance of customers, and changes in counterparty risks, reporting as necessary to General Management, Credit Committee and the Board.

#### **2.4.2 Operational Risk**

Operational risk is the risk arising from day-to-day operating activities which may translate into direct or indirect loss. These losses may result from failure to comply with policies, procedures, laws and regulations; from fraud or forgery; from a breakdown in the availability or integrity of services, systems and information, or damage to NBEUK's reputation.

Operational risks are managed under the provisions of the policies and procedures approved by the Board including:

- Fraud Policy Statement
- Anti-Bribery and Corruption Policy Statement
- Information Security Policy Statement
- Record Retention Policy Statement
- Public Interest Disclosure Act (Whistle Blowing Policy Statement)
- Expenses Policy Statement
- Management and Staff Handbook for Anti-Money Laundering and Counter Terrorist Financing
- Management and Staff Handbook for Anti-Bribery and Corruption
- Management and Staff Handbook for Fraud Prevention
- IT Strategy and Disaster Recovery Contingency Plan
- Departmental procedures manuals, including errors reporting procedures

Operational risks are monitored and managed on a daily basis, as appropriate, by Financial Control Department, Money Laundering Reporting Officer, Retail Department, Settlement Department, Documentary Credit Department with the relevant reporting of any risk identification to the Risk Management Officer, Internal Audit Department and Senior Management, ALCO Committee and the Board. Any incidents are the subject of error reports, which are signed off by Senior Management. In addition, a detailed Annual Report for Money Laundering is provided to the Management Committee and the Board.

#### **2.4.3 Interest rate risk**

Interest rate risk is the risk arising from adverse changes in interest rates. The market risks associated with the Bank's non-trading portfolios ("The Banking Book") primarily relate to the risk that NBEUK will incur under the increased interest expense arising from liquidity and funding requirements during periods of poor market liquidity (balance sheet or non-traded market risk).

The Bank manages its interest rate risks in accordance with the approved limits. Positions are monitored and managed by Treasury Department on a daily basis and hedging strategies used to ensure positions are maintained within the established limits in accordance with the provisions of the Bank's Treasury Policy Statement and Liquidity Policy Statement approved by the Board.

#### **2.4.4 Liquidity risk**

Liquidity risk is the risk that the Bank will not be able to fund assets or meet obligations at a reasonable price. The funding process and liquidity risk management is the prime responsibility of the Treasury Department. The Bank maintains high level of liquid assets and a very stable funding base. The core objectives of liquidity risk management are to ensure that obligations are met in full and on time, regardless of circumstances, and that the Bank continues to fulfil its medium term investment and lending commitments and strategic goals.

Liquidity positions are monitored on a daily basis and a daily liquidity report (LMM) issued by the Financial Control Department which is circulated to the Risk Management Officer (RMO), Treasury Department, Settlement Department and General Management to ensure that ILAAP's minimum liquidity thresholds including individual liquidity guidance (ILG), the adequacy of the required liquid asset buffer, the effectiveness of the contingency funding plan and the results of the quarterly stress testing are adhered to at all times. The ALCO Committee monitors the maturity profile on a monthly basis with ongoing liquidity monitoring by the Treasury Department.

#### **2.4.5 Currency Risk (Market Risk)**

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Board has set limits on positions by currency as stipulated in the Treasury Policy Statement.

NBEUK's currency positions and its pertaining risk are monitored by Treasury Department on a daily basis with a daily compliance report issued by Settlement Department and commented on by Treasury Department. NBEUK manages its currency risk under the provisions of the Treasury Policy and Procedures Manuals approved by the Board of Directors, together with the authorised limits for Treasury Department.

#### **2.4.6 Capital and Liquidity Stress Testing**

NBEUK performs regular stress testing on its capital adequacy requirements and liquidity positions in accordance with the scenario analysis as per the Board's approved ICAAP and ILAAP documents in addition to the scenario analysis applied under the reverse stress testing. Also, the requirements resulted from the PRA's SLRP review and the criteria inherent in the final ILG letter and its related liquidity pillar 2 add-ons amount.

Liquidity stress tests are used both to inform the Bank's liquidity risk tolerance and to formulate the metrics against which that risk is measured and managed. Also, the results of the liquidity stress tests inform the Bank's liquidity risk appetite, recovery plan and resolution pack (RRP), contingency funding plans (CFP) update and determine the required amount (the quantification) of the liquid asset buffer (HQLA), and the amount of maturity transformation inherent in the Bank's balance sheet.

Capital stress tests are used to inform the Bank's capital adequacy and the loss absorbency capabilities both in amount and quality under various scenarios as per the approved ICAAP. Also the results of the capital stress tests will advise on the amount of capital planning buffer (CPB or the PRA buffer) NBEUK is to maintain to cover the maximum projected loss expected to incur under assumed adverse circumstances.

Liquidity stress tests are performed on a quarterly basis and capital and reverse stress tests are performed and updated annually. In addition, periodic ad hoc stress tests are performed as required by Senior Management, ALCO or the Board of Directors.

Detailed results of stress tests are presented to Senior Management, ALCO, and the Board of Directors including the impact of the scenario analysis on the Bank's capital requirements, its capital resources, capital planning buffer, profitability, liquidity positions, amount of liquid asset buffer, survival period, recovery plan and resolution pack and contingency funding plan.

### 3. CAPITAL RESOURCES

The following table provides details of NBEUK's regulatory capital resources as at 30<sup>th</sup> June 2016 compared to its previous position as at 30<sup>th</sup> June 2015.

	Notes	As at 30/06/2015	(GBP 000's) As at 30/06/2016
<b>A) CAPITAL RESOURCES</b>			
Tier 1 Capital			
Called up share capital		130,000	130,000
Retained earnings and other reserves	1.	4,291	8,090
Deferred tax liabilities			
Tier 1 capital after deductions		134,291	138,090
Tier 2 capital			
Subordinated debt		19,077	22,333
Collective provisions		0	0
Tier 2 capital after deductions		19,077	22,333
<b>Total capital resources</b>		<b>153,368</b>	<b>160,423</b>
<b>B) CAPITAL ADEQUACY</b>			
Total Exposures		1,044,368	1,464,093
Risk Weighted Assets		469,969	683,921
Credit Risk Capital 8%		37,598	54,604
Operational Risk Capital		2,424	2,418
Market Risk Capital		9	196
TOTAL PILLAR 1 CAPITAL		40,031	57,218
ICG RATIO %		183%	183%
ICG INDIVIDUAL CAPITAL GUIDANCE	2.	73,257	104,709
CAPITAL BUFFER (TOTAL SURPLUS)		80,111	55,714
CAPITAL PLANNING BUFFER	3.	30,500	39,122
SOLVENCY RATIO		382.43%	280.37%
CAPITAL ADEQUACY RATIO	4.	32.63%	23.46%
TIER 1 CAPITAL RATIO ( LEVERAGE )		12.86%	9.43%
TOTAL CAPITAL RATIO		14.68%	10.95%

**Notes:**

1. The Board and AGM have agreed during their meetings dated 7<sup>th</sup> September 2016 not to declare a dividend and to retain the realised net profit after tax for the year ended 30<sup>th</sup> June 2016 for GBP4.6mn less the adjustments related to the introduction of the accounting standard FRS102. Therefore the retained earnings increased from GBP4.3mn to GBP8.1mn in September 2016 which also strengthened our capital resources to GBP160.4mn up from GBP153.4mn or an increase of 4.60% over the period. The additional subordinated loan of USD30mn from our Parent Company is still undrawn to date.
2. Individual Capital Guidance (ICG) at the end of June 2016 increased to GBP104.7mn compared to GBP73.3mn in June 2015. This was due to the increased placements exposures to a number of the Egyptian banks at a risk weighted assets ratio of up to 150%. Also the required PRA buffer is now subject to an increased rate of 5.47% of RWA's with effect from 1<sup>st</sup> January 2016 together with the newly imposed CRD IV buffer of 0.625%. Therefore the overall capital surplus including the capital buffers reduced to GBP16.6mn compared to GBP49.6mn in June 2015.
3. Pillar 2A capital increased to GBP47.5mn or 45.35% of the total allocated ICG capital as at 30<sup>th</sup> June 2016 on 2015 average of GBP33.2mn a year earlier. This reflects the significant credit risk concentration in Egypt and accords with the outcome of the PRA's ICAAP review. Under the implementation of the Pillar 2 capital framework which came into force with effect from 1<sup>st</sup> January 2016, our Pillar 2A capital is subject to a rate of 6.64% of the Total Risk Exposure Amount (TREA).
4. Under the updated ICAAP, the capital planning buffer "CPB" was increased to GBP39.1mn (from GBP30.5mn at the end of June 2015).
5. NBEUKs capital adequacy ratio declined to 23.46% at the end of June 2016 compared to 32.63% in June 2015. This remains well above the total regulatory capital requirements for NBEUK of 20.11%. NBEUK's leverage ratio stood at 9.43% also maintained well above the regulatory minimum requirements of 3%.

**4. CAPITAL ADEQUACY**

In order to protect the solvency of NBEUK, internal capital is held to provide a cushion for unexpected losses. In assessing the adequacy of its capital, the Bank considers its risk appetite, the material risk types to which the Bank is exposed and the appropriate management strategies for each of the Bank's material risks. In addition to capital adequacy quarterly reporting to the PRA and FCA, a full internal capital adequacy assessment is performed at least annually or more frequently if required in order to assess the Bank's capital adequacy and to determine the levels of capital required including the capital planning buffer going forward to support the current and future risks of the Bank's growing business. All relevant capital adequacy reports are produced by the Financial Control Department and reviewed by the RMO and the Head of Internal Audit and forwarded to General Management, ALCO Committee, Management Committee and the Board.

The RMO is responsible for ensuring that the Bank's current and future risks are reflected in the Internal Capital Adequacy Assessment process (ICAAP) and that sufficient capital is maintained to provide the Bank with adequate headroom to cover expected risks of current and potential business activities and stress testing scenarios.

The amount and composition of the Bank's capital requirements is determined by assessing the minimum capital requirements under Pillar 1, based upon the Capital Requirements Directive (CRD), the applicable approach for risk assessment being Standardised Approach for credit risks and the Basic Indicator Approach for operational risk and the Individual Capital Guidance of the Bank (ICG).

The following table shows the Bank's Pillar 1 capital requirement by asset class as at 30<sup>th</sup> June 2016 compared to the same position of 30<sup>th</sup> June 2015:-

(GBP 000's)

**Credit Risk - Standardised Approach**

	Notes	30/06/2015	30/06/2016
Central governments or central banks		3,327	1,340
Multilateral development banks		0	0
Institutions		28,264	47,640
Corporates		5,307	4,433
Retail		9	13
Short term claims on institutions and corporates		0	0
Other items		691	1,178
<b>Capital Component for Credit Risk</b>	1.	<b>37,598</b>	<b>54,604</b>

<b>Operational risk – Basic Indicator Approach</b>	2.	<b>2,424</b>	<b>2,418</b>
Foreign exchange PRR		9	196
		<b>9</b>	<b>196</b>
<b>Total Pillar 1 capital requirement</b>		<b>40,031</b>	<b>57,218</b>

<b>Total Internal Capital Guidance ICG</b>		<b>73,257</b>	<b>104,709</b>
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NBEUK's overall capital resource requirements includes the minimum capital requirements under Pillar 1 as above, plus the consideration of capital requirements of Pillar II risks, including in particular, concentration risk (credit), concentration risk (funding), concentration risk (business strategy), interest rate risk in the non-trading book, liquidity risk, currency exposure risk, currency income risk, residual risk from credit risk mitigation techniques, systems and controls and reputational risk.

**Notes:**

- Under the Standardised Approach for credit risk, the relevant risk weights are determined based on the assigned external credit ratings by eligible ECAI's such as Moody's and Fitch Ratings.
- Operational Risk Capital Component is determined using the Basic Indicator Approach and calculated as follows:-

	June 2011	June 2012	June 2013	June 2014	June 2015	June 2016
Net Interest Income	7,935	6,675	5,219	4,444	6,594	9,229
Non-Interest Income	6,334	13,188	9,453	9,500	12,130	5,090
Gross Income	14,269	19,863	14,672	13,944	18,724	14,319
<b>Average Gross Income</b>	<b>17,705</b>	<b>15,759</b>	<b>16,268</b>	<b>16,160</b>	<b>15,780</b>	<b>15,662</b>
Operational Risk Capital Requirement (ORCR)	15%	15%	15%	15%	15%	15%
<b>Operational Risk Capital Requirements</b>	<b>2,402</b>	<b>2,364</b>	<b>2,440</b>	<b>2,424</b>	<b>2,367*</b>	<b>2,349</b>

\*) Operational risk component at 30<sup>th</sup> June 2016 was reinstated from £2.418mn to £2.367mn to reflect the impact of the introduced financial adjustments under the terms of the accounting standard FRS102 at the year end.

## 5. LIQUIDITY RISK

As at 30<sup>th</sup> June 2016 NBEUK's liquidity mismatch report (based on FSA 047 and 048 All Currency returns) provides the following information:-

	Notes	Mismatch £000's	Mismatch As % of LAB	Mismatch As % of Total Deposits	Mismatch as % of HQ Securities	Policy Requirements
0 Days to 2 weeks		24,371	10.20%	1.94%	5.59%	Less than or equal to 100% of LAB or less than or equal to 10% of deposits
0 Days to 3 months		(1,627)		0.13%	0.37%	Less than or equal to 40% of deposits or less than or equal to 100% of HQ Securities
Total Deposits	1.	1,256,729				<u>100% buffer for any ILG requirements during the first two weeks of stress, and;</u>  <u>50% or more of the outcome of our stress testing for ILG's requirements out to three months.</u>
Liquid Asset Buffer (LAB) @ MTM		239,019	19.02% of Total Deposits			
Total HQ Securities (Level 1 & 2) @ MTM		436,256				
Total Securities (Level 1,2 & 3)		611,181				
Total MKT & Non-MKT Assets	2.	1,180,098				
Survival Period			158 days after LAB			Versus 20 Days NBEUK policy or PRA minimum benchmark of 14 days.
ILG's requirements (50% of the stressed outcome of ILG stress scenarios)	3.	94,246	NBEUK's actual ILG ratio: 253.61%			50% minimum ILG requirements
One month liquidity coverage ratio (LCR)		98.74%				Minimum 90%
Net Stable Funding Ratio (NFSR)		87%				Minimum 100%
Core Funding Ratio		35%				Minimum 25%
Non marketable loans/core funding		25%				Maximum 100% of core funding

- LCR, Core Funding and NFSR ratios are currently on an observation period and will be implemented as a regulatory requirement by January 2015 and January 2018 respectively.

### Notes

Governmental deposits of GBP743mn as at 30<sup>th</sup> June 2016 continue to dominate our funding profile and represent 52.32% of total liabilities. The remainder comprises capital, sub debt, reserves, other customer and bank deposits totalling GBP659mn.

1. The behaviour of NBEUK's main funding streams is subject to:-
  - i. Daily review by Treasury and Risk Management
  - ii. Regular review and reporting to ALCO

Together, this reporting provides details and historic evidence of the behaviour of the Bank's deposits.

2. NBEUK funding profile is relatively undiversified and concentrated, deriving from a narrow range of sources. Depositors are wholesale dominated by balances from governmental agencies with sticky and stable characteristics over years whereby the Bank is well regarded amongst its customers with whom it has long established relationships, and with whom the Bank is in constant communication.

3. For liquidity stress testing purposes, the Bank has adopted more conservative stress assumptions (as outlined in the scenario 5 of our stress testing at the end of June 2016) than those adopted by the approved ILAAP.

## 6. COUNTERPARTY CREDIT RISK

Counterparty credit risk (CCR) in the context of NBEUK's disclosure is the risk that the counterparty to a derivative transaction posted to our non-trading book could default before the final settlement of the transaction's cash flows. The duration of the derivative and the credit quality of the counterparty are both factored into the internal capital and credit limits for counterparty credit exposures.

The Bank measures the exposure value on counterparty credit exposures under the CCR mark to market method. This exposure value is derived by adding the gross positive fair value of the contract (replacement cost) to the contracts potential credit exposure, which is derived by applying a multiple based on the contracts residual maturity to the notional value of the contract.

The following table shows the counterparty risk and its relevant capital component as at 30<sup>th</sup> June 2016 compared to its position as at 30<sup>th</sup> June 2015.

(GBP 000's)

	30/06/2015		30/06/2016	
	Gross Positive Fair Value	Counterparty Risk Capital Component	Gross Positive Fair Value	Counterparty Risk Capital Component
Banking Book	166	166	110	110
Trading Book	0	0	0	0
<b>TOTAL</b>	<b>166</b>	<b>166</b>	<b>110</b>	<b>110</b>

## 7. CREDIT RISK AND DILUTION RISK

### Impairment of financial assets

NBEUK's credit policies and procedures govern all aspects of the credit risk process, including risk approval and control. All credit applications are reviewed and considered by Credit Committee and where appropriate, approval is recommended to Management Committee and the Board of Directors. All limits, including those for banks and sovereign entities are reviewed at least yearly and include an assessment of all relevant risk factors.

The treatment of large exposures and provision for bad and doubtful loans is governed by the Large Exposures and Provisioning Policy Statement as approved by the Board. Where monies are owing, or where there is doubt that they will be received by NBEUK, or if there is objective evidence of impairment as a result of events that occurred such as significant financial difficulty of the issuer or obligor, a breach of covenants, adverse changes of the payment status of the borrower and national or local economic conditions that correlate with defaults of the relevant borrower, all loans to such obligors are automatically placed on a non-accrual basis. Any interest charged to the customer, but not paid, is written back and not taken into NBEUK's profit and loss account.

NBEUK has prudent policies and procedures to build up reserves against possible losses on the asset portfolio. Specific provisions are in place to deal with exposures classified as impaired or where losses are expected. In addition, NBEUK maintains a collective impairment reserve to cover an identified part of the portfolio where observable data indicates that impairment is likely to have occurred. Exposures from all classes which have not been repaid 90 days after the due payment date are treated as past due under the standardised approach for credit risk.

The following table provides details and movements on provisions for bad and doubtful debts together with the position of the non-performing loans for the year end 30<sup>th</sup> June 2016, compared to its position as at 30<sup>th</sup> June 2015.

**Movements on provisions for bad and doubtful debts**

	(GBP 000's)		
	Specific	General	Total
Provisions at 30 <sup>th</sup> June 2015	4,587	0	4,587
Additions during the year	395	0	395
Reversals of provision during the year	(4,346)	0	(4,346)
Write off in year	0	0	0
Foreign exchange movement	108	0	108
<b>Provisions at 30<sup>th</sup> June 2016</b>	<b>744</b>	<b>0</b>	<b>744</b>
of which:			
Provision against loans and advances to banks	0	0	0
Provision against loans and advances to customers	744	0	744
	<b>744</b>	<b>0</b>	<b>744</b>

**Non-performing loans**

	<b><u>2015</u></b>	<b><u>2016</u></b>
Loans on which interest has been suspended (net of suspended interest)	6,688	1,214
Provisions for bad and doubtful debts	(4,587)	(744)
<b>Net Non-performing loans</b>	<b>2,301</b>	<b>470</b>

**Analysis of credit risk exposures**

Tables (i) to (iv) analyse the Bank's regulatory credit risk exposures as at 30<sup>th</sup> June 2016 compared to its position as at 30<sup>th</sup> June 2015. These exposures equate to the outstanding on-balance sheet exposures and off balance sheet exposures after credit conversion factors under the Standardised Approach as per the PRA and FCA's handbook requirements have been applied.

## i. Analysis of exposures by asset class

(GBP 000's)

	Exposure Value as at 30/06/2015	%	Exposure Value as at 30/06/2016	%
Central governments or central banks	109,971	10.53	136,150	9.30
Multilateral development banks	141,310	13.53	88,187	6.02
Covered Bonds	-	-	89,498	6.11
Institutions	665,310	63.69	1,015,611	69.37
Corporates	114,453	10.96	127,696	8.72
Retail	171	0.02	214	0.01
Short term claims on institutions and corporates	0	0	0	0
Other items (incl Past Due)	13,423	1.27	6,737	0.47
<b>Total</b>	<b>1,044,638</b>	<b>100.00</b>	<b>1,464,093</b>	<b>100.00</b>

## ii. Geographic distribution of net exposures by asset class

(GBP 000's)

	Egypt	UK	US	EU	Rest of World	Total
Central governments or central banks	0	50,000	11,167	11,167	22,333	94,666
Multilateral development banks	0	0	0	43,000	45,187	88,187
Covered Bonds	0	5,240	0	0	84,258	89,498
Institutions	408,523	75,067	116,814	139,528	266,228	1,006,159
Corporates	37,078	22	0	0	35,428	72,529
Retail	107	108	0	0	0	215
Short term claims on institutions and corporates	0	0	0	0	0	0
Other items (incl Past Due)	470	5,522	0	0	0	5,992
<b>Total</b>	<b>*446,178</b>	<b>135,959</b>	<b>127,981</b>	<b>193,695</b>	<b>453,434</b>	<b>1,357,246</b>

\* Egypt's exposure is subject to a cash collateral of 20%

**iii. Distribution of net exposures by Industry and asset class**

(GBP 000's)

	Central Government or Central Banks	Multilateral Development Banks	Institutions	Corporates	Retail	Past Due Items	Covered Bonds	Other	Total
Aux Financial Activities									0
Bank Holding Companies			29,777						29,777
Chemical, Fibres, Rubber									0
Factoring Corporations									0
Food, Beverages / Tobacco						470			470
Hotels and Restaurants				5,651					5,651
Mining and Quarrying				37,078					37,078
Multi Development Banks		88,187							88,187
Other Fin Intermediaries				29,777			5,240		35,017
Other Loans and Advances					214				214
Paper Publishing / Printing				22					22
Public Admin and Defence	94,666								94,666
Bank			976,382				84,258	1	1,060,642
Other Internal Accounts								5,521	5,521
<b>Total</b>	<b>94,666</b>	<b>88,187</b>	<b>1,006,159</b>	<b>72,529</b>	<b>214</b>	<b>470</b>	<b>89,498</b>	<b>5,522</b>	<b>1,357,246</b>

**iv. Residual maturity breakdown of net exposures by asset class**

The following table shows residual maturity of exposures stated on a contractual rather than an expected basis, and does not take into account the cash flows payable or receivable over the life of the exposure.

(GBP 000's)

	< 1 Year	1- 5 Years	>5 Years	Total
Cent Gov or Cent Banks	23,945	37,222	33,500	94,666
Multilateral development banks		88,187		88,187
Covered Bonds		89,498		89,498
Institutions	652,441	353,718		1,006,159
Corporates	52,110	20,419		72,529
Retail	119	96		214
Past due items		470		470
Other Internal items	5,522	0		5,522
<b>Total</b>	<b>734,137</b>	<b>589,610</b>	<b>33,500</b>	<b>1,357,246</b>

## 8. CREDIT RISK: STANDARDISED APPROACH

The Bank uses the most conservative external credit assessments provided by Moody's and Fitch Ratings. These are all recognised by the PRA and the FCA as eligible external credit assessment institutions (ECA) for the purpose of calculating credit risk requirements under the standardised approach.

### Analysis of capital requirement as at 30<sup>th</sup> June 2016 using the Standardised Approach (GBP 000's)

	Gross Exposure Value	Value Adjustment & Provisions	Exposure Value Post Mitigation	Risk Weighted Exposures	Capital Requirement
Central governments or central banks	136,150	0	94,666	16,750	1,340
Multilateral development banks	88,187	0	88,187	0	0
Covered Bonds	89,498	0	89,498	8,950	716
Institutions	1,015,611	0	1,006,159	596,877	47,640
Corporates	127,696	0	72,529	55,407	4,433
Retail	214	0	214	161	13
Other items including past dues	6,736	744	5,992	5,777	462
<b>Total</b>	<b>1,464,093</b>	<b>744</b>	<b>1,357,246</b>	<b>683,921</b>	<b>54,604</b>

Credit risk exposures after mitigations classified by credit ratings and asset classes as at 30<sup>th</sup> June 2016 compared to its position as at 30<sup>th</sup> June 2015:-

#### Central Government or Central Banks

(GBP 000's)

Credit Quality Step	Credit Ratings	Risk Weight	Exposure 30/06/2015	Exposure 30/06/2016
1	AAA – AA-	0%	50,000	61,167
3	BBB	50%	19,077	33,500
5	B	100%	32,236	37,222
6	CCC+ and below	150%	0	0
7	Unrated	100%	8,658	4,262
<b>TOTAL</b>			<b>109,971</b>	<b>136,150</b>

#### Multilateral development banks

(GBP 000's)

Credit Quality Step	Credit Ratings	Risk Weight	Exposure 30/06/2015	Exposure 30/06/2016
1	AAA – AA-	0%	141,310	88,187
<b>TOTAL</b>			<b>141,310</b>	<b>88,187</b>

#### Institutions

(GBP 000's)

Credit Quality Step	Credit Ratings	Risk Weight	Exposure 30/06/2015	Exposure 30/06/2016
1	AAA – AA-	20%	76,217	116,259
2	A+ to A-	50%	223,077	244,877
3	BBB+ to BBB-	50%	155,083	214,715
5	B+ to B-	100%	121,304	0
6	CCC+ and below	150%	89,630	243,817
7	Unrated	100%	0	195,943
<b>TOTAL</b>			<b>665,311</b>	<b>1,015,611</b>

**Corporates**

(GBP 000's)

Credit Quality Step	Credit Ratings	Risk Weight	Exposure 30/06/2015	Exposure 30/06/2016
1	AAA – AA-	20%	25,436	7,444
2	A+ to A-	50%	82,167	22,333
7	Unrated	100%	6,850	97,918
<b>TOTAL</b>			<b>114,453</b>	<b>127,696</b>

**Covered Bonds**

(GBP 000's)

Credit Quality Step	Credit Ratings	Risk Weight	Exposure 30/06/2015	Exposure 30/06/2016
1	AAA – AA-	20%	-	89,498
<b>TOTAL</b>			<b>-</b>	<b>89,498</b>

**Retail exposures have been assigned a risk weight of 75%**

(GBP 000's)

Credit Quality Step	Credit Ratings	Risk Weight	Exposure 30/06/2015	Exposure 30/06/2016
7	Unrated	75%	171	214
<b>TOTAL</b>			<b>171</b>	<b>214</b>

**Other Internal Items**

(GBP 000's)

Credit Quality Step	Credit Ratings	Risk Weight	Exposure 30/06/2015	Exposure 30/06/2016
6	CCC+ and below	150%	0	0
7	Unrated /secured	25%	0	0
Past Due		150%	6,881	1,214
Other		100%	6,541	5,522
<b>TOTAL</b>			<b>13,422</b>	<b>6,736</b>

**9. CREDIT RISK MITIGATION**

The Bank uses several techniques to reduce credit risk of its lending. The most basic of these is performing an assessment of the ability of a borrower to service the proposed level of borrowing without distress. NBEUK with the standardised approach for credit risk may recognise credit risk mitigation in the calculation of risk weighted exposure amounts for the purposes of the calculation of the credit risk capital component. Taking collateral under approved risk limits to mitigate the underlying credit risk and its enforceability in all relevant jurisdictions are perfected in line with the approved Large Exposure Policy Statement and the relevant procedures in place.

The Bank in the normal course of business and prior to any withdrawals under the approved risk limits has to conduct sufficient legal review through the professional agencies (valuers and solicitors) confirming that the agreed collateral arrangements are legally effective and enforceable in all relevant jurisdictions and that the relevant title provides sufficient security for the subject facility with the relevant frequent review and updates to ensure continued enforceability and effectiveness.

## 10. INTEREST RATE RISK IN THE NON-TRADING BOOK

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

In addition interest rate risks in the non-trading book may arise from a number of sources including risk related to timing differences in the re-pricing of assets and liabilities and off balance sheet short and long term positions.

Interest rate risks in NBEUK's non-trading book are tightly managed in accordance with the principles of the Treasury Policy and the underlying risk limits established by the Board of Directors. Positions are monitored and managed by Treasury Department on a daily basis and hedging strategies used to ensure positions are maintained within the established limits.

For the purpose of calculating the capital component for Pillar 2 Risks under the interest rate risks, NBEUK carries out an evaluation of its exposure to the interest rate risk arising from its non-trading activities.

The evaluation of interest rate exposure as above and the calculation of the capital component for interest rate risks are based on the average cumulative gap (mismatch) for twelve months as per the quarterly results of the PRA/FCA's interest rate gap report (FSA 017). The calculation is based on the duration of the actual interest rate mismatch exposures and reflects the potential exposure resulting from a parallel change in interest rates of 200bps to each major currency exposure in both directions.

We therefore hold an amount of capital equal to 100% of this interest rate risk calculation to reflect our conservative approach.

## 11. REMUNERATION CODE

The PRA and FCA policy statement (PS12/15; PS15/16) "Strengthening the Alignment of Risk and Reward: New Remuneration Rules" (June 2015) sets out the regulatory requirements in respect of staff remuneration within the banking sector together with the policy statement (PS10/21) "Implementing CRD3 requirements on the disclosure of remuneration" both of which were issued in December 2010.

NBEUK qualifies as a Tier 2 firm under the Code and is required to provide disclosures of both quantitative information as well as qualitative information about decision making policies for remuneration and links between pay and performance. NBEUK has an established Remuneration Committee comprising three members with broad responsibility for the implementation of the Code and the annual review of the bank's adherence to it.

The Committee shall meet on not less than one occasion during the year to consider Human Resources' issues with particular emphasis on the overall reward framework across the Bank.

Within the authority delegated by the Board namely via the approved Remuneration Policy Statement and the Committee's terms of reference, the Committee is responsible for approving the remuneration plan taking into account the pay and conditions across the Bank which includes the terms of bonus and other incentives of Executive Directors and other Senior Bank employees including those in position of significant influence and those having an impact on the risk profile (Code Staff). Fifteen members of staff have been identified as Code Staff including those who serve on Management Committee, Non-Executive Directors and the PRA and FCA approved persons.

The monthly average number of persons employed by the Company during the year was 62 (2015: 61).

The following sections of NBEUK's Pillar 3 disclosures reflect the requirements of PS10/21 in addition to the regulatory disclosure requirements.

The staff costs of the Bank as at 30<sup>th</sup> June 2016 compared to its position a year earlier were as follows:-

(GBP)		
<b>Staff costs:</b>	<b>2015</b>	<b>2016</b>
Salaries and other emoluments	4,349,382	4,171,557
Social security costs	484,692	427,330
Other pension costs:		
- Defined contribution scheme	395,520	347,395
Other Staff Costs	239,202	163,496
<b>Total fixed staff employment costs</b>	<b>5,468,796</b>	<b>5,109,778</b>
Variable staff cost: Performance awards	245,615	289,425
<b>Total staff employment costs</b>	<b>5,714,411</b>	<b>5,399,203</b>
Other employment related costs (training)	18,476	35,530
<b>TOTAL STAFF COSTS</b>	<b>5,732,887</b>	<b>5,434,733</b>

Remuneration at NBEUK includes fixed salary payment and variable payment for annual bonuses. The variable payment element is differentiated by performance. All Code Staff receive a salary to reflect their market value, responsibility and contribution to the bank. This approach allows the Bank to not pay a bonus when appropriate. Employees including Code Staff with poor performance ratings will receive little or no bonus. The determination of the bonus pool is a fully discretionary process informed by various performance metrics, the key one being profit before tax, affordability and the commercial requirement to remain competitive in the market place.

Guaranteed bonuses are not offered as part of the Bank's current performance award arrangements and the Bank did not offer any "sign-on" inducements. No severance payments were made during the year.