Crown Agents Bank Limited

Pillar 3 Disclosures

December 2015

Crown Agents Bank

CONTENTS

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1. Introduction

1.1. Background

Note: on 31 March 2016, the ownership of Crown Agents Bank Limited was transferred to Merlin Holdco (UK) Ltd a company controlled by funds managed by Helios Investment Partners LLP. As a result, since that date, the Bank's Control Framework, and in particular the Committee Structure, has changed. This document discloses the Control Framework and Committee Structure under the new ownership

The Capital Requirements Directive (CRD) introduced a new framework under which banks and financial institutions are required to calculate their capital. This was based on global standards introduced by the Basel Committee on Banking Supervision through the Basel II framework. The framework consists of 3 Pillars:

Pillar 1	**Minimum capital requirements:** defines the rules for the calculation of credit, market and operational risk to ensure that banks hold adequate regulatory capital against the risks they assume within their current business.
Pillar 2	**Supervisory review process:** sets out the key principles for the supervisory review of a bank's risk management framework and its capital adequacy. It sets out specific oversight responsibilities for both the Board and senior management, thereby reinforcing the principles of internal control and other corporate governance practices.
Pillar 3	**Market discipline:** sets out the items covered by this report; it requires expanded disclosures to permit investors and other market participants to obtain an understanding of the risk profiles of the bank.

The Financial Conduct Authority (FCA) and Prudential Regulatory Authority (PRA) have responsibility for implementing the CRD within the United Kingdom. The FCA sets out its minimum Pillar 3 disclosure requirements in its handbook under Chapter 11 of the Prudential Sourcebook for Banks, Building Societies and Investment Companies (BIPRU 11).

The disclosure requirements in BIPRU 11 aim to complement the minimum capital requirements (Pillar 1) and the supervisory review process (Pillar 2), and aim to encourage market discipline by allowing market participants to assess the impact of key information on risk exposures and the risk assessment processes of the firm.

The following represents Crown Agents Bank Limited's (the Bank) Pillar 3 disclosures in accordance with this requirement.

1.2. Frequency, Location, and Verification

It is the Bank's intention to publish its Pillar 3 Disclosures on an annual basis. Disclosures are designed to comply with the disclosure requirements laid out in the Capital Requirements Regulations 2015 (Part Eight) (CRR), and will be based on the financial year end following publication of audited accounts. These disclosures are therefore based on the results of the year ended 31st December 2015 unless otherwise stated.

The disclosures will be available on the Bank's website, and should be read in conjunction with the Bank's annual report and accounts.

The disclosures have not been, and are not required to be, subject to independent external audit and do not constitute any part of the Bank's financial statements. The Pillar 3 disclosures are published on the Bank's website (www. Crownagentsbank.com).

1.3. Scope of Disclosures

The disclosures below are the required Pillar 3 disclosures and apply solely to the Bank.

The Company is an unquoted company registered in England, authorised and regulated by the FCA and regulated by the PRA. It is a single branch bank, whose principal function is to provide multicurrency account management, payment and other specialist banking services to central banks, governments, development agencies, NGOs and other corporate organisations worldwide. Appendices A & B show the Bank's management and ownership structures.

The Bank continues to develop the quality and transparency of disclosures to ensure that they are as clear and informative as possible.

The Financial Stability Board ('FSB') established the Enhanced Disclosures Task Force ('EDTF') with a remit to broaden and deepen the risk disclosures of financial institutions in a number of areas, including risk management, liquidity and funding risk, credit risk and market risk. This document includes improvements to disclosures to comply with recommendations raised in 2015.

1.4. Summary of key capital ratios

Capital ratios are a measurement of a company's financial strength and reflect the level of protection it holds against any unexpected losses. The key capital ratios under CRD IV for the Bank are presented below. Prior year comparatives are presented on a Basel II basis.

Capital ratios	**2014**	**2015**
Common Equity Tier 1 (CET1) ratio	18.91%	16.33%
Tier 1 capital ratio	18.91%	16.33%
Total capital ratio	21.51%	16.81%
Risk Weighted Assets (£m)	131,171	142,484
Leverage ratio	2.93%	3.85%

Further details on the Bank's capital ratios, risk weighted assets and leverage ratio are presented in Section 4 of this document.

2. Governance arrangements

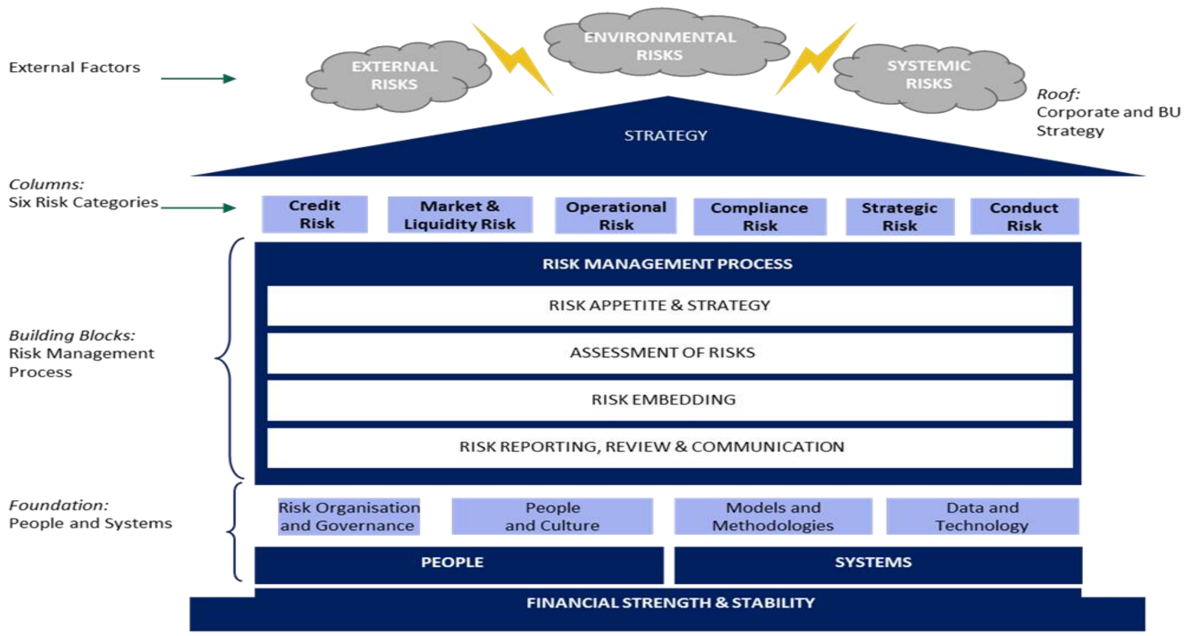
Through its normal operations the Bank is exposed to a number of risks, the most significant of which are credit, market and liquidity, operational, compliance (including regulatory), strategic and conduct risks. The Board of the Bank is responsible for determining the long term strategy of the business, the markets in which it operates, and the level of risk acceptable to the Bank, the last of which is controlled through the Bank's Risk Appetite and Tolerances Statement (RATS). Risk Management has an oversight role in the maintenance of policies and procedures, evaluating and monitoring risk levels and reports through the individual committees to the Board on risk issues generally.

2.1. Risk Management

The Bank's Corporate Governance Manual outlines how the Bank's Board and the Executive Management team fulfil their respective risk management responsibilities through the deployment of a risk management framework. This framework covers the full spectrum of risk to which the Bank is exposed and sets out how those risks are described and the measures which apply to mitigate those risks. It is the use of this framework (or "House") which will enable the Bank to maximise value to its shareholder and its customers by aligning risk management with the business strategy; assessing the impact of emerging legislation and regulation; and developing the Bank's risk appetite accordingly.

Crown Agent's Bank Enterprise Risk Framework ("The House")

The House provides the risk framework to support our corporate and business unit strategy for the benefit of our clients , employees, and shareholders. It provides us with a methodology to identify, measure and manage both internal and external risks to our business.



Key Principles

- Forward-looking
- Enterprise-wide, consistent application across all risk categories
- Dynamic, allowing pro-active management of the risk profile and risk appetite
- Flexible and scalable to allow for changes in business and regulatory requirements
- Usable at all levels within the organisation e.g., departments, corporate, and divisional
- Embedded in business processes such as planning, and performance management

2.2. Monitoring & Control

The Bank's approach to capital management is driven by its desire to maintain a strong capital base to support the development of its business and to meet regulatory capital requirements at all times.

Each year the Bank updates its five year strategic plan which covers both the development of the business and its impact on the capital of the Bank. The plans are underpinned by the Bank's risk appetite and ensure that the available levels of capital are appropriate to the business plans and strategy. The plans also ensure that business growth assumptions are integrated into the overall capital assessment.

The Bank prepares a detailed Internal Capital Adequacy Assessment to support its capital requirements. Each material risk is assessed through a series of stress testing scenarios, relevant mitigants considered and appropriate levels of capital determined. This Internal Capital Adequacy Assessment is carried out at least annually, is a key part of the Bank's management disciplines through its review by the Assets and Liabilities Committee (ALCO), and approval by the Board. It is ultimately reviewed by the PRA, when a minimum level of capital is agreed.

The Bank monitors its capital requirements on a daily basis using a traffic light system to ensure internal and external capital requirements are met. Its Regulatory Capital Policy sets out the actions to be taken when capital reaches pre-set levels. At 31st December 2015 and throughout the year then ended, the Bank complied with the capital requirements that were in force.

2.3. Risk categories

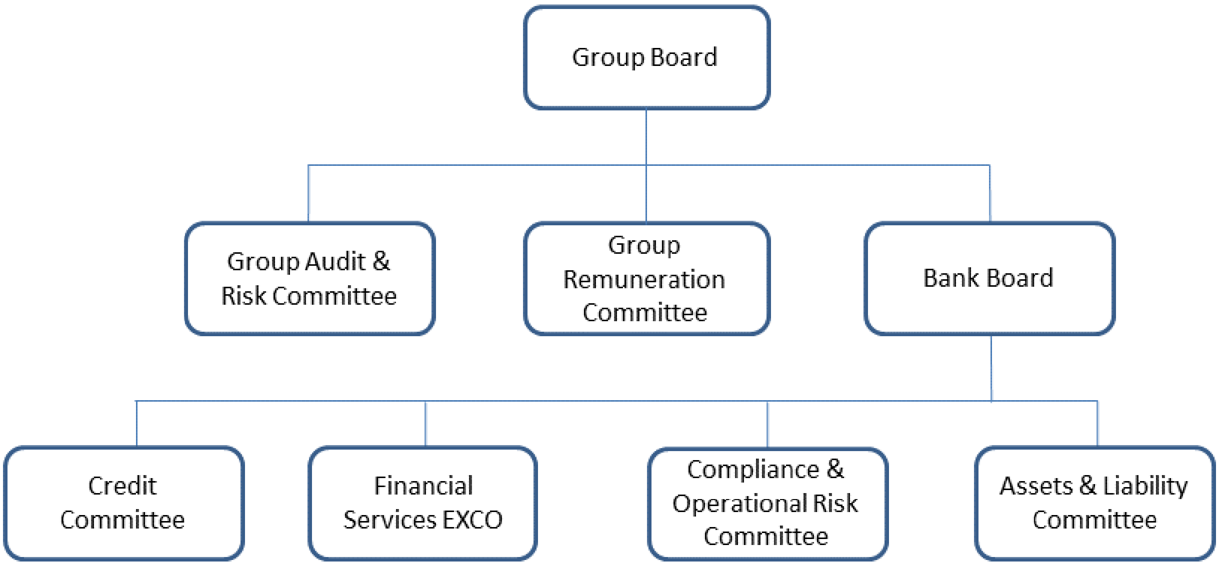
The Bank recognises six broad categories of risk inherent within its operations:

- Credit risk – the risk of financial loss arising from a borrower or counterparty failing to meet their financial obligations to the Bank in accordance with agreed terms.
- Market & Liquidity risk – Market risk is the risk that the value of, or net income arising from, the Bank's assets and liabilities changes as a result of changes to market forces, in particular interest rates, exchange rates or equity prices. Liquidity risk is the risk that the Bank is not able to meet its financial obligations as they fall due, or can do so only at excessive cost.
- Operational risk – is the risk of financial loss and/or reputational damage resulting from inadequate or failed internal processes, people and systems or from external events including financial crime.
- Regulatory / Compliance (including relevant reputational) risk – is the risk to the Bank's reputation of failure to comply with regulatory requirements.
- Strategic risk – the risk which can affect the Bank's ability to achieve its corporate and strategic objectives.
- Conduct risk – the risk of detriment caused to the Bank`s customers due to the inappropriate execution of its business activities and processes

2.4. Control Framework

2.4.1. Committees

The Bank's supervision is further driven through the establishment of a number of committees which are responsible for technical governance of the business ensuring adherence to internal policies and with powers to make decisions related to the day to day running of the business. Certain Committees are in transition following the change of control. The key functions and responsibilities of the committees are described as follows:



2.4.2. Group Board

The Merlin Holdco (UK) Ltd (Merlin) group Board is the primary governing body and has ultimate responsibility for setting the group strategy. Consolidated reporting is made to the group Board on a quarterly basis.

2.4.3. Group Audit & Risk Committee

Merlin has an Audit and Risk Committee which monitors and manages risk issues throughout the Merlin group, including the Bank. It monitors compliance with the Bank's policies and procedures through the review of audit and other reports, and with recommendations of its Regulators, the Prudential Regulatory Authority and Financial Conduct Authority. It ensures that any reports of the external auditors are considered in full and implemented where appropriate.

The Committee consists of two independent non-executive directors of Merlin, (who are also non-executive directors of the Bank) and one other non-executive director of the Bank. It receives frequent reports and meets at least four times annually. It also monitors the work and considers the reports of the group's Internal Audit and Compliance functions, monitoring the implementation of their recommendations where appropriate, giving due consideration to the effectiveness of internal controls and compliance checks. To comply with the requirements of the Banking Act and to ensure prudent management of the business, the Bank has established a range of internal controls, which have continued to operate effectively. Updates to the Bank's Risk Register following management review are also made available to the Audit and Risk Committee.

Any issues of concern are reported to subsequent board meetings for discussion.

2.4.4. Group Remuneration and Nominations Committee

The Group Remuneration and Nominations Committee provides a framework for ensuring that the Bank complies with its regulatory requirements in respect of remuneration. It meets at least on an annual basis and its main functions are to:

- Determine and agree with the Board the framework or broad policy for the remuneration of the company's Chairman, Chief Executive, the executive directors, the company secretary and such other members of the executive management as it is designated to consider. The remuneration of Non-executive directors is a matter for the Chairman and the Chief Executive. No director or manager may be involved in any decisions as to their own remuneration;
- Review the ongoing appropriateness and relevance of the remuneration policy;
- Determine, within the terms of the agreed policy, the total individual remuneration package of personnel designated as Code Staff within the Financial Services subsidiaries;
- Approve the design of, and determine targets for, any performance related pay schemes operated by the Bank and approve the total annual payments made under such schemes;
- Oversee any major changes in employee benefits structures throughout the Bank or group.

In addition, the committee will meet on an ad hoc basis to consider nominations to the Merlin group boards, and its various committees.

2.4.5. Bank Board

The Bank Board is the primary governing body for the Bank and has ultimate responsibility for setting the bank strategy, corporate objectives and risk appetite. That strategy takes account of the interest of all stakeholders in the Bank.

The Risk Appetite and Tolerances Statement (RATS) established by the Board sets out the levels of risk which the Bank is willing to take within the confines of the group strategy. The Board is also responsible for the establishment of a control environment to manage the risks encapsulated within the RATS.

The Board also maintains close oversight of the current and future activities through a combination of quarterly board reports and monthly financial results, including budgets, forecasts and other operational reports.

2.4.6. Credit Committee

The role of the Credit Committee is to review the Bank's credit portfolio to ensure it remains within the Bank's credit risk appetite; to review and maintain the Bank's credit policy; and to assess the clients and counterparties with which the Bank will undertake business. It meets quarterly to review client, counterparty and country exposures, as well as considering issues of a strategic (credit related) nature. Minutes of the meetings are taken. Business is also conducted between meetings by a subcommittee which considers "routine" credit exposures within delegated limits, as well as round robin forms, e-mails and ad hoc discussions.

The Credit Committee reports to the Board, on a quarterly basis, on matters within its terms of reference, and will make recommendations to the Board on items within its remit where actions are required.

2.4.7. Financial Services Executive Committee (FS EXCO)

The FS Exco takes day to day responsibility for running the business. The FS Exco implements the strategy and financial plan, which is approved by the Board annually, and ensures the performance of the business is conducted in accordance with the Board's established risk appetite. It reports to the Board on at least a quarterly basis through the Chief Executive Officer's (CEO) and the financial reports.

2.4.8. Compliance & Operational Risk Committee (CORC)

CORC has been established to

- Develop an operational risk framework through which operational risk is monitored, measured and managed;
- Monitor compliance with internal policies and procedures and with external regulatory and legal requirements;
- Monitor forthcoming compliance regulation and manage the Bank's response;
- Consider the recommendations of any regulatory related notices or instructions and present responses to the Board
- Review key operational risk documentation; and
- Monitor operational risk events.

CORC reports quarterly to the Board through the Risk and Compliance report, which will, on at least an annual basis, include the report from the MLRO.

2.4.9. Assets and Liabilities Committee (ALCO)

ALCO monitors the liquidity and capital adequacy of the Bank on a monthly basis, and ensures that the Bank adheres to the market risk, interest rate risk and liquidity policies and objectives set down by the Board. It also has responsibility for ensuring that the policies that are implemented are adequate to remain within prudential and regulatory limits. ALCO reports to the Board on at least a quarterly basis. Reports on these matters are generated by Finance Division on a daily basis. In addition ALCO:

- Reviews the ICAAP and recommends it to the Board
- Reviews the ILAA and recommends it to the Board
- Allocates capital and liquidity to support business activities by department and/or product in terms of risk/reward

In addition to the recommendations outlined above, the ALCO will report on matters impacting the balance sheet to the Board each quarter.

2.5. Directorships held by members of the Board

The number of external directorships and partnerships held by the Executive and Non-Executive Directors who served on the Board as at the year ended 31 December 2015 (or appointed subsequently) in addition to their roles within the Merlin group were:

Name	Position	Directorships[1]
Paul Batchelor	Chairman	2
Nick Beecroft	Senior Independent Director	1
Arnold Ekpe**	Non-Executive Director	4
Trevor Gander*	Independent Non-Executive Director	-
Richard Jones	Executive Director	-
Douglas MacLennan	Executive Director	1
Derek McMenamin	Independent Non-Executive Director	1
Carol Pattullo	Executive Director	-
Simon Poole**	Non-Executive Director	3
Mary Reilly	Non-Executive Director	4

* resigned 30 November 2015
** appointed 19 April 2016

(1) The number of directorships shown excludes the Bank and its parent group, and also counts external directorships held within the same group of companies as a single directorship in line with CRD IV.

The Board of the Bank is responsible for providing governance and oversight over strategy, risk management and operations of the bank. The key responsibilities include:

- Approval of the Bank's strategic and financial plans and regular review of progress to ensure the sustainability and health of the business;
- Ensuring that processes are maintained to ensure the integrity of the financial reporting and disclosures by the company and compliance with legal and ethical responsibilities;
- Periodical review and approval of the risk strategy, policies, risk appetite and risk management framework, including approval of the Bank's ICAAP, ILAA and RRP on at least an annual basis;
- Ensuring that there is an appropriate system of internal audit and periodically reviewing its effectiveness;
- Delegating authority for day-to-day running of business to the CEO.

As reflected in the Bank's Policies and its Authorities Manual, the Board delegates the day-to-day capital adequacy and liquidity risk management responsibilities to the CEO and the FS Exco. The Management team meets weekly to discuss current issues and monthly (as the FS Exco) with a full agenda covering all aspects of the business including new business and emerging risks. It reports to the Board quarterly.

In the event of a capital or liquidity crisis the Bank's Assets and Liabilities Committee (ALCO), headed by the CEO, will take responsibility, ensuring that the overall strategy is approved by the Board.

3. Risk Appetite

Risk appetite is the maximum level of residual risk that the Bank is prepared to accept to deliver its business objectives. The Bank has developed a robust framework that is used to articulate risk appetite throughout the Bank and to external stakeholders.

The Board is responsible for the establishment of the Bank's Risk Appetite and Tolerances Statement. It establishes the Bank's parameters for risk appetite by:

- Providing strategic leadership and guidance;
- Reviewing and approving annual budgets and forecasts, under both normal and stressed conditions, for the Bank and each division; and
- Regularly reviewing, anticipating and monitoring the Bank's risk performance through quarterly Board reports.

The Board delegates the management and control of risk appetite to the Credit Committee (CC) (for credit risk appetite); to the Compliance and Operational Risk Committee (CORC) for compliance (including conduct) and operational related issues; to the Assets and Liabilities Committee (ALCO) for balance sheet related issues; and to the FS Exco for all other risk appetite. It ensures that risk appetite is in line with Bank strategy and the Bank's desired balance between risk and reward. Each committee is responsible for recommending to the Board the respective levels of risk appetite and risk tolerances for the Bank.

The Bank's risk appetite statements are defined by five broad metrics:

- Headline earnings;
- Liquidity;
- Regulatory capital;
- Economic capital; and
- The confidence level applied to our capital adequacy to cover any unexpected losses.

These metrics are then converted into tolerance levels and limits through an analysis of the risks that impact on them. The Bank's risk assessment process is linked to its Risk Appetite and Tolerances Statement; this means that it links qualitative terms which are used in the Risk Appetite and Tolerances Statement, to a quantitative assessment of each risk. In turn this enables a comparison to be made between risk appetite, and residual risk.

The Bank seeks to focus on benefiting the emerging markets in which it seeks to operate as well as ensuring it remains commercially viable in order to continue to service its clients and donor organisations. As a result the Bank's over-riding approach to risk is closely controlled. It seeks to provide a market rate of return to its depositors while at the same time safeguarding assets through careful appraisal of placements made.

The Bank offers quality, ethical, banking products and services that provide clients with the assurance that their funds will be placed with a bank which acts responsibly. As a consequence, the Bank is selective about both the products and services it offers as well as its investment decisions. However, within these parameters, the Bank seeks a profitable return by optimising its return within its risk tolerances, the expansion of its client base, and through alert management of cost/income ratios.

The Bank does not run a trading book; it offers limited advances facilities; and it focuses money market exposures primarily to F1+ and F1 rated institutions, and to securities issued by these institutions, along with top rated sovereigns, and multinational development banks.

The Bank's business model is not asset-led and its exposure to money markets is restricted to highly rated counterparties. Many of its client facilities are secured by reimbursable undertakings e.g. World Bank funded letters of credit and/or cash cover.

4. Capital Resources

4.1. Total available capital

CRD IV increases the quantity and quality of capital that firms are required to hold, through the introduction of additional and increased deductions from Common Equity Tier One ('CET1') resources and a phased implementation of new buffers, designed to prevent firms from breaching their minimum regulatory requirement in a stressed environment.

At 31 December 2015 and throughout the financial year, the Bank complied with the capital requirements that were in force as set out by European and UK legislation, and enforced by the PRA.

4.2. Capital resources

The table below shows the composition of the Bank's regulatory capital position as at 31 December 2015 on a CRD IV basis. Prior year comparatives are presented under the Basel II rules.

In 2015, the Bank prepared its accounts under Financial Reporting Standard 102, for the first time. As a result the Bank now categorises certain assets as Intangible Assets the deduction of which, from Tier 1 Regulatory Capital, is being phased in as follows:

Year	Deduction
2015	40%
2016	60%
2017	80%
2018	100%

The 2014 comparatives are those reported previously to the PRA and are based on the Bank's UK GAAP accounts used at the time.

The capital resources of the Bank are set out below. The Bank is required to report capital resources and risk weighted assets to the PRA. At the 31 December 2015, those details were:

Capital Resources	**2014 £'000**	**2015 £'000**
Common Equity Tier 1 Capital (CET1):		
Share capital (100% owned by CAL)	7,300	7,300
Retained earnings	14,541	19,038
Less deduction for Intangible Assets at 40%		(1,064)
Total Common Equity Tier 1 Capital	**21,841**	**25,274**
Tier 2 Capital:		
Revaluation reserve	6,712	746
Total Capital Resources	**28,553**	**26,020**
	2014 CRD IV £'000	**2015 CRD IV £'000**
Risk weighted assets – Pillar 1(1)		
Credit risk	123,333	141,770
Concentration risk	1,000	711
Market risk	14	26
Operational risk	12,400	12,270
Total risk weighted assets	136,747	154,777
Capital ratios(2)		
Common Equity Tier 1 capital ratio (2015: Core Tier 1 capital ratio)	21,841	25,274
Tier 1 capital ratio	15.97%	16.33%
Total capital ratio	20.88%	16.81%

(1) Comparative amounts shown reflect the impact of the CRD IV rules on risk weighted assets derived from underlying records prepared under UK GAAP.
(2) Capital ratios are calculated as total regulatory capital divided by risk weighted assets

Explanatory Notes

The Pillar 1 calculations are based on the Standardised Approach for Credit Risk and on the Basic Indicator Approach for Operational Risk.

4.3. Tier 1 Capital

The Bank's Tier 1 capital comprises only Shareholder's equity, which itself comprises issued share capital and accumulated accounting profits. There is now a deduction for Intangible assets, as noted above.

4.4. Tier 2 Capital

The Bank's Tier 2 capital comprises that portion of the revaluation surplus on long term leases which the Bank uses for its own purposes.

Note: the comparative figure includes the entire revaluation surplus on long term leases rather than only that proportion of the leases which the Bank uses for its own purposes. The change is as a result of the move to FRS 102.

4.5. Leverage Ratio

CRD IV requires firms to disclose a non-risk based leverage ratio and the processes used to manage the risk of excessive leverage. The leverage ratio measures the relationship between the capital resources of the organisation and its total assets. The purpose of monitoring and managing this metric is to enable regulators to constrain the build-up of excessive leverage. It is calculated as:

$$\frac{\text{Tier 1 capital}}{\text{Total on and off balance sheet assets adjusted for deductions}}$$

The Basel III framework published by the Basel Committee on Banking Supervision ('BCBS') contains a minimum requirement of 3 per cent for the leverage ratio during the testing phase for the framework, which runs until 1 January 2017. As shown in the table below, whilst the Bank's leverage ratio was outside this minimum requirement at 31 December 2014, it has taken steps to bring this ratio within the minimum requirement.

The Bank's leverage ratio is monitored by ALCO on a monthly basis and is included in the capital forecast and business-as-usual stress testing. The Bank's leverage ratio is included within its RATS, which formalises the monitoring and escalation framework and the Bank's leverage ratio limits.

Leverage ratio	**2014 CRD IV £'000**	**2015 CRD IV £'000**
Total Tier 1 capital for the leverage ratio		
Total Common Equity Tier 1 (CET1) capital	21,841	25,274
Total Tier 1 capital	21,841	25,274
Exposures for the leverage ratio		
Total statutory assets per the Balance Sheet	833,360	647,905
Off balance sheet items	2,816	27,189
Derivative exposures adjustment	-	
Leverage ratio exposure	836,176	675,094
Leverage ratio	2.61%	3.74%

5. Capital management

As part of the Internal Capital Adequacy Assessment Process ('ICAAP') applicable to CRD IV firms, the Board is required to consider all material risks which the Bank faces and determines whether additional capital is required in order to provide additional protection to depositors and borrowers and to ensure the Bank is sufficiently well capitalised to withstand a severe economic downturn.

The Board manages its internal capital levels for both current and future activities and documents its risk appetite and capital requirements during stress scenarios as part of the ICAAP.

The ICAAP represents the aggregated view on risk for the Bank and is used by the Board and management to understand the levels of capital required to be held over the near and medium term and to assess the resilience of the Bank against failure. The Bank completed its last ICAAP in September 2015 and is currently in the process of revising the current year ICAAP, which, will be subject to a Supervisory Review Evaluation Process ('SREP') by the PRA.

The Bank is required to maintain a certain level of capital to meet several requirements:

- To meet minimum regulatory capital requirements;
- To ensure the Bank can meet its objectives, including growth objectives;
- To ensure the Bank can withstand future uncertainty, such as a severe economic downturn; and
- To provide assurance to depositors, borrowers, shareholders and other third parties.

The Bank presents regular reports on the levels of capital, as well as the results of stress scenarios, to the ALCO and Board.

The key assumptions and risk drivers used to create the ICAAP are regularly monitored and reported and any material deviation from the forecast and risk profile of the Bank would mean the ICAAP would need to be reviewed.

The Bank aims to maintain sufficient capital to cover regulatory requirements, including any capital planning buffers, and to maintain an operational capital buffer.

Risk arises from the Bank's activities and will be affected by any unexpected increase in regulatory requirements or poor financial performance, losses being higher than expected and any downturn in market conditions.

The Bank undertakes certain activities to manage and mitigate capital risk. The primary mechanism to ensure that sufficient capital is held is through regulating the volume of asset origination. In addition, capital risk management activities include capital forecasting over a period of 2 to 3 years designed to provide a forward view on capital allocation and excess regulatory capital. Furthermore, stress testing and sensitivity analysis is performed to provide information on the Bank's capital position. Capital requirements under stressed conditions are considered as part of the ICAAP.

5.1. Minimum capital requirement: Pillar 1

The Bank's overall capital resources requirement under Pillar 1 is calculated by adding the capital resources requirements for credit risk, market risk, operational risk and credit valuation adjustment ('CVA'). The following table shows the Bank's capital resources requirement and capital resources surplus under Pillar 1:

Total minimum Pillar 1 capital requirement	**31 December 2014 £'000**	**31 December 2015 £'000**
Capital resources	28,553	26,020
Capital resources requirement – Pillar 1		
Credit risk	9,867	11,341
Counterparty risk	80	57
Market risk	1	2
Operational risk	992	982
Capital resources requirement under Pillar 1	10,940	12,382
Capital resources surplus over Pillar 1 requirement	17,613	13,638

The overall Pillar 1 capital resources requirement for the Bank is £1.4 million higher compared to 2014. The Bank's largest exposures continue to be credit risk exposures arising from placements with rated financial institutions. Minimum Pillar 1 capital requirements for credit risk are considered in further detail in Section 6 of this document.

6. Credit Risk

Credit risk is the risk of financial loss arising from a borrower or counterparty failing to meet their financial obligations to the Bank in accordance with agreed terms. This risk arises principally from the Bank's placement of deposits within the money markets, and certain off-balance sheet activities. These include trade finance and forward foreign exchange transactions. The Bank does not actively trade in financial instruments, other than for liquidity management purposes.

The Bank evaluates its level of risk through consideration of the level of exposure that it has to a range of different measures. Exposure is defined as the maximum loss that a financial institution might suffer if a borrower, counterparty or group fails to meet their obligations or if assets and off balance sheet positions (after offsets) have to be realised. Mark to market exposures are carefully monitored in respect of forward foreign exchange transactions.

The Bank's approach to credit risk is closely controlled. Commercial client relationships are not founded on a willingness to offer credit exposure and credit is not used as a marketing tool. However the Bank recognises that exposure to counterparty institutions is unavoidable if an acceptable level of profitability is to be maintained. The Bank's products are linked to the provision of international banking and payment services on a pre-funded basis. Risk is further mitigated by cash cover or MLA (Multilateral Agency) guarantees held for most trade finance business and large FX trades for clients. Uncovered trade finance deals are restricted and spread across a variety and location of entities and countries, and subject to additional review prior to acceptance, as well as higher levels of monitoring and control once in place..

The Bank's strategy includes plans to expand its trade finance activities and to provide a limited amount of targeted unfunded credit lines.

Credit risk is assessed in line with the Standardised Approach laid down in the CRD.

6.1. Controls & Mitigation

The Bank reviews its money market counterparty selection criteria, limiting its exposure to investment grade rated institutions. It restricts client credit exposure to 25% of capital. Limits are set by the Bank's Credit Committee which meets on a quarterly basis. Exposures are monitored on a daily basis. Allowances are made for currency fluctuations to ensure limits are not breached. The Bank's credit policy is formalised in a policy paper which is reviewed annually by its Board.

Credit risk is principally controlled by establishing and enforcing authorisation limits, including set-off limits, and by checking the creditworthiness of counterparties and defining exposure levels to those counterparties. Daily monitoring of positions ensures that prudential limits are not exceeded. The Bank continues to adopt a conservative credit policy, and has suffered only a single (minor) credit exposure loss in the last 20+ years.

Regular stress testing considers the likelihood of the failure of a market counterparty, credit concentrations and country risk.

6.2. Minimum capital requirement: credit risk

The Bank uses the Standardised Approach in determining the appropriate level of capital to be held for regulatory purposes. Under this approach the Bank must set aside capital equal to 8 per cent of its total risk weighted assets to cover its Pillar 1 capital requirements.

The following table shows the credit risk exposures and the composition of the minimum capital requirements for credit risk at 31 December 2014 and 31 December 2015:

Exposures subject to the Standardised Approach 31 December 2014	**Credit risk exposure**	**Minimum capital requirement**
	£'000	**£'000**
Central government and central banks	509,524	37
Multilateral development banks	-	-
Institutions	306,493	8,217
Corporates	4,619	370
Other items	15,540	1,243
Total	836,176	9,867

Exposures subject to the Standardised Approach 31 December 2015	**Credit risk exposure**	**Minimum capital requirement**
	£'000	**£'000**
Central government and central banks	335,085	28
Multilateral development banks	5,246	-
Institutions	297,152	9,073
Corporates	28,018	911
Other items	16,607	1,329
Total	682,108	11,341

The overall capital requirement for credit risk has increased by 15.5% between 2014 and 2015. This is largely on account of:

1. The fact that, whilst the Bank's exposures to Institutions have gone down by 3%, the current mix of banks/exposures are now attracting a higher risk weighting.
2. Increased exposures to Corporates, which are largely banks in jurisdictions which are not equivalently regulated.

The exposures categorised within 'Other items' predominantly relate to other balance sheet assets that have no associated credit risk. These comprise various non-financial assets, including fixed assets, cash, prepayments, sundry debtors and deferred tax assets.

6.3. Risk weighted assets

The table below shows movements in the RWAs for credit risk (as shown above) from 31 December 2014 to 31 December 2015.

Credit risk RWAs flow statement	**£'000**
Credit risk RWAs at 31 December 2014	123,333
Book growth/composition change	19,151
Credit risk RWAs at 31 December 2015	142,484

Credit RWAs have increased by approximately 15.5% during the year to £142,484,000 as at 31 December 2015. Whilst the Bank's total exposures have reduced during the year, the exposures concerned are attracting a higher risk weighting.

6.4. Credit risk exposures

The credit risk exposures for the Bank as at 31 December 2015 are summarised in the following sections.

6.5. Credit risk exposures by sector

The following table shows the total amount of exposures, net of provisions at 31 December 2015, including pipeline commitments and after offsets, analysed by sector.

Credit risk exposures analysed by sector

31 December 2014 (All figures in £'000)	**Financial**	**Government and public administration**	**Other commercial**	**Total**
Central government and central banks		509,524		509,524
Multilateral development banks				
Institutions	306,493			306,493
Corporates			4,619	4,619
Other items			15,540	15,540
Total	306,493	509,524	20,159	836,176

Credit risk exposures analysed by sector

31 December 2015 (All figures in £'000)	**Financial**	**Government and public administration**	**Other commercial**	**Total**
Central government and central banks		335,085		335,085
Multilateral development banks	5,246			5,246
Institutions	297,152			297,152

Corporates			28,018	28,018
Other items			16,607	16,607
Total	302,398	335,085	44,625	682,108

The reduction in the Bank's credit exposures during 2015 (reflected in a corresponding decrease in customer liabilities) has resulted in an decrease in exposures across a number of sectors, in particular deposits with Central Banks.

6.6. Geographic distribution of credit risk exposures

The geographical spread of the Bank's credit risk exposures are set out in the table below.

Credit risk exposures analysed by geographical region

31 December 2014 **Exposures subject to the Standardised Approach**	**UK**	**Other**	**Total**
	£'000	**£'000**	**£'000**
Central government and central banks	506,676	2,848	509,524
Multilateral development banks			
Institutions	51,496	254,997	306,493
Corporates	3,948	671	4,619
Other items	15,540		15,540
Total	577,660	258,516	836,176
31 December 2015			
Central government and central banks	321,569	13,516	335,085
Multilateral development banks		5,246	5,246
Institutions	59,448	237,704	297,152
Corporates	1,380	26,638	28,018
Other items	16,607		16,607
Total	399,004	283,104	682,108

Credit risk exposures outside of the UK typically arise on money market placements with, and Certificates of Deposit issued by, Tier 1 banks that are held as part of the Bank's liquidity buffer, or as earning assets.

6.7. Residual maturity of credit risk exposures

The table below summarises the Bank's exposures, including off balance sheet items, analysed by remaining contractual maturity.

Residual maturity of credit risk exposures 31 December 2014	Within 1 year £'000	After 1 year but within 5 years £'000	More than 5 years £'000	Undated £'000	Total £'000
Central government and central banks	2,848			506,676	509,524
Multilateral development banks	2,757				2,757
Institutions	266,684	1,611		38,197	306,493
Corporates	4,435	184			4,619
Other items				15,540	15,540
Total	273,967	1,795		560,414	836,176
31 December 2015					
Central government and central banks	13,516			321,569	335,085
Multilateral development banks	3,194	2,052			5,246
Institutions	267,301			29,851	297,152
Corporates	27,972	46			28,018
Other items				16,607	16,607
Total	311,983	2,098		368,027	682,108

The maturity of exposures is shown on a contractual basis.

6.8. Management of credit risk

Credit risks associated with credit exposure are managed through the use of detailed credit policies which outline the approach to credit exposure, underwriting criteria, credit mandates, concentration limits and product terms. The Bank maintains a dynamic approach to credit management. Its credit policies and performance against risk appetites are regularly reviewed. The Bank will take necessary steps if specific issues are identified or if credit performance deteriorates, or is expected to deteriorate, due to economic or sector-specific weaknesses.

The Bank also seeks to mitigate credit risk by focusing on business sectors where it has specific expertise and through limiting concentrated exposures on larger loans or certain sectors which can represent higher risk. The Bank also seeks to obtain security cover from borrowers.

External rating agency ratings for borrowers are not always available in the specialist segments in which the Bank operates. Credit risk is, however, assessed through a combination of due diligence, reviewing credit reference agency reports, reviewing financial information, and the use of experienced underwriters.

The Bank has a single Credit policy and dedicated credit risk management team which assesses credit risk, supported by a Credit Committee with significant credit experience.

6.9. Treasury credit risk

Credit risk exists in relation to Treasury assets where the Bank has placed deposits or acquired assets with other financial institutions. The Bank's policy is currently to place such deposits or acquire assets which are rated at least F1, hence the Bank considers that the credit risk of such assets is relatively low. As the

Bank does not maintain a trading book, all such assets are placed or acquired with the intention of holding to maturity. Some of these assets are held as a part of the Bank's liquid assets buffer (see section 9 below).

Regulatory capital is allocated to the Treasury assets based on the Standardised Approach, in accordance with the regulation of the PRA. Credit ratings used in the determination of such exposures are provided by Fitch, Moody's and Standard & Poors.

Credit quality of Treasury financial assets

	Exposure value by external rating				
	AA+ to AA-	**A+ to A-**	**BBB+**	**Unrated**	**Total**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
2014					
Cash and balances at central banks and Loans & advances to banks	522,983	190,526	66		713,575
Certificates of Deposit	9,626	90,304			99,930
Derivatives held for risk management purposes	8,190				8,190
	540,799	280,830	66		821,695
2015					
Cash and balances at central banks and Loans & advances to banks	327,813	130,082	22	148	458,065
Supranationals					
Certificates of Deposit and other debt instruments		173,375			173,375
Derivatives held for risk management purposes	2,930	3,903	625	37	7,495
	330,743	307,360	647	185	638,935

As at 31 December 2014 and, apart from a small provision of £5K, at 31 December 2015 none of the Treasury assets were past due or impaired.

Credit ratings are based on the specific obligor to whom the Bank is exposed.

Cash placements

Credit risk of Bank counterparties is controlled through the Treasury policy and the Risk Appetite and Tolerances Statement which limits the maximum exposure by entity where the Bank may place cash deposits. All institutions need a sufficiently high long term and short term rating at inception.

Gilts and supranational bonds

As part of the liquidity buffer, the Bank may hold a portfolio of Gilts and Supranational Bonds. These instruments are rated at least AA-, and typically carry sovereign risk.

Derivatives

Credit risk on derivatives is controlled through a policy of only entering into contracts with a small number of UK credit institutions, with a credit rating of at least AA- at inception. No derivative contracts are collateralised.

6.10. Credit risk concentration

Concentration risk exists through having high or excessive exposures to a concentration of certain counterparties, regions or sectors. Concentration risks from credit exposure activities are managed and controlled through the adoption of concentration limits through the Risk Appetite and Tolerances Statement (RATS). Reported exposures against concentration limits are regularly monitored.

6.11. Counterparty credit risk

The Bank is exposed to counterparty credit risk from derivative transactions for the purpose of reducing exposures to fluctuations in interest rates and exchange rates; such derivatives are not used for proprietary trading purposes.

Counterparty credit risk is the risk that a counterparty to a derivative instrument to which the Bank has an exposure could default.

The Bank calculates counterparty credit risk exposures using the mark-to-market method. Exposure is calculated as the positive mark-to-market value of outstanding contracts plus an additional potential future credit exposure that varies according to the transaction.

The following table shows the exposures to counterparty credit risk for derivative contracts:

Net exposures to counterparty credit risk for derivative contracts

	2014 £'000	**2015 £'000**
Net derivative credit exposure	8,190	7495

The net derivatives credit exposure, which represents the credit exposure to forward foreign exchange contracts only, is stated after including potential future credit exposures as required in the calculation of exposure.

Counterparty credit limits are established for authorised counterparties and are updated on a periodic basis to take account of any ratings migration and the Bank's assessment of the credit risk for the institution. The maximum exposure limit is set at 100 per cent of the Bank's capital resources, although each counterparty is assessed on individual merit. Exposures to central banks; multilateral development banks; other public sector institutions; and any other entities which carry a zero per cent risk weighting as per the Standardised Approach, have limits set at up to 100 per cent of the Bank's capital resources. The exposure limit for each institution is maintained in an Authorised Counterparties List which is reviewed at least annually or more frequently should a change in ratings occur.

7. Market Risk

Market risk is the risk that the value of, or net income arising from, the Bank's assets and liabilities changes as a result of changes to market forces, in particular interest rates or exchange rates. The main market risk faced by the Bank is interest rate risk.

The Bank has a highly restricted appetite to Market Risk; it does not operate a trading book and therefore is exposed to Market Risk primarily through its small exposures to capital instruments in which the Bank has invested, together with currency exposures arising through its daily funding, payments and trade finance activities. The risk to capital investments is further mitigated as instruments purchased for such purposes are generally held to maturity; as a result it would normally only be the credit to the issuer to which the Bank would be exposed. The Bank does not maintain a trading book, and permits only low levels of intraday and overnight exposures to market or interest rate movements.

7.1. Controls & Mitigation

The Bank maintains risk management systems to identify, measure, monitor, and control market risk including the daily distribution of spot and forward FX and other positions, and the resultant calculation of the relevant capital requirement against those positions. Under Pillar 1, the market risk is calculated at 8% of the sterling equivalent open position for FX positions. The Bank does not enter into any financial derivatives contracts other than forward FX.

The Assets and Liabilities Committee (ALCO) is charged with responsibility for Market Risk and meets on a monthly basis. The Board sets Market Risk and Foreign Currency policies which govern the management of Market Risk.

Interest rate and currency movements are considered as part of the Bank's programme of stress testing.

8. Interest rate risk

Interest rate risk is the risk of loss through mismatched asset and liability positions sensitive to changes in interest rates.

8.1. Management of interest rate risk

The Bank's balance sheet is liability led, in that assets are not generated unless a corresponding liability has arisen from customer deposits.

Interest rate risk primarily arises from where the maturities of assets do not match those of the liabilities.

The Bank aims to minimise interest rate risk and has a policy of placing funds with market counterparties or purchasing assets against its fixed term client deposits.

As market circumstances permit, the Bank will mismatch in order to enhance returns. This can happen when the Bank chooses to match short term client fixed deposits with overnight assets in order to take advantage of preferable Bank of England call account rates or when the Bank puts longer term assets against its "behaviouralised" current account balances in order to take advantage of better yields. In both cases interest rate risk is minimal. In the first case a cut in rates would have an effect until the deposits mature and the rates can be adjusted. In the second case the longer term assets do not leave the bank with funding requirements.

8.2. Asset-liability gap risk

The Bank's balance sheet is liability led, in that assets are not generated unless a corresponding liability has arisen from customer deposits, creating a natural hedge.

Given timing differences and the price of hedging small gaps, it is not cost effective to have an absolute match of assets and liabilities. The risk exposure of the overall asset-liability interest rate profile is monitored against approved limits using two main measures:

- Changes to economic value of the balance sheet as a result of 2 per cent shift in the interest yield curve; and
- The quantum of "behaviouralised " deposits held at any time with the Bank of England.

8.3. Other market risks

The Bank does not carry out proprietary trading or hold any positions in assets or equity which are actively traded.

The Bank does, however, from time to time, hold a portfolio of asset backed securities and a portfolio of liquid assets (typically UK Gilts, Treasury bills and Supranational Bonds) which, together with its balance with the Bank Of England, are used for liquidity buffer purposes. As at 31 December 2015 the buffer consisted solely of the Bank of England balance. Further information on the Bank's liquidity buffer is provided in Section 9.

The interest rate risk on these liquid assets is considered as part of the asset-liability gap risk described above. The instruments are also exposed to other forms of market risk e.g. credit spread risk. Prices are monitored on a day to day basis to ensure that the Bank is aware of any material diminution in value.

9. Liquidity Risk

Liquidity risk is perceived as very low, given the Bank's business model, which is deposit driven, rather than asset led. From time to time liquid assets are held in certain currencies such as GBP call accounts (where improved margins are earned) and the Bank of England Reserve Account. These are used against liabilities in other currencies. Liquidity limits are also measured on a cumulative time band basis and used to earn increased risk return margins where possible. Many liabilities are call or current accounts and some are placed out for longer periods to optimise interest rates received. Whilst these funds tend to be sticky they are treated as next day, limiting placements against them. Investments over and above this have to be in the form of liquid assets such as CDs.

9.1. Controls & Mitigation

Liquidity risk is the risk that the Bank is not able to meet its financial obligations as they fall due, or can do so only at excessive cost. The risk can arise because:

- The Bank has insufficient funds to pay the amounts that it owes (either to depositors or creditors);
- The Bank has sufficient funds but they are not readily accessible; or
- The Bank's credit rating, asset quality or reputation deteriorates to such an extent that it is prevented from refinancing its borrowings on maturity.

Liquidity is measured and monitored daily on a cumulative basis by time bands from next day out to the end of the book. Liquidity risk is considered by ALCO and its monthly meetings. The Bank's Treasury policy sets mismatch limits to be followed and any Individual Liquidity Guidance set by the PRA is monitored and measured on a daily basis.

Within its ILAAP, the Bank considers both set stress testing scenarios set by the regulator and its own idiosyncratic scenarios.

To protect the Bank and its depositors against liquidity risks, the Bank maintains a liquidity buffer which is based on the Bank's liquidity needs under stressed conditions. The liquidity buffer is monitored on a daily basis to ensure there are sufficient liquid assets at all times to cover cash flow movements and fluctuations in funding and to enable the Bank to meet all financial obligations and to support anticipated asset growth.

Liquidity risk is specifically assessed through the Individual Liquidity Adequacy Assessment ('ILAA'), which is approved by the Board. Through the ILAA process, the Bank has assessed the level of liquidity necessary to prudently cover systemic and idiosyncratic risks and the ILAA process determines the appropriate liquidity buffer, taking into account the specific nature of the deposit base.

The ILAA requires the Bank to consider all material liquidity risks in detail and the ILAA has documented the Bank's analysis of each key liquidity risk driver and set a liquidity risk appetite against each of these drivers. Liquidity risks are specifically considered by ALCO each month.

Based on the business model of funding primarily through donor aid and wholesale deposits, the board has set a liquidity risk appetite which it considers to be appropriate to provide it with the assurance that the relevant liquidity risk drivers should be considered and appropriately stressed and that the Bank is able to meet liabilities beyond the targeted survival period.

The Bank's liquidity buffer (aligned with the definition of liquid asset buffer in CRD IV) is categorised as primary liquidity. The Bank also holds other liquid assets, including unencumbered cash and other securities that meet the definition of secondary liquidity. Together, these assets comprise the Bank's liquidity portfolio as shown below.

Liquidity portfolio	31 December 2014 £'000	31 December 2015 £'000
Bank of England reserve account and unencumbered cash and bank balances	509,060	321,569
Eligible securities and certificates of deposit	90,304	-
Total liquidity buffer	599,364	321,569
of which: primary liquidity	509,060	321,569
of which: secondary liquidity	90,304	-
Total liquidity buffer as a % of funding liabilities	75%	51.95%

Primary liquidity has decreased by £187 million, or 36.8%, to £322 million as at 31 December 2015, as a result of lower levels of client deposits.

9.2. Liquidity ratios

CRR provided for two new liquidity safeguards. The Liquidity Coverage Ratio ('LCR') aims to improve the resilience of banks to liquidity risks over a 30 day period. The Net Stable Funding Ratio ('NSFR') aims to ensure that banks have an acceptable amount of stable funding to support their assets over a one year period of extended stress.

9.2.1. Liquidity Coverage Ratio

In January 2014, the Basel Committee on Banking Supervision ('BCBS') issued its revised draft guidance for calculating the LCR, which came into force from 1 January 2015 on a phased basis. The detailed rules for the calculation of the LCR are set out in the Liquidity Coverage Requirements Delegated Act, which was adopted by the European Union in October 2014 and have been directly applicable in the United Kingdom since 1 October 2015, as well as PRA rules and supervisory statements on CRD IV Liquidity.

Under the finalised rules, the LCR is calculated as:

$$\frac{\text{High Quality Liquid Assets}}{\text{Cash outflows – capped cash inflows}}$$

High Quality Liquid Assets, cash outflows and capped cash inflows are defined in the Liquidity Coverage Requirements Delegated Act.

Based on these rules, the Bank's LCR as at 31 December 2015 was 629% (31 December 2014 - 136%). This is in excess of the minimum standard of 60% set out in the delegated act, effective from 1 October 2015.

The PRA requires a minimum LCR requirement of 80%, applicable in the UK from 1 October 2015. This would then increase to 100 per cent from 1 January 2018 on a phased basis., The Bank's LCR at 31 December 2015 is well in excess of the requirements.

9.2.2. Net Stable Funding Ratio

The NSFR is the Banks “stable funding” (typically its capital together with its deposits including various levels of discount) divided by its “required stable funding” (typically its exposures to third parties, again including various levels of discount). The NSFR is currently not mandatory but will be implemented at a minimum of 90% from January 2018.

The Bank’s NSFR as at 31 December 2015 was 349% (2014 - 445%), substantially in excess of the minimum level that will apply from 2018.

9.3. Liquidity risk drivers

This section provides an overview of the Bank’s key liquidity risk drivers.

9.3.1. Deposit funding risk

The deposit funding risk is the primary liquidity risk driver for the Bank and this could occur if there was a concern by depositors over the current or future creditworthiness of the Bank. Although the Bank seeks to operate in such a way as to protect depositors, an extremely low proportion of deposits are currently protected by the government’s Financial Services Compensation Scheme (‘FSCS’). The FSCS currently provides £75,000 of protection to eligible depositors.

9.3.2. Wholesale funding

The Bank mainly finances its operations through wholesale deposit taking, although it does not have long term wholesale funding lines in place. The Bank does have relationship banking facilities in place which are used to hedge against currency exposures.

9.3.3. Payments systems

The Bank does not form part of the UK payment system. However, in the event there are problems with one of the payment systems, the Bank has access to other facilities with which to make payments if needed.

9.3.4. Contingency funding plan

As a regulated firm, the Bank is required to maintain a Contingency Funding Plan (‘CFP’). The plan (which is now part of the Bank’s Recovery and Resolution Plan (‘RRP’)) involves a two stage process, covering preventative measures and corrective measures to be invoked when there is a potential or actual risk to the Bank's liquidity or capital position. The CFP/RRP provides a plan for managing a liquidity or capital situation or crisis within the Bank, caused by internal events, external events or a combination thereof. The plan outlines what actions the Bank could take to ensure it complies with the liquidity adequacy rules, maintains sufficient capital and operates within its risk appetite and limits, as set and approved by the Board.

10. Operational Risk

The Bank's client base has traditionally been serviced with a highly bespoke, tailored level of service, which had meant the use of many different operating and pricing mechanisms. The Banks new banking system has enabled it to introduce significant levels of standardisation across all clients and counterparties which has improved its daily operation and control environment. However, the markets in which the Bank operates generally have high levels of corruption, and this in turn exposes the Bank to the possibility of both internal and external fraud.

Taken together this has required the Bank to rely on the implementation of procedures, processes and controls which mitigate against the above risks whilst at the same time being proportionate.

10.1. Controls & Mitigation

Operational risk is the risk of financial loss and/or reputational damage resulting from inadequate or failed internal processes, people and systems or from external events including financial crime. This risk includes IT, information security, project, outsourcing, tax, legal, fraud, and compliance risks.

Key control standards include new product/increased volume reviews; levels of authority and individual approval limits; detailed procedures; segregation of duties; regular and timely reconciliations; succession planning and business continuity. Regardless of value, all operational failings wherein a loss, near miss or fortuitous profit occurs are investigated by Risk Management which recommends additional controls and procedures where relevant.

The Bank has an Operational Risk Policy which is reviewed periodically by the Board. The Compliance and Operational Risk Committee meets monthly to discuss operational issues. The Basic Indicator Approach set out in the EU Capital Requirements Directive is used to assess capital requirements for operational risk. Stress testing shows that the current regulatory requirement for Operational Risk is sufficient to cover the risks identified.

10.2. Management of operational risk

The Bank aims to maintain robust operational systems and controls and seeks to operate within a defined level of operational risk. The operational risk appetite considers risk events, the assessment of internal controls as well as holding additional capital for certain operational risks.

As part of the operational risk management process, the Bank has an Operational Risk Policy, undertakes a Risk & Control Self-Assessment process across the Bank, and has business continuity plans in place. The Bank records all operational risks and risk events.

Through the establishment of, and investment in, sound systems, controls and audit functions, the Bank aims to minimise operational failures. Operational risk is reviewed by the Compliance and Operational Risk Committee (CORC), which meets monthly to ensure that a quality and robust IT, operations and compliance service is delivered at all times and is capable of supporting the changing business requirements of the Bank. It has responsibility for monitoring all the key operational risks facing the organisation, including compliance and operational risks. The CORC provides a quarterly report to the Board on operational risk matters.

The Bank has placed emphasis on ensuring that the IT infrastructure, performance, resilience, and security meet the on-going needs of the business.

10.3. Operational risk capital calculation approach

The operational risk charge for the Bank under Pillar 1 is calculated using the Basic Indicator Approach, whereby a 15 per cent multiplier is applied to the 3 year historical average net income. The capital requirement calculated under this approach at 31 December 2015 was £981K (2014- £992K). The capital Risk Weighted Assets equivalent is set out in the table in section 4.2 above.

The table below shows movements in RWAs for operational risk (as shown above) from 31 December 2014 to 31 December 2015.

Operational risk RWAs flow statement Bank

Operational risk RWAs	**£'000**
As at 1 January 2015	12,400
Revenue reduction	(130)
As at 31 December 2015	12,270

The decrease in RWAs for operational risk is due to the reduction in revenue generated by the Bank over the last three years compared to the three years ending 31st December 2014.

11. Compliance (including Regulatory) Risk

The Bank seeks to comply at all times with all rules, regulations and laws to which it is exposed through all of its activities, and continues to develop staff training programmes to ensure its staff are both aware of and comply with such. As a result, while it has zero tolerance for financial crime, Regulatory Risk, and Conduct of Business Risk, it recognises that some markets for its activities are higher risk areas, which may heighten its exposure to such risks from time to time.

However it also recognises that errors may be made in the submission of financial reports and returns either through their being inaccurate or incomplete, or their being submitted outside of permitted deadlines. In addition, the Bank also recognises that many of the current reports are being replaced by new European Banking Authority (EBA) reports. As a result, while every effort is and will be made to ensure that reports are submitted accurately, completely and on time, the Bank recognises that this may not always be achievable. It will keep report submission under review and monitor their submission through regular Management information. As a result the Bank considers it appropriate to set a risk appetite for financial reporting as one of no regulatory or other fines related to reporting submissions.

In respect of legal risk, as mentioned above, the Bank makes every effort to comply with its obligations, however cannot control the actions of its clients, counterparties and others with whom it may from time to time come into contact.

11.1. Controls & Mitigation

The Bank keeps abreast of banking regulations through receipt of PRA, FCA, British Bankers Association and EBA bulletins. Staff regularly attend workshops to ensure that their knowledge on regulatory issues is up to date. Staff receive regular training in respect of Financial Crime issues and all clients are assessed as to the level of risk they pose in respect of Money Laundering and Bribery and Corruption. The Financial Crime Policy is regularly reviewed and approved by the Board. The Bank has a compliance and monitoring testing programme in place which is regularly reviewed.

The Bank continually reviews the resources dedicated to combatting Financial Crime and throughout the year has been actively recruiting to enhance its Financial Crime staffing.

The Compliance and Operational Risk Committee meet monthly to discuss compliance issues. An in-house legal team advises on any legal issues which may arise.

12. Strategic Risk

Strategic risk is the risk which can affect the Bank's ability to achieve its corporate and strategic objectives. Strategic risk is particularly important as the Bank continues its growth strategy. The Bank seeks to mitigate strategic risk by focusing on a sustainable business model which is aligned to the Bank's business strategy.

The strategy of the Bank is established through the creation of a rolling five-year plan, agreed by the Board. Each year an Annual Operating Plan and budget, which dovetails with the overarching strategic plan is created and also agreed by the Board.

The Bank and its parent are prepared to accept a risk that earnings will fluctuate if necessary, for example to maintain other risk appetites at agreed levels. The current pre-tax return on capital target of 6% - 8% recognises that other risk appetite targets may float dependent on market circumstances and the operating environment.

Strategic risk can arise as a result of both internal and external factors. The Bank seeks to identify and mitigate the individual components of strategic risk through the application of the Risk Management Framework.

The Bank's strategic direction and performance is impacted by external factors (that are similar to those impacting other financial institutions) and internal operational factors.

12.1. External factors

External factors include uncertainty around future interest rate movements and increased competition, especially from new entrants to the market, which may challenge product and pricing margins. The Bank closely monitors competitor activity, pricing, and customer behaviour and feedback and reflects this in pricing and marketing plans.

As a regulated business, the Bank must also comply with the complex and changing regulatory environment. Prudential and conduct regulation continues to evolve and the Bank maintains regulatory monitoring activity to understand future requirements and how this may affect the Bank. To comply with current prudential regulatory requirements, the Bank maintains adequate capital and liquidity resources to satisfy these requirements at all times. Notwithstanding, the Bank's borrowing costs and capital requirements could be affected by future prudential regulatory developments.

There remains a keen focus on capital management to ensure that the Bank has an appropriate capital structure in place to support the Bank's growth strategy.

The Bank has a zero risk appetite for material regulatory breaches. To ensure compliance with regulatory requirements, the Bank has policies, processes and standards which provide the framework for business activities and staff to operate to which are in accordance with the laws, regulations and voluntary codes which apply to the Bank and its activities. Compliance with regulation incurs significant costs which are factored into the operational cost and are considered in relation to the specific products and services that the Bank offers.

12.2. Internal factors

Internal factors which impact strategic risk include the adequacy of IT systems, data security, project management, supplier and outsourcing arrangements and from internal and third party fraud and compliance failings. As the Bank grows it continues to monitor the adequacy and ability of its third party suppliers to support the Bank, now and in the future and where necessary will seek alternative arrangements.

12.3. Controls & Mitigation

Targets are regularly reviewed as part of the Bank's strategic review process, and its discussions with its stakeholders over expected contribution levels. FS EXCO meets on a monthly basis to review progress against plans. Forecasts and budgets are continually updated.

13. Conduct risk

Conduct risk is the risk of detriment caused to the Bank`s customers due to the inappropriate execution of its business activities and processes. The Bank extends the definition of 'customer' to include SME and wholesale customers (but excludes intermediaries and other third parties) across all business segments, including both regulated and non-regulated activities, thereby applying its conduct risk policies to all credit exposure and deposit-taking activities.

The Bank has a zero appetite for systemic unfair outcomes, which may result in significant detriment to the Bank's customers. Systemic unfair outcomes may arise from poor product design, poor sale processes or unacceptable operational practices which risk repeated or continual outcomes which are detrimental to customers.

However, occasional failures in operational processes may occur, for example administration and processing errors or interruptions to IT systems. These occasional events may have an impact on customers, leading to customer detriment. The Bank has set a tolerance around the detriment caused through such non-systemic process failings.

The risk is that customers can suffer detriment due to actions, processes or products which originate from within the Bank. Conduct risk can arise through the design of products that do not meet customers' needs, mishandling complaints where the Bank has behaved inappropriately towards its customers, inappropriate sale processes and exhibiting behaviour that does not meet market or regulatory standards.

Customer detriment could affect the Bank's reputation, lead to loss of market share due to damage to the Bank's brand, may lead to customer redress payments and could lead to regulatory action and censure.

The Bank mitigates conduct risk by monitoring various operational metrics and by tracking activities which affect customers, monitoring customer complaints, implementing process improvements and adhering to service standards. The conduct risk metrics (which include among others, staff performance levels, training, customer feedback and complaints, product retention rates and cancellations and customer service standards) vary across the business lines and consist of individual business line conduct risk KPIs, the sum of which is measured against the risk appetite.

Conduct risk metrics and KPIs are in place to evidence fair outcomes, identify any emerging issues and document remedial actions. Each customer-facing area is responsible for implementing controls designed to manage and report on conduct risk, which includes understanding how customer detriment may occur, how it is identified and how it is prevented going forward. Conduct risk is monitored by CORC.

14. Insurance Risk

The Bank has arranged its own insurance. Comprehensive insurance cover has been taken out with reputable third party insurance companies including professional indemnity, public and employers' liability. The levels of cover, policy excesses, and the financial strength of the insurer are reviewed and discussed annually with brokers.

15. Pension Obligation Risk

At the date of this report (31st December 2015) certain of the Bank's staff were members of either the group defined benefit pension scheme or its personal pension scheme. At that date the Bank was part of the Crown Agents Limited group, and as a result the Bank considers it may have had secondary pension obligation risk in respect of the defined benefit scheme. The Bank paid contributions and costs to Crown Agents Limited as determined by the fund actuaries. Any risk of funding shortfall is with CAL. The defined benefits scheme was closed to new members on 31st March 2006 (new staff are eligible to join a stakeholder pension scheme), and was closed to future accrual on the 1st April 2015. The defined benefit group scheme is subject to triennial actuarial review. On an actuarial basis at last valuation date there was no deficit. On an accounting basis there is a deficit. Given the stock market rise of the last few years, and the current growth of the UK economy, it can be reasonably expected that the value of assets will grow as well which will have an impact on any overall deficit.

While the Pensions Regulator (TPR) can require the Bank to contribute towards any deficit in the scheme, the length of time over which that contribution needs to be made is not set in stone.

Stress tests have been carried out assuming that the Bank has to make contributions for its staff in the event of the failure of CAL. Regular meetings are held with the group in respect of the pension fund.

Following the change of control as at 31st March, the obligations of the CAL pension scheme belong entirely to the CAL group; the Bank has no further exposure to that scheme.

16. Remuneration

The PRA has defined certain requirements relating to remuneration, referred to as the Remuneration Code (‘the Code’). Firms that fall within the scope of the Code (which includes banks) must establish, implement and maintain remuneration policies, procedures and practices that are consistent with and promote sound and effective risk management. Policies and procedures must be comprehensive and proportionate to the nature, scale and complexity of the firm’s activities.

A firm must maintain a record of its Code Staff (being those staff whose professional activities have a material impact on the firm’s risk profile) and take reasonable steps to ensure Code Staff understand the implications of their status.

The disclosure requirements of Pillar 3 are defined by CRR Article 450. Data is provided for remuneration received by Code Staff for the year ended 31 December 2015.

During the year, the Bank designated a total of 13 individuals (including Non-Executive Directors) who were classed as Code Staff. Of these, 10 were categorised as Senior Management (being the Executive and Non-Executive Directors who served during the year, and members of the Executive Committee), as well as 3 individuals categorised as other Code Staff.

16.1. Approach to remuneration

The Bank’s remuneration policies are designed to comply with the Code and the Bank is committed to adherence to its practices and guidelines in respect of Code Staff.

The key principles behind the Bank’s remuneration policy are those that we believe are critical to the business and reflect our values and recognise the need to be competitive. The policy is to set remuneration levels which are aligned within the overall Bank stated risk appetite and ICAAP measures, and to ensure that the Executive Directors, Senior Management and employees are fairly and responsibly rewarded in return for high levels of individual and business performance.

The overall aim of the policy is to attract, motivate and retain Executives of high calibre who can deliver sustained performance consistent with strategic goals, appropriate risk management and to reward them for enhancing value.

The following key principles underpin these themes:

- Attract and retain high calibre individuals – employee turnover will be monitored for the proportion attributable to remuneration policy and practices; the performance management framework will be maintained to ensure it continues to reflect and support business goals; assessment of the value of roles will be through an objective measurable methodology, that ensures value is attached to tangible services and outputs of the role;
- Remuneration will not be excessive – losses associated with remuneration set in excess of market rates will be avoided through the regular application of comparisons against independent third party data;
- Remuneration is aligned to the long term success of the Bank – performance related components of remuneration will be aligned to risk adjusted financial measures which reflect achievement of the Bank's longer term business plan;
- Proportion of variable pay is appropriate, predominantly cash based and may be deferred – where a significant proportion of remuneration is variable, it will be designed to reward longer term success. The ratio of fixed to variable remuneration will differ depending on the specific incentive schemes in operation across the business, however as a general rule the Bank seeks to ensure that the majority of an individual's remuneration is fixed;
- No reward for poor performance - the performance management framework focuses on objective measurement of outputs along with behavioural measures which assess the way in which work is done.

16.2. Decision-making process for determining remuneration policy

In line with regulatory guidance, remuneration is overseen by the Remuneration Committee ('the Committee') of the parent company's Board of Directors. The Committee is responsible for:

- Reviewing the appropriateness and relevance of the remuneration policy;
- Determining and reviewing regularly the policy, terms, objectives and content of the Executive Directors' service contracts;
- Approving the design of and determining targets for any performance-related pay schemes applying to the Executive Directors;
- Determining the policy and scope of pension arrangements for the Executive Directors;
- Reviewing and approving the introduction of any new incentive arrangement across any part of the organisation;
- Overseeing any major changes to the Bank's employee benefits structures;
- Overseeing remuneration policy throughout the Bank, noting the risks posed by remuneration policies; and
- Overseeing the annual pay review budget.

The Committee's terms of reference were last reviewed and updated in November 2015.

16.3. Remuneration policy for Code Staff

The objective of the remuneration policy is to ensure that appropriate incentives are awarded for individual contributions to the success of the Bank and encourage enhanced performance. The policy in relation to the various elements of remuneration structures for Executive Directors and other Code Staff is set out below.

16.3.1. Basic salary

The basic salary of the Executive Directors and other members of the senior leadership team (as for all employees) is determined by taking into account the responsibilities and experience of the individual director and having regard to relevant market comparisons. Progression is reflected through the annual salary and personal review processes.

16.3.2. Variable pay

In 2015, the Executive Directors and other Code Staff participated in a non-pensionable performance incentive scheme, the metrics of which reflected the Bank's key objectives. These elements were all set to provide challenging objectives, giving the Executive Directors an incentive to perform at the highest level.

16.3.3. Benefits

Each Executive Director is provided with benefits which comprise a car allowance, pension arrangements, private medical insurance, critical illness cover, life assurance and Bank income protection insurance. The Executive Directors are invited to participate in the Bank's pension plan. Other Code Staff have similar cash, pension, life assurance and private medical insurance arrangements.

16.3.4. Link between pay and performance

Performance-based remuneration is awarded by the Remuneration Committee in a manner which promotes sound risk management (within the Bank's stated risk appetite and ICAAP measures) and does not induce excessive risk-taking.

The Bank's remuneration policy focuses on ensuring sound and effective risk management through:

- A stringent governance structure for setting goals and communicating these to employees;
- Performance assessment metrics for Executive Directors and other Code Staff are reviewed and agreed by the Chief Risk Officer and include both financial and non-financial goals; and
- Making all variable remuneration awards at the discretion of the Remuneration Committee and subject to individual, business unit, overall Bank performance, stated risk appetite and ICAAP measures.

In practice all remuneration decisions would be approved by the CEO and the relevant HR Business Partner before implementation and as part of this would also be reviewed from a risk perspective. For Code Staff the remuneration decisions are reviewed and approved by the Committee.

16.3.5. Design and structure of remuneration

There are three main elements of remuneration available to Code Staff:

- Basic salary;
- Variable awards (made under the performance incentive scheme); and
- Benefits (car allowance, pension and insurance).

All the current Executive Directors have entered into contracts that can be terminated after the relevant notice period has been served or by the payment by the Bank of an amount equivalent to the remuneration payable during such notice period. Service contracts for other Code Staff have notice periods which vary depending on the particular role.

Non-Executive Directors are appointed by letter for an initial term of three years and will generally be expected to serve a second three year term.

The variable incentive scheme is operated in a manner which promotes sound risk management (within the Bank's stated risk appetite and ICAAP measures) and does not induce excessive risk-taking. This is done by ensuring:

- An appropriate balance between fixed and performance-based components;
- Awards are made by assessing both individual performance against KPIs and underlying Bank performance (using an appropriate combination of financial & non-financial metrics). Individuals performance within control functions are assessed against the achievement of objectives linked to their functions which are independent of the financial performance of the business area that the individual controls;
- The outcomes are also moderated by the extent to which personal objectives had been achieved and based on any input from the FS Exco with regards to any adjustments required for risk; and
- The awarding of performance-based remuneration for Executive Directors and other Code Staff is at the full discretion of the Committee.

16.4. Salary and fees

All Code Staff, other than Non-Executive Directors, receive a basic salary that reflects the risks and responsibilities attached to each specific role. Salaries are reviewed by the Remuneration Committee on an annual basis with consideration given to external market data for similar roles in the financial services sector. Other factors considered by the Remuneration Committee include the individual's skills, experience and performance.

Non-Executive Directors receive fees for their services. Fees are reviewed and approved by the Nomination Committee on an annual basis with consideration given to the level of fees at comparable organisations.

16.5. Variable awards

The Bank makes only one type of variable award scheme available to Code Staff – a Performance incentive scheme**.** In 2015, the Executive Directors and other Code Staff participated in a non-pensionable performance incentive scheme, the metrics of which reflected the Bank's key objectives.

When considering the performance of the Bank and participants the Committee will assess progress against a number of key financial and operational drivers including:

- Profit before tax;
- Return on assets / return on equity;
- Cost/income ratio;
- Stated risk appetite;
- ICAAP measures;
- Progress in the Bank's focus areas; and
- Compliance with internal business procedures.

The performance of individuals within control functions is assessed independently of the financial performance of the business area that the individual controls.

These measures were all set to provide challenging objectives that are aligned with the Bank's strategy, giving the Executive Directors an incentive to perform at the highest level. The financial outcomes were also moderated by the extent to which personal objectives had been achieved.

Where individual KPIs are achieved but the underlying performance of the Bank is unsatisfactory, annual performance-based payments may be reduced in part or withheld altogether at the Committee's discretion.

Payment of performance-based remuneration will be subject to any deferral requirements as required by the Committee at their discretion.

16.6. Remuneration for Code Staff

The following tables display the 2015 remuneration for the Bank's Executive Directors, Non-Executive Directors, Senior Management and colleagues whose professional activities have a material impact on the risk profile of the company (together, Code Staff).

During the year, Code Staff received total remuneration as shown in the table below:

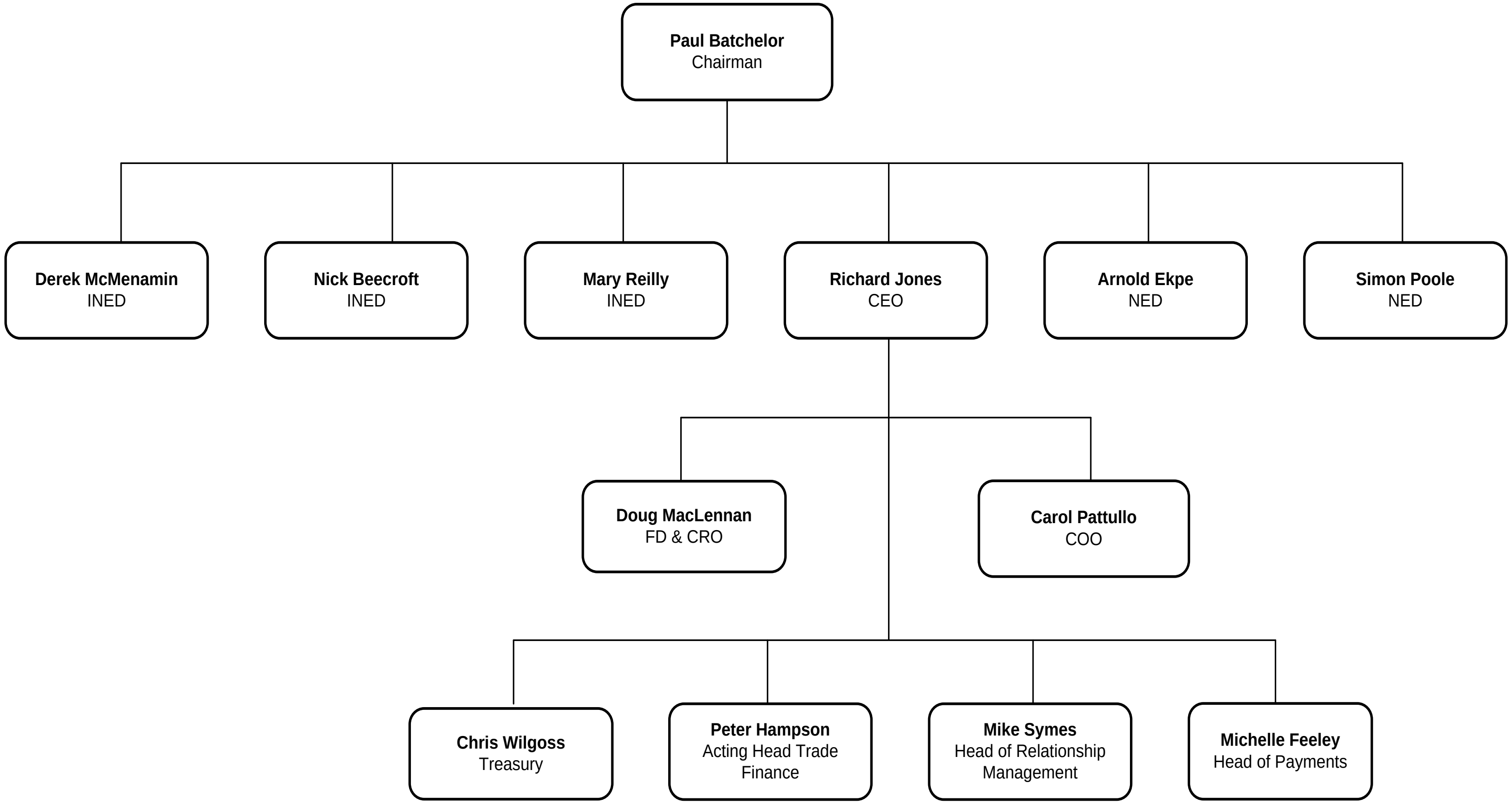
Remuneration by band Remuneration band (Euros)	**Number of Code Staff**
Less than 1 million	13

16.7. Fixed and variable remuneration

The table below shows the total fixed and variable remuneration awarded to Code Staff in 2015 and the number of beneficiaries.

Fixed and variable remuneration to Code Staff	**Senior management £'000**	**Other Code Staff £'000**	**Total £'000**
Total fixed remuneration	658	111	769
Cash awards under performance incentive scheme	74	-	74
Total remuneration	732	111	843
Number of Code Staff	10	3	13

Senior Management Structure Chart - April 2016 Appendix A



Group Structure Chart April 2016 Appendix B