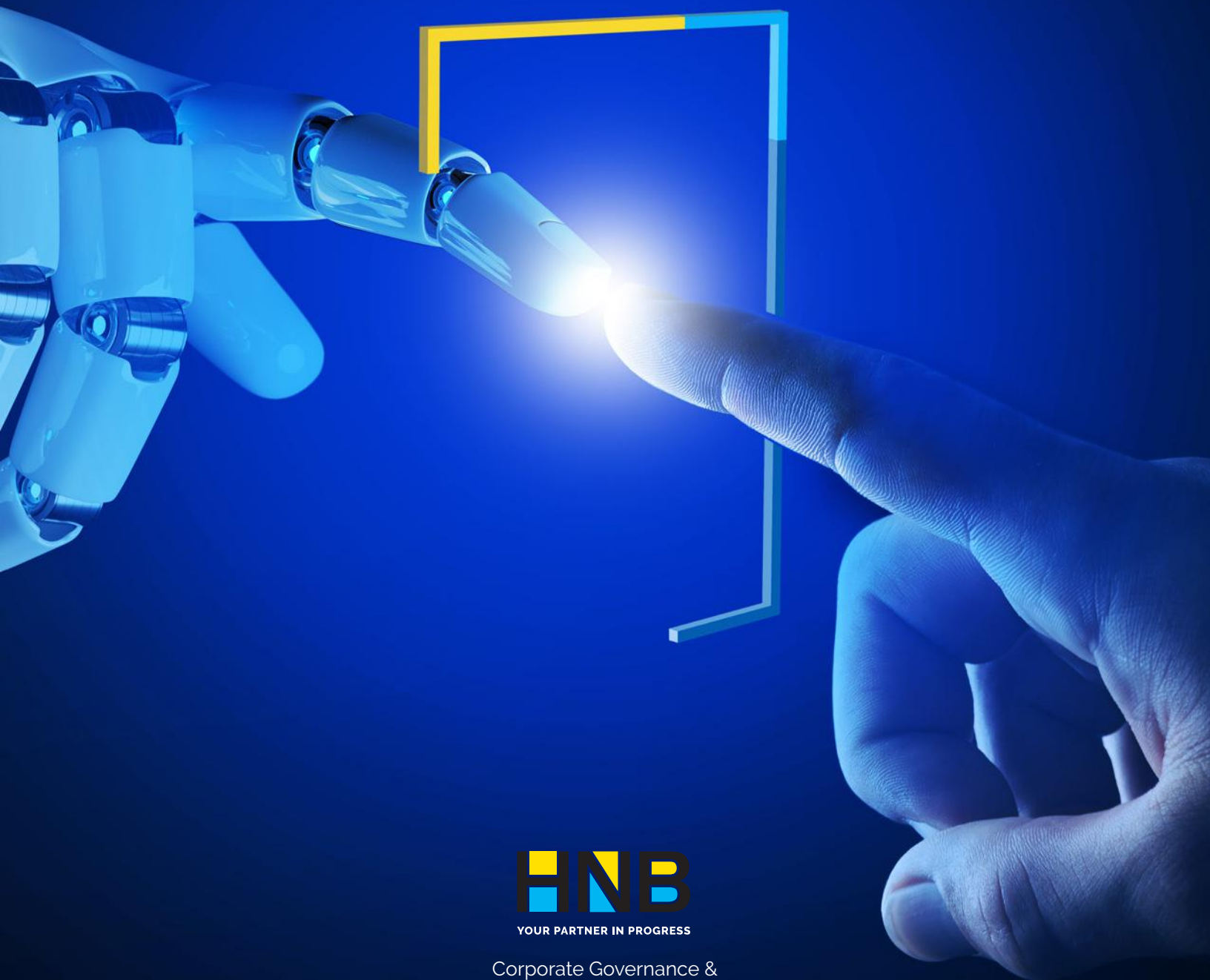


# SECURING THE FUTURE



YOUR PARTNER IN PROGRESS

Corporate Governance &  
Risk Management Report 2019



# ABOUT OUR REPORT

This is our seventh Annual Report prepared in line with the Guiding Principles and Content Elements of the International <IR> Framework and the 13th report referencing GRI standards for bringing out non-financial performance. It comprises two key components as follows:

## Corporate Governance and Risk Review Report

Intended for providers of financial capital and regulators who require deeper insights in to the Bank's approach to managing risk and financial capital.

### Frameworks Applied

- Code of Best Practice on Corporate Governance issued by the Institute of Chartered Accountants of Sri Lanka
- Banking Act Direction No.11 of 2007 and subsequent amendments thereto
- Directions issued by Central Bank of Sri Lanka on Risk Management including the Basle Capital Accord (II)
- Baseline Security Standards
- Sri Lanka Financial Reporting Standards issued by the Institute of Chartered Accountants of Sri Lanka
- Companies Act No.7 of 2007
- PCIDSS – Payment card Industry Data Security Standards

Assurance has been provided by Ernst & Young to Central Bank of Sri Lanka on Compliance with the Banking Act Direction No.11 of 2007 and subsequent amendments.

## Integrated Annual Report 2019

Primarily for providers of financial capital, this report will also be of interest to other stakeholders as it summarises information on all material issues impacting our performance, reflecting our efforts to entrench integrated thinking.

### Frameworks Applied

- Companies Act No.7 of 2007
- Sri Lanka Financial Reporting Standards issued by the Institute of Chartered Accountants of Sri Lanka
- <IR> Framework issued by the International Integrated Reporting Council
- GRI Standards
- Communicating Sustainability issued by the Colombo Stock Exchange

Assurance has been provided by Ernst & Young on the Financial Statements including the Notes to the Accounts.

DNV-GL has provided assurance that the report is in line with the <IR> Framework.

## Scope & Boundaries

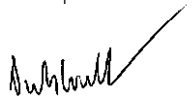
Financial information is presented in accordance with regulatory requirements and present a view of both the Bank and the Group including all subsidiaries. Non-financial information presented within the report, unless explicitly stated, refers to information relating only to the Bank and excludes the subsidiaries as the Bank accounts for over 80% of Total Operating Income, PAT, Total Assets & Total Liabilities.

	2019 Rs Bn	Bank %	2018 Rs Bn	Bank %
Total Operating Income	76.5	78%	75.1	81%
PAT	15.0	93%	19.1	81%
Total Assets	1,196.4	94%	1,148.6	95%
Total Liabilities	1,045.9	95%	1,011.3	96%

Management of the Hatton National Bank PLC have reviewed and approved the relevant content of all reports and recommended the report to the Group's Board Audit Committee and Board for their approval as per delegation of authority.

The Board Acknowledges its responsibility to ensure that the Annual Integrated Report provides a balanced view of its performance in 2019 and is of the opinion that it addresses all material issues that it believes may have a bearing on the Group's capacity to create value over the short term.

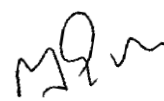
The reports were unanimously approved by the Board on 20th February 2020 and is signed on its behalf by



Dinesh Weerakkody  
Chairman



Asoka Pieris  
Chairman  
Board Audit Committee



Jonathan Alles  
Managing Director/CEO

Colombo, Sri Lanka  
20th February 2020

# CONTENTS

About Our Report	1
Contents	2
Message from Chairman	3
Corporate Governance Report	4
Risk & Capital Review	41
Market Discipline – Disclosure Requirements Under Pillar III	81

# MESSAGE FROM CHAIRMAN



*"We have a responsibility not simply to meet regulatory requirements, but to act in accordance with our stated values in creating sustainable shared value."*

It gives me pleasure to present the 2019 Corporate Governance Report on behalf of the HNB Board. This report provides us an opportunity to account for the work of the Board during 2019 and describe the Bank's robust Corporate Governance and practices applied.

## **Commitment to Governance, Ethics and Integrity**

HNB is committed to the highest standards of governance, integrity and ethics. The Board believes sound governance is fundamental to driving sustainable growth, where both robust practices and a strong culture nurtured on the Bank's values underpin the delivery of its vision and strategy.

The Board seeks to set the tone from the top, leading by example and embracing globally accepted best practices that promote transparency, fairness and accountability. We believe governance is as much about how we do things, as what we do.

## **Board Responsibility**

The Board assumes collective responsibility for strategy, policy, performance, oversight and accountability and has set in place a governance framework and structure appropriate to the Bank's size, nature, complexity and risk profile. It is reviewed when necessary, to adapt to internal developments, regulatory requirements, the business environment including technological advancements and international best practice. The Board acknowledges a well-governed company draws the confidence of stakeholders.

## **Delivering Stakeholder Value**

Stakeholder engagement has evolved as the role of corporations in society has changed over time. Increased focus on Environmental, Social and Governance (ESG) considerations has led a shift away from shareholder primacy to a balanced commitment to all shareholders and stakeholders for a sustainable future.

HNB is committed to understanding and being responsive to the interests and expectations of all stakeholders in delivering sustainable shared value. The feedback obtained from our stakeholder engagement mechanisms forms a key input in strategy formulation, boosting competitiveness through innovation and the creation of new products and markets. It also ensures the Bank's growth is responsible and sustainable. We believe it is the nature and quality of our relationships that sets us apart, driving the continued success of our business and the development of our brand.

## **Technology Governance and Security**

Our digital transformation continues to present new and exciting opportunities, as a platform for business and a source of competitive advantage. Yet, recent ATM and online global data breaches have raised stakeholder concerns over industry security and user privacy safeguards in place.

HNB is committed to protecting its customers and invests extensively in the security of our information and cyber risk management systems. Effectiveness of the systems are regularly reviewed at Board Meetings and through the BIRMC and BAC. Maintaining stakeholder trust and confidence in the Bank and safeguarding its reputation, is of critical concern to the Board.

## **2019 Highlights**

During the year, the Bank continued to operate in an increasingly challenging environment characterised by continued political instability, heightened financial market volatility, external vulnerabilities and sluggish economic growth. Conscious of our fiduciary and statutory duties, the Board, together with Corporate Management, spent a considerable amount of time reviewing the impact of these factors on the Bank and its stakeholders, averting risks while seizing opportunities. Deteriorating asset quality prompted the Board to appoint a Board Recoveries Sub-Committee, to give oversight to the effective monitoring, management and

recovery of overdue loans in improving the Bank's financial metrics. The Board satisfies itself that all decisions taken are fair, ethical and underpinned by the Bank's values and are in the best interests of both the Bank and its stakeholders.

The Board continues to support the management in the transformation journey, as the Bank transforms and innovates to serve customers and employees better. Governance structures, policies and processes were reviewed and benchmarked to ensure compliance with statutory and regulatory requirements and that they satisfied the evolving needs of the Bank. A new branch operating model was launched during the year, to enhance the Bank's flexibility and speed in responding to customer needs while improving effectiveness of credit management. The 2019 Board appraisal was completed during the year and recommendations for improvement considered. Director training focused on building the Board's range of relevant skills and competencies while the two new Board appointments added to the Board's leadership capital.

As required by the above Code, I hereby confirm that I am not aware of any material violations if any of the provisions embodied (i) in the Board Charter, by the Board of Directors of the Bank; or (ii) in the Bank's Codes of Conduct and Ethics, by any member of the Corporate Management team of Hatton National Bank PLC.

A handwritten signature in black ink, appearing to read 'Dinesh Weerakkody'. The signature is fluid and cursive, with a long, sweeping underline that extends to the right.

**Dinesh Weerakkody**  
Chairman

Colombo, Sri Lanka  
20th February 2020

# CORPORATE GOVERNANCE REPORT

## Board of Directors

### CHAIRMAN



**Dinesh Weerakkody**

- Appointed Chairman - May 2018
- Appointed Director - June 2017
- Expertise - HRM, Finance and Board Leadership
- Independent Non-Executive Director



### EXECUTIVE DIRECTOR



**Jonathan Alles**

- Appointed MD/CEO - July 2013
- Appointed Director - May 2013
- Expertise - Banking and Finance



### INDEPENDENT NON-EXECUTIVE DIRECTORS



**Rohan Karunaratne (Dr)**

- Appointed - October 2011
- Expertise - Engineering



**Palitha Pelpola**

- Appointed - April 2015
- Expertise - Public Sector Leadership and Communication



**Duliksha Soosaipillai**

- Appointed - April 2015
- Expertise - Finance, Enterprise Risk, Corporate Governance



**Nilanth de Silva**

- Appointed - April 2015
- Expertise - Banking



**Madu Ratnayake**

- Appointed - October 2018
- Expertise - Information Technology



**Asoka Pieris**

- Appointed - April 2019
- Expertise - Accounting and Finance



**Harsha Cabraal (Dr)**

- Appointed - September 2019
- Expertise - Legal



### NON-EXECUTIVE DIRECTORS



**Rusi Captain**

- Appointed - April 2012
- Expertise - Strategy and Leadership



**Amal Cabraal**

- Appointed - April 2014
- Expertise - Management and Marketing



**Damien Fernando**

- Appointed - October 2018
- Expertise - Management & Finance



**Prawira Saldin**

- Appointed - July 2018
- Expertise - Management & Finance (Alternate Director to Mr Rusi Captain)



**Prasad Samarasinghe (Dr)**

- Appointed - July 2019
- Expertise - Information Technology/ Telecommunication (Alternate Director to Mr Damien Fernando)

- |       |   |      |   |
|-------|---|------|---|
| BAC   | Board Audit Committee                       | BCC  | Board Credit Committee                  |
| BIRMC | Board Integrated Risk Management Committee  | SIRC | Strategy & Investment Review Committee  |
| NC    | Nomination Committee                        | PADC | Procurement & Assets Disposal Committee |
| HRRC  | HR & Remuneration Committee                 | BRC  | Board Recoveries Committee              |
| RPTRC | Related Party Transactions Review Committee | C    | Chairman                                |

## Board Composition

*Well balanced in knowledge, skills, experience, diversity and independence to make a meaningful contribution to the management of the Bank.*

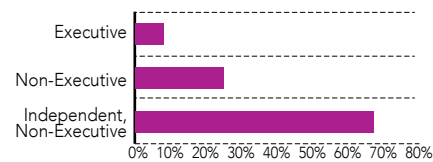
### BOARD SIZE



Appropriate Board size promoting accountability and encouraging healthy, constructive debate and decision-making, while meeting regulatory requirements.

### INDEPENDENCE

Comprises 92% of Non-Executive Directors, the majority of whom are independent.



Non-Executive Directors are independent

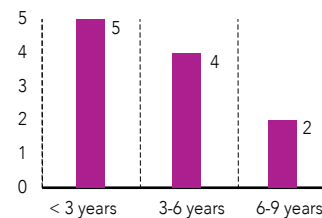
### DIVERSITY OF EXPERTISE

Experienced Board with an appropriate balance of knowledge and skills in areas relevant to the Bank.



### DIVERSITY OF NON-EXECUTIVE TENURE

Sound balance between continuity, new expertise and insights.



Average Tenure  
**4 Years**

### AGE DIVERSITY

Well represented, balancing experience and perspectives.

Average Age  
**58 Years**



### GENDER DIVERSITY



100% 0%

Subsequent to the resignation of Ms Rose Cooray during the year, gender representation on the Board is nil. A female Director will be appointed in the future on identification of a suitable candidate fitting the required Board profile and skills gap.

## CORPORATE GOVERNANCE REPORT

### Our Approach to Corporate Governance

The HNB Board is committed to ensuring the Bank pursues its strategic goals in accordance with sound Corporate Governance principles, safeguarding its reputation, values and assets while balancing stakeholder interests. At HNB, governance is not simply a matter of compliance. Rather, it is a strong commitment to ethical and effective leadership in the creation of sustained value for all stakeholders. Governance is integrated into who we are, the way we think and the way we operate. It is the golden thread that binds all the strategic pillars of our value creation story together, ensuring we make choices aligned with our values and corporate objectives.

Our governance framework ensures the right people, make the right choices, in the right way, while being accountable for their actions. The Board leads by example, consistently demonstrating the Bank's values, and governing in a manner that embeds ethics throughout the organisation, so as to ensure that leadership is effective and that the Bank acts as a responsible corporate citizen.

### BOARD GOVERNANCE HIGHLIGHTS 2019

- Mandated the Board Recoveries Sub-Committee to give oversight to the recoveries function of the Bank
- Appointed two new Directors broadening the Board's financial and legal expertise
- Approved a new branch operating model aimed at enhancing customer centricity and effective credit management
- Gave oversight to the ongoing digital transformation of the Bank
- Continued to monitor and review the Bank's technology and information system security
- Monitored and reviewed the implementation of the strategic plan, satisfying itself of the integration of Environment, Social and Governance (ESG) considerations into value creation
- Gave oversight to culture transformation initiated during the year, aligned to the new corporate values and based on the ethical foundations of the Bank
- Held the first Non-Executive Director forum to discuss the affairs and the future of the Bank.



Sustainable Growth



Superior Customer Service



Smart Technology & Processes



Engaged People



## Our Governance Framework

Our governance framework is underpinned by a fit for purpose organisation structure, comprehensive policy framework, distinct reporting mechanisms, sound internal controls, robust risk management processes and an ethical work culture designed to facilitate transparency, accountability and measurement & management of performance. These elements are regularly reviewed to align to the Bank's strategy, regulatory requirements, evolving business environment, technology advancements and international best practice.

The Board remains committed to the principles of the Banking Direction No.11 of 2007 on Corporate Governance and the Code of Best Practice on Corporate Governance issued by the Institute of Chartered Accountants of Sri Lanka in 2017

and ensures that its recommendations are materially entrenched into the Board's internal controls, policies, terms of reference and overall procedures and processes. Details of compliance are set out on CG&RR pages 26 to 40. The External Auditors, Messrs. Ernst and Young, have performed procedures set out in Sri Lanka Standards on Related Service 4400 (SLSRS 4400) issued by Institute of Chartered Accountants of Sri Lanka to meet the compliance requirement of the Corporate Governance directive.

## CORPORATE GOVERNANCE

### EFFECTIVE AND ETHICAL LEADERSHIP



#### Right People

- Governance Structure
- The Board
  - Board Composition
  - Board Invigoration
  - Chairman
  - MD/CEO
  - Company Secretary
- Board Sub-Committees
- Executive Management
- Succession Planning



#### Right Choices

- Comprehensive Policy Framework
- Balancing Stakeholder Interest
- Focus on Environment, Social and Governance (ESG) Considerations
- Informed Decision Making
- Gender Parity
- Innovation Governance



#### Right Way

- Values and Culture
- Code of Conduct & Ethics
- Compliance
- Balance of Power
- Independent Judgement
- Board Meetings
- Conflict of Interest
- Whistle-blowing
- Fair and Responsible Remuneration



#### Accountability

- Reporting and Disclosure
- The Annual General Meeting (AGM)
- Risk Management and Internal Controls
- Technology Governance and Security
- Board Appraisal
- Governance of Group Companies
- Communication
- Business Continuity Planning

# CORPORATE GOVERNANCE REPORT



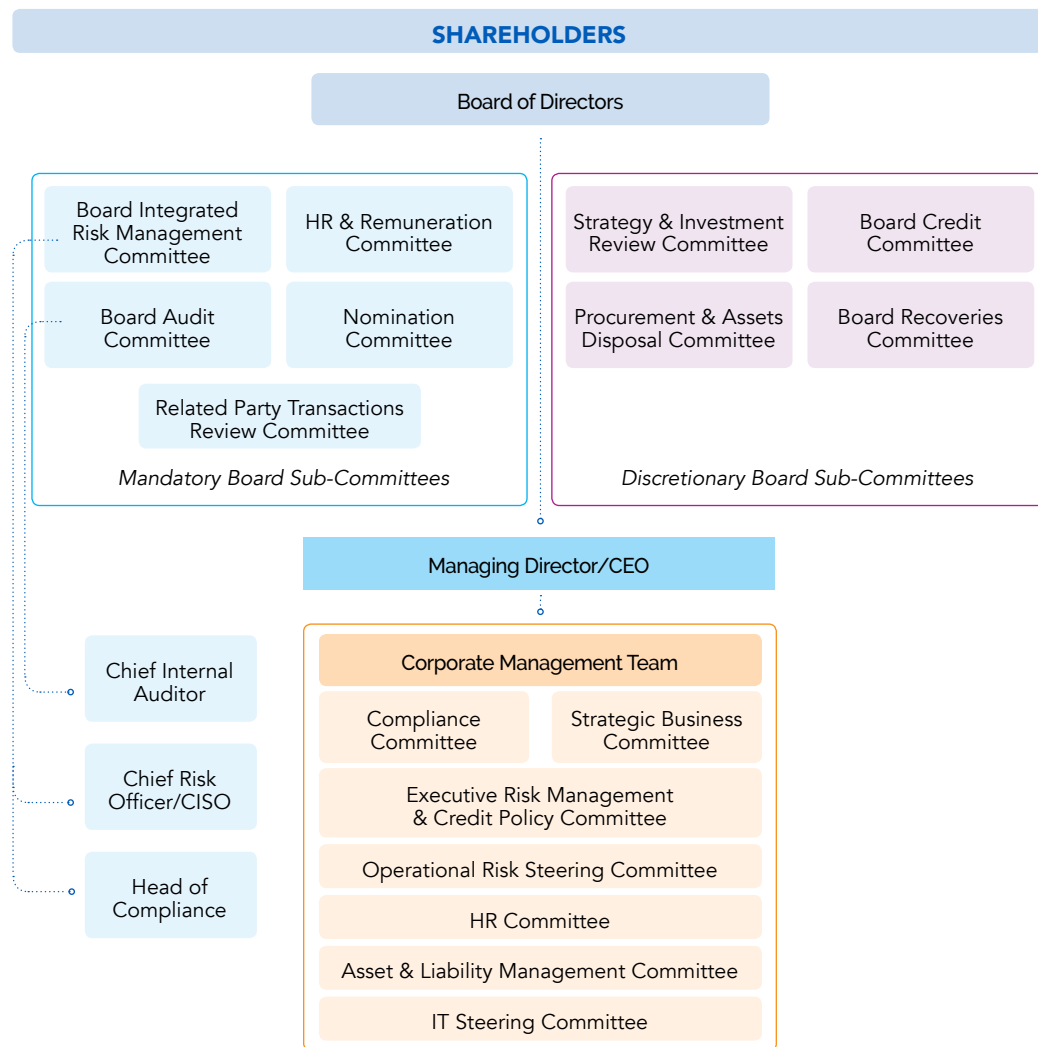
## Right People

- Governance Structure
- The Board
- Board Sub-Committees
- Executive Management
- Succession Planning

Operating in a fast-paced environment, HNB is cognisant of the need to remain agile to be able to capitalise on business opportunities and respond to market threats. Timely, informed decisions are critical to initiate change and maintain a competitive edge. The HNB organisation structure seeks to drive efficacy in governance by facilitating decisions to be taken at the right level of business by the people best placed to take them.

At HNB, roles and responsibilities are clearly defined by mandates and job descriptions, and by which means authority is delegated and accountability established. Key Management Personnel (KMP) are empowered to take decisions within the defined framework and have access to resources to implement their decisions. KMP are competent and have the requisite skills knowledge and experience to carry out their duties. Strategically aligned Key Performance Indicators (KPI) drive performance and the achievement of objectives.

### Governance Structure



The HNB Board provides direction and leadership to the Bank and holds ultimate responsibility for the overall governance, performance, strategy and affairs of the Bank. The Board has delegated functions warranting greater attention, to nine (9) Board Sub-Committees while daily management of the Bank and implementation of the Bank's strategic plan has been delegated to the

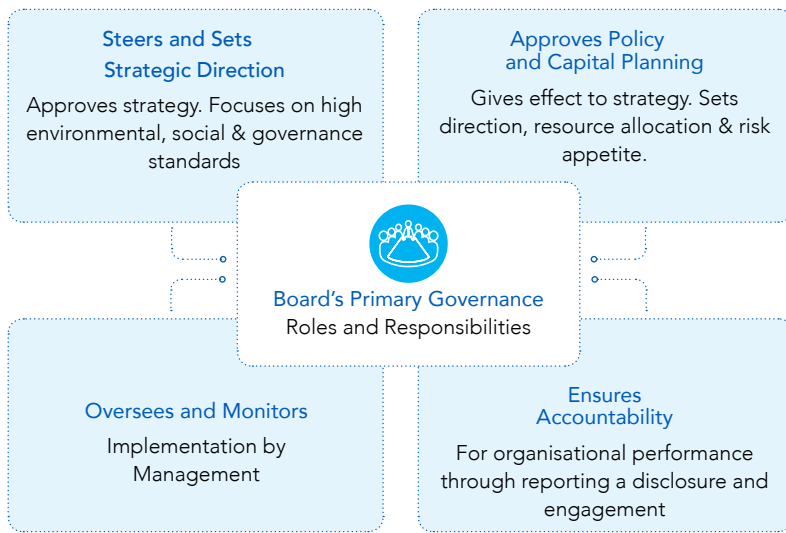
Executive Management lead by the MD/CEO. Regular reporting on key matters enables effective oversight by the Board.

During the year, two (2) management Sub-Committees namely, Compliance and Strategic Business; were created to enable greater focus and drive in implementing the strategic plan and expediting business

outcomes. The branch operating model was also revamped to introduce separate verticals for sales sourcing and operations facilitating faster credit decisions and better Non-Performing Assets (NPA) control. It involved revising job descriptions and training and empowering officers with the skills and knowledge required to engage in their new, specialised roles.

## The Board

Board roles and responsibilities are mandated in the Board Charter.



## Board Composition

The Board is diverse and well balanced as reflected on CG&RR page 5. to effectively discharge its governance roles and responsibilities. Non-Executive Directors are eminent professionals in their respective fields. The sole Executive Director is the MD/CEO who is an experienced banker. Sixty seven percent (67%) of Board Members are Independent Non-Executive Directors, who bring varied perspectives to Board deliberations and constructively challenge management. Directors are deemed independent based on the criteria specified in the Banking Act Direction No.11 of 2007. All Directors submit annual declarations to this effect which are evaluated to ensure compliance with the criteria. Directors possess financial acumen and knowledge gained through experience from leading large enterprises and professional backgrounds.

*"The fundamental role of the Board is to provide entrepreneurial and coherent leadership within a framework of prudent and efficient controls which enables risk to be assessed and managed."*

Board Charter

## KEY RESPONSIBILITIES

- Provide strategic direction
- Monitor implementation of strategy
- Set corporate values and promote ethical behaviours
- Determine Bank's risk appetite and establish systems of risk management, internal control and compliance
- Be responsive to the needs of society with focus on environmental, social and ethical standards
- Meet shareholders, employees and other stakeholders' obligations, balancing their interests in a fair manner
- Present a balanced and understandable assessment of the Bank's position and prospects
- Safeguard assets and ensure legitimate use
- Assess effectiveness of the Board and Sub-Committees through self-evaluation
- Ensure succession planning and the continued ability of the Bank to operate without any disruption

(Summarised extract of the Board Charter)



**67%**

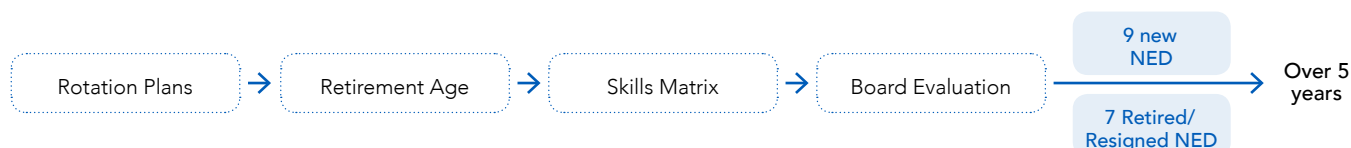
**Independent, Non-Executive Directors**

## CORPORATE GOVERNANCE REPORT

**Board Invigoration**

The Board is refreshed periodically through new appointments, rotation/re-election and retirement of Non- Executive Directors.

Board refreshment ensures the introduction of Members with new expertise and perspectives, while maintaining continuity. New appointments to the Board over the recent years sought to broaden the Board's expertise in technical, finance, legal and IT. The Board is equipped to support the Bank's business transformation, through effective strategic counsel for market relevance, innovation and digitisation.

**New Appointments**

The HNB Board Nomination Committee (NC) regularly reviews the combined knowledge, experience and diversity of the Board in relation to the Bank's strategic plans and any gaps thereof.

Potential appointees with the required attributes are identified, short listed and subsequently recommended to Board for approval by the Nomination Committee (NC), following a formal and transparent process. The candidate's other Directorships and commitments are also considered to ensure sufficient time to discharge their roles and responsibilities. On approval, names are referred to the Central Bank of Sri Lanka for approval as a "fit and proper" person, prior to appointment.

Appointments are communicated to the CSE and shareholders through press releases together with a brief resume of the Director disclosing relevant expertise, key appointments, shareholding and whether he is independent.

**Re-election/Re-appointment**

The Articles of Association of the Bank require 1/3 of the Non-Executive Directors to retire from office and stand for re-election by the shareholders at the subsequent Annual General Meeting, subject to completing three (3) years in office from his/her last date of re-election. This allows for the introduction of Members with new skills, insights and perspectives, while retaining valuable industry knowledge and maintaining continuity. The Nomination Committee (NC) assesses each Director for their interests, independence and active engagement, prior to recommendation to the Board for re-election. No Director has served on the Board for more than three (3) years from date of last appointment, without being subject to re-election/re-appointment at an AGM of the Bank, except Mr Amal Cabraal.

The name of the Director standing for re-election is circulated to shareholders together with the notice of AGM.

**Retirement/Resignation & Director Tenure**

Director tenure is limited to a maximum term of nine (9) years and an age limit of up to seventy (70) years, whichever comes first in line with the provisions of the Banking Act Direction No.11 of 2007.

Resignations or removal, if any, of Directors and the reasons are promptly informed to the regulatory authorities and shareholders as per CSE requirements together with a statement confirming whether or not there are any matters that need to be brought to the attention of shareholders.

Appointment	Retirement	Resignation	Alternate Director	Re-election/Re-appointment
Appointments of Mr Asoka Pieris and Dr Harsha Cabraal as Independent Non-Executive Directors (INED)	Retirement of Ms Rose Cooray (NED)	Resignation of Mr Sujeewa Mudalige (INED)	Appointment of Dr Prasad Samarasinghe as alternate Director to Mr Damien Fernando (NED)	Mr Amal Cabraal, Mr Asoka Pieris and Dr Harsha Cabraal will offer themselves for re-election at the AGM to be held on 30th March 2020

## Board Focus Areas 2019

### BOARD FOCUS AREAS 2019



#### Strategy & Business

- Review and approval of policy, key metrics and structural changes supporting implementation of Strategic Plan
- Approval of significant investments
- Digitisation and upgrade of IT systems supporting digital transformation strategy
- Approval of 2020 budget
- Oversight of implementation of Project Everest



#### Risk & Oversight

- Performance review of the Bank
- Approval and oversight of the Bank's Risk envelope
- Approval of Financial Statements and Annual Report
- Compliance review
- Review of impacts from operating environment
- Review of loan recoveries/NPL
- Review of Cyber Security Risk



#### Governance

- Director Appointments/Rotation/Resignations
- Mandated new Board Sub-Committees on Recoveries and Digital Banking
- Board appraisal and action plan to implement recommendations
- Review of policy frameworks
- Succession planning
- Board training



#### Stakeholder Engagement

- Review of shareholder communications and Annual General Meeting
- Review of feedback from investor forums and quarterly analyst calls
- Review of regulatory reviews
- Engagement with CBSL



#### Financial Performance

- 2019 budget
- Financial impact from adverse market conditions
- HNB's solvency, liquidity and going concern status and proposed dividend payments
- Financial impact of regulatory changes on capital requirements
- Financial impact of changes in operational costs

## Key Leadership Roles and Responsibilities

### Chairman

#### Role

Leads the Board, preserving good Corporate Governance and ensuring that it works effectively, acting in the best interest of the Bank at all times.

#### Responsibilities

- Ensuring Board's effectiveness, setting its agenda and chairing its meetings;
- Ensuring the provision of accurate, timely and clear information to Directors;
- Ensuring that all Board members understand the information provided and discussed;
- Ensuring implementation of Board decisions;
- Ensuring effective communications with shareholders;
- Facilitating coordination between Board Committees, especially between the Audit, Risk and Remuneration Committees;
- Arranging the regular evaluation of the performance of the Board, its Committees, and the individual Directors including the Chief Executive Officer;
- Ensuring the Chief Risk Officer, the Head of Compliance and the Chief Internal Auditor have a direct access to the Board;
- Facilitating the effective contribution of Directors and ensuring constructive relations between Executive and Non-Executive Directors;
- Ensuring that a comprehensive induction program is provided for new Directors;
- Addressing the development needs of individual Directors and the Board as a whole, in enhancing Boardroom capital.

### Managing Director/Chief Executive Officer

#### Role

Accountable to the Board for exercise of authorities delegated and for the performance of the Bank.

#### Responsibilities

- Ensuring proper succession planning of the Executive Team and assessing their performance;
- Developing the Bank's strategy for consideration and approval by the Board;
- Developing and recommending budgets to the Board to support the Bank's strategy;
- Monitoring and reporting to Board the performance and compliance with regulatory and policy framework;
- Establishing an appropriate organisational structure for the Bank;
- Setting the tone for ethical leadership and creating an ethical environment;
- Ensuring a culture that is based on the Bank's values;
- Ensuring that the Bank operates within the Board's stated risk appetite.

## CORPORATE GOVERNANCE REPORT

## Company Secretary

The Company Secretary guides the Board on discharging its duties and responsibilities, promoting best practices in Corporate Governance. Her responsibilities include;

- Ensuring the conduct of Board and General Meetings in accordance with the Articles of Association and relevant legislation.
- Maintaining statutory registers and the minutes of Board Meetings.
- Prompt communication to regulators and shareholders.
- Filing statutory returns and facilitating access to legal advice in consultation with the Board, where necessary.

All Directors have access to the services of the Company Secretary, Ms Thushari Ranaweera, Attorney-at-Law. Appointment and removal of the Company Secretary is a matter for the Board.

## Board Sub-Committees

The Board has delegated certain responsibilities requiring greater attention to nine (9) Board Sub-Committees with oversight responsibility for same. This enables the Board to allocate sufficient time to matters within its scope, particularly execution of strategy and forward-looking agenda items, while ensuring delegated matters receive in-depth focus. Committees consist largely of Independent Non-Executive Directors. The Committee Chairmen are accountable for the effective functioning of the Committees and report regularly to the Board on Committee activities,

highlighting matters for Board attention. Committee mandates are reviewed regularly.

The roles, responsibilities and composition of Board Committees are set out on CG&RR pages 12 to 13, and the Board is satisfied that the Committees effectively discharged their duties during the year under review. Reports of the five (5) Committees constituted under regulatory requirements are given on IR pages 107 to 119 of this Annual Report.

An increase in Non-Performing Assets due to prevailing adverse market conditions

prompted the Board to take proactive action and mandate a Board Recoveries Sub-Committee in April 2019, to provide oversight to the portfolio recoveries function of the Bank in realising the desired outcomes set by the Board. Led by Mr Damien Fernando (Non-Executive Director) as Chairman. The COO, business line heads and other KMP engaged in loan recoveries attend the Meeting by invitation. Aggressive monitoring and oversight by the Committee has contributed towards the Bank containing its NPA ratio, despite the industry experiencing further deterioration.

## Board Sub-Committees &amp; Areas of Oversight as at 31st December 2019

	Composition of Directors	Areas of Oversight	Report Reference
Mandatory Committees	<b>Board Audit Committee (BAC)</b> <ul style="list-style-type: none"> <li>• Mr Asoka Pieris - Chairman</li> <li>• Dr Rohan Karunaratne</li> <li>• Mr Nilanth de Silva</li> <li>• Mr Rusi Captain</li> <li>• Mr Damien Fernando</li> </ul>	<ul style="list-style-type: none"> <li>• Integrity of financial reporting and disclosures</li> <li>• Internal controls and internal audit</li> <li>• External audit</li> <li>• Compliance</li> </ul>	IR Pages 115 to 117
	<b>Board Integrated Risk Management Committee (BIRMC)</b> <ul style="list-style-type: none"> <li>• Mr Duliksha Soosaipillai - Chairman</li> <li>• Mr Jonathan Alles</li> <li>• Mr Madu Ratnayake</li> <li>• Mr Rusi Captain</li> </ul>	<ul style="list-style-type: none"> <li>• Comprehensive Risk Management Framework</li> <li>• Risk measurement, monitoring and management</li> <li>• Compliance with regulatory and internal prudential requirements</li> <li>• Review Basel III implementation</li> </ul>	IR Pages 111 to 114
	<b>Nomination Committee (NC)</b> <ul style="list-style-type: none"> <li>• Mr Dinesh Weerakkody - Chairman</li> <li>• Mr Rusi Captain</li> <li>• Mr Palitha Pelpola</li> </ul>	<ul style="list-style-type: none"> <li>• Selection and appointment of Directors, MD/CEO and Key Management Personnel</li> <li>• Expertise gaps, succession, and re-election</li> <li>• Board Corporate Governance</li> </ul>	IR Pages 109 to 110

	<b>Composition of Directors</b>	<b>Areas of Oversight</b>	<b>Report Reference</b>
<b>Mandatory Committees</b>	<b>HR &amp; Remuneration Committee (HRRC)</b> <ul style="list-style-type: none"> <li>Mr Dinesh Weerakkody - Chairman</li> <li>Mr Amal Cabraal</li> <li>Mr Palitha Pelpola</li> </ul>	<ul style="list-style-type: none"> <li>HR Policies including remuneration</li> <li>Organisation values and Code of Conduct</li> <li>Compliance with labour laws</li> <li>HR Systems including performance evaluation, talent management, succession</li> </ul>	IR Pages 107 to 108
	<b>Related Party Transactions Review Committee (RPTRC)</b> <ul style="list-style-type: none"> <li>Mr Nilanth de Silva - Chairman</li> <li>Mr Jonathan Alles</li> <li>Mr Palitha Pelpola</li> </ul>	<ul style="list-style-type: none"> <li>Related Party Transaction Policy</li> <li>Scrutiny of Related Party Transactions</li> <li>Market disclosures on Related Party Transactions</li> <li>Quarterly and annual disclosures of Related Party Transactions</li> <li>Avoidance of conflict of interest</li> </ul>	IR Pages 118 to 119
<b>Discretionary Committees</b>	<b>Board Credit Committee (BCC)</b> <ul style="list-style-type: none"> <li>Mr Nilanth de Silva - Chairman</li> <li>Dr Rohan Karunaratne</li> <li>Mr Amal Cabraal</li> <li>Mr Asoka Pieris</li> <li>Dr Harsha Cabraal</li> </ul>	<ul style="list-style-type: none"> <li>Credit Policy and Lending Guidelines</li> <li>Credit risk control measures including pricing of credit risk</li> <li>Performance of credit risk indicators</li> <li>Formulate and periodically review the credit policy</li> <li>Authorise credit facilities over and above the delegated limits of specified categories</li> </ul>	-
	<b>Strategy &amp; Investment Review Committee (SIRC)</b> <ul style="list-style-type: none"> <li>Mr Amal Cabraal - Chairman</li> <li>Mr Duliksha Soosaipillai</li> <li>Mr Damien Fernando</li> <li>Mr Madu Ratnayake</li> </ul>	<ul style="list-style-type: none"> <li>Review of economic climate, capital markets activity</li> <li>Economic and monetary policy direction emerging trends and their potential/impact</li> <li>Investment policy</li> <li>Review Bank's investment portfolios and their performance</li> </ul>	-
	<b>Procurement &amp; Asset Disposal Committee (PADC)</b> <ul style="list-style-type: none"> <li>Dr Rohan Karunaratne - Chairman</li> <li>Mr Duliksha Soosaipillai</li> <li>Mr Damien Fernando</li> <li>Mr Madu Ratnayake</li> </ul>	<ul style="list-style-type: none"> <li>Procurement and Disposal Policy</li> <li>Approve procurements and disposal in line with delegation</li> </ul>	-
	<b>Board Recoveries Committee (BRC)</b> <ul style="list-style-type: none"> <li>Mr Damien Fernando - Chairman</li> <li>Mr Amal Cabraal</li> <li>Mr Duliksha Soosaipillai</li> <li>Mr Nilanth de Silva</li> <li>Mr Asoka Pieris</li> <li>Dr Harsha Cabraal</li> </ul>	<ul style="list-style-type: none"> <li>Provide strategic direction for speedy recovery of defaulted facilities</li> <li>Review effectiveness of recovery initiatives deployed</li> <li>Ensure engagement of relevant stakeholders in the recovery process</li> <li>Recommend credit and recovery capability requirements to ensure effective management of NPA and Recoveries</li> </ul>	-

## CORPORATE GOVERNANCE REPORT

### Executive Management

The Board has delegated authority to the Executive Management led by the MD/CEO to manage, direct, control and coordinate the day-to-day business activities and affairs of the Bank. Delegation of authority is reviewed periodically to ensure limits are aligned to the Bank's evolving business context. The Board strives to create an effective balance between meeting the Board's oversight responsibilities and maintaining an entrepreneurial environment in which management can operate.

All functional departments are headed by competent individuals and are adequately resourced.

The Chief Internal Auditor reports directly to the BAC, while the Chief Risk Officer/CISO and the Head of Compliance report directly to the BIRMC ensuring independence of these key functions.

*"The Board would maintain a sound relationship with the Executive Management which would in turn assist the Board to develop structures, processes and practices that fit the Bank and its business needs."*

Board Charter

#### Corporate Management Team

The MD/CEO is accountable for the implementation of the Bank's strategy, and its performance and is supported by the Corporate Management Team.

The Corporate Management Team consists largely of department heads and provides counsel to the MD/CEO, acting as a sound board and ensuring overall coordination across the respective departments. The complementary skills and diverse experience of the team members strengthens the Bank's ability to deliver strategy with specific focus on the strategic value drivers.

#### Executive Committees

Several committees have been established to facilitate co-operation across departments, healthy debate on matters considered critical for the Bank's operations and decentralisation of control under delegated authority to improve efficacy in business matters. Management is open and transparent with the Board and escalates concerns to its attention in the appropriate forums and in a timely manner.

### Succession Planning

The Board is assisted by the Nomination Committee (NC) in developing succession plans for the Board to ensure the Board has a mix of skills and experience to support delivery of the Bank's strategic plan. The Nomination Committee reviews succession planning for KMP, focusing on developing employees to assume the current and future responsibilities in key positions. A list of competencies necessary for each key position is reviewed and revised annually by the Nomination Committee based on the Bank's strategic plan and existing competitive and regulatory challenges.





## Right Choices

- Comprehensive Policy Framework
- Informed Decision Making
- Balancing Stakeholder Interest
- Gender Parity
- Focus on Environment, Social and Governance (ESG) Considerations
- Innovation Governance

Today's world characterised by climate change, social media, disruptive technology and demographic shifts has exposed organisations to a new range of risks and opportunities. Boards are challenged by the complexity of problems and the decisions they need to take in the creation of value. Their judgements could have significant consequences for the organisation, stakeholders and the wider community. An outcome contrary to expectations of society could result in loss of reputation and diminution in corporate value.

The HNB Board of Directors are fully cognisant of their fiduciary responsibilities and the need to exercise duty of care that promotes the Bank's best interests. While in the past, decisions were inclined towards shareholder primacy, business judgement calls have evolved to a present need to balance stakeholder interests and follow environmental, social and governance considerations for a sustainable future. The Board approved governance framework sets in place processes and procedures to guide the Board in making the right choices, within an agreed risk appetite.

### Comprehensive Policy Framework

The Bank's strong policy framework serves as a guide to behaviour and decision making at all levels of the organisation. The framework facilitates compliance with laws and regulations while managing stakeholders' expectations and risk. Policy documents are typically modelled against international best practice, appropriate to the Bank's context.

### External Compliance Framework

#### Key Regulatory/Voluntary Requirements

- Companies Act No. 7 of 2007
- Banking Act No. 30 of 1988 (as amended) and all Directions/Guidelines issued thereunder
- Continued Listing Rules of the Colombo Stock Exchange (CSE)
- Code of Best Practice on Related Party Transactions issued by the Securities & Exchange Commission
- Foreign Exchange Act No.12 of 2017
- Securities and Exchange Commission of Sri Lanka Act No. 36 of 1987 (as amended)
- Sri Lanka Accounting and Auditing Standards Act No.15 of 1995
- Shop and Office Act, Industrial Disputes Act, Employees' Provident Fund Act, Employees' Trust Fund Act, Payment of Gratuity Act, Maternity Benefits Ordinance, etc.
- Inland Revenue Act No. 24 of 2017
- Code of Best Practice on Corporate Governance issued by the Institute of Chartered Accountants of Sri Lanka in 2017
- Integrated Reporting Framework
- Global Reporting Initiative Standards

## CORPORATE GOVERNANCE REPORT

## Bank's Policy Framework

<p><b>General</b></p> <ul style="list-style-type: none"> <li>Articles of Association</li> <li>Charters/Terms of Reference of Board, Board Sub-Committees and Management Committees</li> <li>Delegation of Authority</li> <li>Code of Conduct for Employees</li> <li>Charter for Management/Good Governance of Group Companies</li> </ul>	<p><b>Talent Management</b></p> <ul style="list-style-type: none"> <li>Talent Acquisition Policy</li> <li>Talent Development Policy</li> <li>Talent Mobility Policy</li> <li>Overseas Training Policy</li> <li>Remuneration Policy</li> <li>Succession Planning Policy</li> <li>Promotion (Executive and Non-Executive) Policy</li> <li>Travel Policy</li> <li>Work Life Balance Policy</li> </ul>	<p><b>Risk Management</b></p> <ul style="list-style-type: none"> <li>Overall Risk Management Framework</li> <li>Board Risk Appetite</li> <li>Compliance Policy</li> <li>Integrated Stress Testing Policy</li> </ul> <p><b>Credit Risk</b></p> <ul style="list-style-type: none"> <li>Credit Policy</li> <li>Credit Risk Policy</li> <li>Review of Personal Loan Policy</li> <li>Policy on Valuation of Immovable/Movable Policy</li> <li>Policy on Provisioning for Facilities</li> <li>Recovery Policy</li> <li>Memorandum Transfer/Write-off Policy</li> </ul>
<p><b>External Relations</b></p> <ul style="list-style-type: none"> <li>Customer Charter</li> <li>Corporate Communication Policy</li> <li>Related Party Policy</li> <li>Product and Delivery Channel Review Policy</li> <li>Social Media Policy</li> </ul>	<p><b>Conduct &amp; Culture</b></p> <ul style="list-style-type: none"> <li>Ethics Policy</li> <li>Anti-Bribery and Corruption Policy</li> <li>Anti-Harassment Policy</li> <li>Employee Recognition and Rewards Policy</li> <li>Employee Share Trading Policy</li> <li>Equability and Diversity Policy</li> <li>Grievance Handling Policy</li> <li>Industrial Relations Policy</li> <li>Management and Resolution of Complaints Policy</li> <li>Human Rights Policy</li> <li>Whistle-blowing Policy</li> <li>Health &amp; Safety Policy</li> </ul>	<p><b>Market Risk</b></p> <ul style="list-style-type: none"> <li>Treasury Policy</li> <li>Liquidity Policy</li> <li>Contingency Funding Plan</li> <li>Treasury Front Office Dispute Resolution Policy</li> <li>Assets and Liabilities Management Policy</li> </ul> <p><b>Operational Risk</b></p> <ul style="list-style-type: none"> <li>Operational Risk Management Policy</li> <li>Information Security Policy</li> <li>Cyber Security Policy</li> <li>Anti-Money Laundering and Combating the Financing of Terrorism Policy</li> <li>Politically Exposed Persons Policy</li> <li>Investment Policy</li> <li>FATCA Policy</li> <li>Review of Environment and Social Risk Policy</li> <li>IT Recovery Policy</li> <li>IT Service Management Policy</li> </ul>
<p><b>Procurement &amp; Outsourcing</b></p> <ul style="list-style-type: none"> <li>Outsourcing Policy</li> <li>Procurement Policy</li> <li>Agency Banking Policy</li> </ul>		

## Balancing Stakeholder Interests

The Bank is committed to balancing the interests of all stakeholders in the creation of sustainable value. Our stakeholder engagement mechanisms are structured and comprehensive, providing valuable insight into stakeholder concerns. Feedback obtained is a key input in strategy formulation, ensuring the corporate plan remains relevant to current expectations and the Bank's growth is responsible and sustainable.

*A formal customer communication management process is in place including a centralised dedicated unit set up to manage and resolve customer complaints. The Unit is headed by the Customer Experience Officer and facilitates objective engagement with customers. A 24x7 trilingual customer hotline is also available for handling customer complaints.*

*Shareholders are engaged through multiple channels of communication, including the Annual General Meeting (AGM), Annual Report, interim financial statements, a dedicated investor relations page on the Bank's website, press releases in three (3) languages in the main newspapers and notification of key events through announcements in the CSE. Shareholders may also direct questions or request for information from the Bank. Refer Reporting and Disclosure and the AGM on CG&RR page 23 for further details.*

## Focus on Environment, Social and Governance (ESG) Considerations

HNB is committed to understanding and being responsive to the interests and expectations of stakeholders in creating a sustainable business. We believe embedding ESG considerations into every aspect of our organisation is not the right way to do business – it's the only way. The Board satisfies itself that ESG value creation across the various capitals is integrated into the Bank's strategy. These initiatives are reported in a holistic manner from IR pages 44 to 77. Reporting is as follows;

ESG Element	Report	Page Reference
Economic Sustainability	Financial Capital	IR pages 45 to 51
Environment	Natural Capital	IR pages 74 to 77
Labour Practices	Human Capital	IR pages 58 to 63
Stakeholder Identification, Engagement and Effective Communication	Listening to Stakeholders	IR page 34
Governance	Corporate Governance and Risk Report	CG&RR pages 3 to 80
Society	Social and Relationship Capital	IR pages 64 to 71
Commitment to Sustainability Reporting	About Our Report	IR page 4

These reports have been prepared in line with the Guiding Principles and Content Elements of the International <IR> Framework and referencing GRI standards, among other frameworks.

## Informed Decision Making

Good decision-making requires possessing the right knowledge. HNB Board Members are equipped with the necessary awareness, insight and information through the following mechanisms.

### Supply of Information

The Board pack, generally circulated seven (7) days in advance of a Board Meeting, provides comprehensive qualitative and quantitative information on issues to be raised at the Board Meeting. Further, Executive Management and external experts make regular presentations regarding the business environment and in relation to operations of the Bank.

### Access to Information

Directors have unrestricted access to Bank Management, organisation information, and resources to facilitate discharge of their duties. Directors are entitled to seek independent professional advice, co-ordinated through the Company Secretary, at the Bank's expense. Copies of such advice obtained are circulated to Directors who request for it.

## Knowledge Development

On appointment, Directors are provided with a folder containing relevant governance information, including the Bank's founding documents, mandates, legislation and policies. Directors are apprised of the Bank's business and given an opportunity to meet with KMP and visit key branches.

Directors are kept abreast of applicable legislation and regulation, relevant sector developments and changes in the risk and general business environment on an on-going basis. Directors undertake training and professional development as they consider necessary, which requirements are coordinated through the Company Secretary. They are Members of the Sri Lanka Institute of Directors and attend sessions from time to time. Directors also undertake other Continuous Professional Development (CPD) programmes in their personal capacity to update their knowledge on relevant and emerging topics.

## CORPORATE GOVERNANCE REPORT

**Gender Parity**

The Bank has been at the forefront of women empowerment in Sri Lanka actively supporting women's advancement and forging gender parity.

**Policies and Practices**

HNB appreciates the positive impact on productivity and competitiveness in engaging a gender diverse workforce. The Bank has in place policies that ensure equal opportunity and a safe workplace and has implemented family friendly mobility practices that support female employees to fulfil their career aspirations. Examples of such practices are disclosed on IR pages 58 to 63. The success of these initiatives is demonstrated in the increase in female representation to 43% of the workforce and 19% of senior management in 2019. Board representation is currently nil as explained on CG&RR page 5, Board Composition.

**Responsible Branding**

HNB's women-centric product schemes have sought to bridge the gender gap in the country by driving financial inclusion and economic independence of women. Initiatives such as Gami Pubuduwa provides access

to personalized finance and microfinance products and enhanced financial literacy and management ability among women entrepreneurs. In marketing these products, the Bank has been conscious of portraying both women and men proportionately, respectfully and realistically.

**Innovation Governance**

Today, technology and innovation are major drivers of sustainable value creation. As a financial services organisation, the Bank's ability to continually innovate is critical to remaining relevant to the changing needs of customers and other stakeholders. The Board is aware of its role in innovation governance and to this end, encourages the creativity and flexibility that promotes innovative thinking, while managing risk within the agreed appetite. Over the past few years the Board has sort to enhance its skills and knowledge base, particularly in information technology and commercial law, through new Board appointments, to support delivery of the Bank's strategy and leverage opportunities that innovation presents.

*"The Directors of HNB shall at all times discharge their duties professionally with due diligence and efficiency and to the best of their abilities. All Directors shall have a sound understanding of the Bank."*

Board Charter

Our policies seek to harness the full potential of all our employees by providing equal opportunity and a safe environment in the workplace.

- Equality and Diversity Policy
- Employee Recognition and Rewards Policy
- Anti-Harassment Policy
- Grievance Handling Policy
- Management and Resolution of Complaints Policy
- Human Rights Policy
- Health & Safety Policy
- Code of Conduct & Ethics



## Right Way

- Values and Culture
- Code of Conduct & Ethics
- Compliance
- Balance of Power
- Independent Judgement
- Board Meetings
- Conflict of Interest
- Whistle-blowing
- Fair and Responsible Remuneration

HNB is a values-based organisation, committed to high standards of integrity and ethics. The Board sets the tone, leading by example and demonstrating responsibility, accountability, fairness and transparency in their decisions and actions.

The Bank has nurtured a strong culture of compliance and good conduct, advocating and incentivising employees for doing the right business, the right way.

### Values and Culture

The values and culture of the Bank was reviewed in the context of the Vision and corporate values redefined last year, in alignment with the new vision. This year a shift in culture was initiated with the support of the Board and Management in driving and enabling a new leadership mindset where all employees are inspired to strive for high standards of performance in an agile, digital, innovative, fast paced, customer centric and competitive environment. The new values-based approach is anchored on the deep-rooted ethical foundations of the Bank.

### Code of Conduct and Ethics

All employees, KMP and Directors are bound by the Bank's Code of Conduct & Ethics. The Code, available in all three (3) languages, provides guidelines on the conduct of the Bank's businesses and operations and is aligned to HNB's values, standards, policies and procedures. Directors also abide by a 'Standard of Conduct' embodied in the Board Charter.

The Board is not aware of any material violations of any of the provisions of the Code of Conduct and Ethics/Standard of Conduct by any Director or KMP of the Bank.

### Compliance

The Board is conscious of its duty to comply with laws, regulations and internal procedures and policies of the Bank. Controls have been placed to provide reasonable assurance

of compliance, including establishment of a compliance function. The function is headed by a dedicated Compliance Officer who reports direct to the Board Integrated Risk Management Committee (BIRMC). The Compliance Officer submits a report on mandatory banking and statutory requirements on a quarterly basis to the BAC and the BIRMC.

### Balance of Power

A clear division of roles and responsibilities ensures that none of the Directors have unfettered powers in the Board decision-making process. Key roles of Chairman and MD/CEO are separate as disclosed on CG&RR page 11, strengthening the Board's effectiveness and ensuring objective decision making in the discharge of duties.

### Independent Judgment

Directors exercise independent judgement in the effective discharge of duties, engaging in constructive Board deliberations and objective evaluation of matters set before them. Directors' demonstrated independence in judgment and character is assessed by the Board as a whole, in the annual Board appraisal and feedback provided.

### CODE OF CONDUCT & ETHICS

- Act ethically, responsibly, honestly and with integrity, in the best interest of the Bank
- Safeguard the Bank from fraud, corruption, collusion and coercion
- Compliance with laws, rules and regulations
- Avoidance of conflict of interest
- Discrimination and harassment
- Bribery and corruption
- Confidentiality
- Fair dealing
- Entertainment and gifts
- Accurate accounting and record keeping
- Fair and transparent procurement practices
- Protection and proper use of Bank assets including information assets
- Encourage whistle-blowing
- Corporate opportunities

## CORPORATE GOVERNANCE REPORT

### Board Meetings

Board Meetings are well chaired. Meeting agendas are relevant. Meetings are held regularly and minutes documented accurately. The company secretarial function supports the Board effectively. Special Board Meetings are convened when required.

#### Board Agenda

The Chairman sets the Board agenda, assisted by the Company Secretary and MD/CEO. The agenda is prioritised and timed to ensure all items are discussed. Agenda and Board Papers for Meetings are sent generally seven (7) days before the Meeting, allowing Members sufficient time to review the same. Urgent Board Papers are included on an exceptional basis.

#### Minutes

All proceedings of the Meetings, including Directors' concerns regarding matters which are not resolved unanimously, are minuted and the minute book is maintained with signed copies of the minutes. Board minutes are circulated to Members within two (2) weeks of the Meeting being held, in compliance with code. Board decisions/prescribed actions are followed-up through an action tracker.

#### Meetings

During the year, the Board held seventeen (17) Meetings. Attendance at Meetings is given below and Board focus areas on CG&RR page 11. The Chairman met once (01) with the Non-Executive Directors during the year and feedback was provided to the MD/CEO by the Chairman.

#### Resolutions

Resolutions concerning business matters may be passed by circulation, within regulations. However, if a single Director deem it necessary that such resolution must be decided at a Board Meeting not by circulation, the Chairman shall put the resolution to be decided in a Meeting.

#### Items Regularly on the Board Agenda

- |  |  |  |
|--|--|--|
| <ul style="list-style-type: none"> <li>• MD/CEO's review</li> <li>• Bank's financial and operational results</li> <li>• Financial forecasts</li> <li>• Board Committee minutes &amp; feedback</li> </ul> | <ul style="list-style-type: none"> <li>• Risk Report including Dashboards</li> <li>• Internal control report</li> <li>• Compliance report</li> </ul> | <ul style="list-style-type: none"> <li>• Directors' and KMP's declaration of interest/Related Party Transactions</li> <li>• Presentation by business units/support services</li> </ul> |
|--|--|--|

## Attendance at Meetings

Board Member	Date of Appointment to the Board	Board	Board Audit Committee	HR & Remuneration Committee	Nomination Committee	Board Integrated Risk Management Committee	Related Party Transactions Review Committee	Strategy & Investment Review Committee	Procurement & Assets Disposal Committee	Board Credit Committee	Board Recoveries Committee
Total Meetings Held		17	9	3	5	12	4	10	9	6	9
Mr Dinesh Weerakkody	29th June 2017	■ 17/17		■ 3/3	■ 5/5						
Mr Jonathan Alles (MD/CEO)	01st May 2013	17/17	*4	*2	*1	4/12	**3/4	*6		*6	
Ms Rose Cooray (Retired w.e.f. 15th February 2019)	15th February 2010	2/2			*1,1/1	1/1		*1,1/1	*1,1/1		
Dr Rohan Karunaratne	06th October 2011	**16/17	**6/9						■ 8/9	5/6	
Mr Sujeewa Mudalige (Resigned w.e.f. 29th March 2019)	02nd April 2012	3/5	2/2	0/1		*2		3/3			
Mr Rusi Captain	02nd April 2012	**17/17	**8/9		**5/5	**9/9					
Mr Amal Cabraal	01st April 2014	17/17	*1	3/3		*1		■ 10/10		5/6	8/9
Mr Palitha Pelpola	30th April 2015	13/17		2/2	5/5		2/4			2/2	
Mr Duliksha Soosaipillai	30th April 2015	17/17	*6			■ 12/12		9/10	9/9		9/9
Mr Nilanth de Silva	30th April 2015	17/17	9/9				■ 4/4			■ 6/6	8/9
Mr Madu Ratnayake	25th October 2018	**15/17				8/12		7/9	5/9		
Mr Damien Fernando	25th October 2018	**17/17	**8/9					**8/10	**6/6		■ **9/9
Mr Asoka Pieris	01st April 2019	**11/11	■ 6/7			*7				3/4	6/7
Dr Harsha Cabraal	26th September 2019	**2/3									

\* Meetings attended by invitation

\*\* Includes Meetings attended by an alternative Director

■ Chairman

## Conflict of Interest

A Director or KMP is prohibited from using his or her position, or confidential or price-sensitive information, for personal benefit or benefit of any third party, whether financially or otherwise. Directors notify the Board promptly of any conflicts of interest they may have in relation to particular items of business or other Directorships. Directors do not participate in and excuse themselves from the Meeting when the Board considers matters in which a conflict may arise.

Directors and KMP declare their business interests at appointment and quarterly

thereafter. A register of individual Directors' interests is maintained by the Company Secretary and updated and signed by the Directors, with new updates noted by the Board at the next Meeting. The Board is aware of other commitments of its Directors and is satisfied that all Directors allocate sufficient time to enable them to discharge their responsibilities at HNB effectively.

The Related Party Transactions Review Committee (RPTRC) reviews and provides oversight over Related Party Transactions to ensure transactions are fair and in the best

interest of HNB. The Committee is guided by the Bank's Related Party Transactions Policy and applicable regulations.

Key appointments of the Directors are included in their profiles on IR pages 20 to 23 and Related Party Transactions are disclosed in Note 60 of the Financial Statements on pages 277 to 283 in the IR. The total number of Board seats (excluding Directorship in HNB) held by each Director as at 31st December 2019 is given below.

## CORPORATE GOVERNANCE REPORT

## Directorships in Other Companies

Name of Director	Directorship Status	No. of Board seats held in Listed Companies		No. of Board seats held in Unlisted Companies	
		Executive Capacity	Non-Executive Capacity	Executive Capacity	Non-Executive Capacity
Mr Dinesh Weerakkody (Chairman)	■	-	3	-	4
Mr Jonathan Alles (MD/CEO)	■	-	1	-	4
Dr Rohan Karunaratne	■	-	1	1	6
Mr Rusi Captain	■	-	1	18	-
Mr Amal Cabraal	■	-	4	-	8
Mr Palitha Pelpola	■	-	1	-	-
Mr Duliksha Soosaipillai	■	-	3	-	-
Mr Nilanth de Silva	■	-	1	-	2
Mr Madu Ratnayake	■	-	-	-	-
Mr Damien Fernando	■	-	1	-	2
Mr Asoka Pieris (Appointed w.e.f 01st April 2019)	■	-	1	-	2
Dr Harsha Cabral (Appointed w.e.f 26th September 2019)	■	-	4	-	8
Mr Prawira Saldin (Alternate Director to Mr Rusi Captain)	■	-	2	-	7
Dr Prasad Samarasinghe (Alternate Director to Mr Damien Fernando)	■	-	1	3	-

■ Executive Director ■ Independent Non-Executive Director ■ Non-Executive Director

### Whistle-blowing

Whistle-blowing facilitates anonymous reporting of unethical or unlawful behaviour in relation to possible inappropriate financial reporting, internal controls or other matters by employees. Dr Rohan Karunaratne, Independent Non-Executive Director, was appointed by the Board to handle whistle blowing matters subsequent to the retirement of Ms Rose Cooray in February 2019. Information on accessibility, anonymity, processes and the policy relating to the whistle-blowing service is communicated to all employees.

### Fair and Responsible Remuneration

HNB rewards fairly. Remuneration of executives and staff members is linked to sustainable value creation objectives in line with the Bank's strategy and is based on clear

performance targets that have adequate stretch and market benchmarking.

The Remuneration packages of Executive Directors are designed to attract eminent professionals as Directors with the requisite skills and experience. Remuneration is structured taking into consideration performance and risk factors entailed in the job and aligned to corporate and individual performance. Remuneration of Executive Directors are compliant with the provisions of Schedule E of the Code of Best Practice on Corporate Governance issued by the Institute of Chartered Accountants of Sri Lanka in 2017 and comprises two components, fixed remuneration and variable remuneration comprising of an annual performance bonus.

No special early termination clauses are included in the contract of employment of Executive Directors that would entitle

### REMUNERATION POLICY

Remuneration offered;

- rewards value delivered and adjusts for risk assumed,
- is motivational
- is competitive in the marketplace for skills
- promotes and rewards teamwork

them to extra compensation. However, such compensation, if any, would be determined by the Board of Directors.

The HRRC is responsible for making recommendations to the Board regarding remuneration of the Executive Director and KMP compliant with the provisions of Schedule E of the Code of Best Practice on Corporate Governance issued by the Institute of Chartered Accountants of Sri Lanka in 2017 and remuneration policies of the Bank. MD/CEO participates at Meetings when deciding the remuneration of the Corporate Management team. All rights under the ESOP scheme have been expired during 2018.

Independent Professional advice is sought when required, by the Board/HRRC on the HR related matters.

The Board as a whole determines the remuneration of the NED's who receive a fee for being the Chairman or a Director of the Board and additional fee for being a Member of a committee. Non-Executive Directors do not receive any performance related/incentive payments.

Refer IR page 277 for the total Directors' Remuneration.





## Accountability

- Reporting and Disclosure
- The Annual General Meeting (AGM)
- Risk Management and Internal Controls
- Technology Governance and Security
- Board Appraisal
- Governance of Group Companies
- Communication
- Business Continuity Planning

The Board has ultimate responsibility and accountability for the performance of the Bank and its state of affairs. Although certain responsibilities have been delegated by the Board to Sub-Committees and Management, these responsibilities have been delegated without abdicating accountability. The Board ensures accountability to stakeholders through various means as explained below.

### Reporting and Disclosure

HNB is committed to fair and transparent reporting with emphasis on integrity, timeliness and relevance of information disclosed. Information is presented in such a manner as to avoid the creation of a false market. Such disclosure and reporting enables stakeholders to effectively assess performance and take informed decisions. All reporting and disclosures are in compliance with applicable laws and regulations.

### Annual Report and Interim Financials

The Annual Report is the key medium through which the Board presents a fair and balanced review of the of the Bank's financial position, performance and prospects combining narrative and visual elements to facilitate readability and comprehension. External audit/third-party assurance has been obtained where relevant, to enhance credibility. The Board of Directors reviews and approves the Annual Report, prior to publication while the Interim Financials are reviewed and recommended by the Board Audit Committee and approved by the Board of Directors, prior to publication. The high standard of reporting maintained by the Bank is evidenced by the awards received over an extended period.

### Independence and Objectivity of the External Auditor

The shareholders appointed Messrs. Ernst & Young (Chartered Accountants) as the External Auditor for 2019 at the last AGM, on recommendation of the Board.

The Board Audit Committee (BAC) engages with the External Auditor for audit and non-audit services in line with professional & ethical standards, regulatory requirements and in compliance with Bank policy, as detailed

in the BAC Report on IR pages 115 to 117. BAC remains satisfied with the independence, impartiality, competence, resources, service levels and objectivity of Messrs. Ernst & Young in rendering their services. Messrs. Ernst & Young have submitted their Annual Statement confirming independence in relation to the external audit as required by the Companies Act No. 07 of 2007. The Bank is compliant with the mandatory rotation of the lead partner in compliance with CBSL guidelines to enhance independence between auditor and client.

The Board has recommended Messrs. KPMG (Chartered Accountants) as the External Auditor of the Bank for the year 2020, subject to the approval of shareholders at the next AGM as per Bank's auditor rotation policy.

### Shareholder Access to Corporate Information

Shareholders may, at any time, request for publicly available information and provide comments and suggestions to Directors or Management of the Bank. The Company Secretary maintains a record of all correspondence received and delivers as soon as practicable such correspondence to the Board or individual Director/s as applicable, for a response.

### The Annual General Meeting (AGM)

The AGM is the main mechanism for the Board to interact with shareholders and report the performance of the Bank. It provides opportunity for shareholders' views to be heard and be fully considered. The Board encourages informed participation by shareholders. Notice of the AGM, the Annual Report and Accounts, any resolution together with the corresponding information that may

***"The Board of Directors should assume the overall responsibility and accountability in respect of: (a) the management of the affairs of the Bank, i.e., conduct of business and maintenance of prudent risk management mechanisms; and (b) the safety and soundness of the Bank."***

*Banking Act Direction No. 11 of 2007  
Corporate Governance for Licensed  
Commercial Banks in Sri Lanka*

be set before the shareholders at the AGM, together with a summary of the procedures governing voting at the AGM are circulated to shareholders a minimum fifteen (15) days prior to the AGM in compliance with statutory requirements. HNB proposes a separate resolution for each item of business, giving shareholders the opportunity to consider and vote on each issue, separately. Institutional investors are encouraged to give due weight to all relevant factors including Board composition and structure, when evaluating the Bank's Governance structures.

At the AGM, the Board provides an update to shareholders on the Bank's performance. Shareholders are then offered an opportunity to ask questions and vote on resolutions. It is the key forum for shareholders to engage in decision making matters reserved for the shareholders which typically include proposals to adopt the Annual Report and Accounts,

## CORPORATE GOVERNANCE REPORT

appointment of Directors and Auditors and other matters requiring special resolutions. The Chairman, Board Members including the Chairmen of the Sub-Committees and External Auditors are present and available to answer any queries raised. All Shareholders are encouraged to participate at the AGMs and exercise their voting rights. HNB has a history of well attended AGMs and 241 shareholders attended or were represented by proxy at the March 2019 AGM.

The Bank has a mechanism to record and count all proxy votes lodged for each resolution. The following information is made available at the AGM and posted on the Bank's website. ([www.hnb.net](http://www.hnb.net))

- Number of shares in respect of which proxy appointments have been validly made
- Number of votes for and against the resolution
- Number of shares in respect of which the vote was directed to be withheld

In the event, there are a significant proportion of the votes cast against a resolution, the Board will take steps to understand the reasons behind the vote results and determine if any actions are required.

### Risk Management and Internal Controls

Risk review and risk management are integral elements of the Bank's Corporate Governance framework. These elements aim to ensure business specific operational and strategic risks, emerging risks, as well as risks posed by the external environment, are adequately and timely identified and mitigated. Through the Board Integrated Risk Management Committee (BIRMC) the Board governs the Bank's risk management framework which includes identifying risks, developing risk strategy, formulating policies, setting procedures, establishing limits and managing exposures, among others. The Risk department supports the BIRMC in execution of responsibilities. The framework is applied consistently across all strategic business units of the Bank.

The enhanced volatile political and economic environment in the country has increased the overall risk profile of the Bank in the period under review. Key risks together with

mitigation strategies, are detailed in the Risk & Capital Review, pages 42 to 43 of the CG&RR. However, the Board is satisfied the stringent monitoring and management of risk has been effective in limiting impact on the business.

### Internal Controls

Combined with risk management, the Board formulates and implements effective internal control systems to safeguard shareholder interests and the assets of the Bank, in meeting strategic objectives. These systems cover all controls, including financial, operational and compliance and are monitored and regularly reviewed for effectiveness by the Board. The Board Audit Committee assists in the discharge of its duties with regards to internal controls, supported by the Internal Audit Department. Details of the internal audit function and systems of internal control are explained in the Board Audit Committee Report given on IR pages 115 to 117, of the IR. The Board is satisfied with the integrity of financial information and the robustness of the internal controls and systems of the Bank.

### Technology Governance and Security

As the Bank continues its digital transformation, the Board is critically aware of the need to continually monitor the opportunities and risks technology presents. The appointments of Mr Madu Ratnayake to the Board last year and Dr Prasad Samarasinghe in the current year as an Alternative Director to Mr Damien Fernando, has served to enhance the Board's skills base and knowledge of technology and information governance.

Monitoring of the information technology system remains a responsibility of a number of forums in the Bank including that of the Risk Management Department and the Internal Audit Department which reports to the Board Integrated Risk Management Committee (BIRMC) and Board Audit Committees (BAC) respectively.

An information and cyber risk vertical has been established within the Risk Management Department, under the purview of the Chief Risk Officer (CRO), to introduce and implement policies.

Technology governance and security is a recurring item on the Board Meeting agenda. Effectiveness of Information

### CYBER SECURITY AND INFORMATION ASSETS POLICY STATEMENT

It is the Policy of HNB that its information assets shall be protected from all cyber threats identified, whether internal or external, deliberate or accidental, such that the brand is protected; confidentiality of information is maintained; integrity of information can be relied upon; availability of information is ensured; and all legal, regulatory, statutory and contractual obligations are met.

Technology system is regularly reviewed at Board Meetings, through the tabling of BAC and BIRMC Meeting minutes and updates provided by the Chairmen of the respective Committees. Management of Information and Cyber Risk is described in detail on CG&RR pages 62 to 63 of the Risk & Capital Review.

### Board Appraisal

An annual evaluation is conducted to assess the effectiveness of the Board as a whole. Overseen by the Chairman, Directors assess their collective performance against measures including the independence of Directors, in judgement and character. Collated results are made available to the Nomination Committee (NC) who make recommendations to the Board on areas for improvement. Outcome of the assessment carried out in January 2019 for the year 2018, was tabled at the Board Meeting held in March 2019. Areas identified for improvement were communicated to the Board, including training needs and skills and knowledge gaps.

The Board assesses the performance of the MD/CEO annually using criteria aligned to the short, medium and long-term objectives of the Bank which are agreed with the MD/CEO at the beginning of the year. Performance is reviewed at the end of the financial year against the backdrop of the operating environment. It is discussed by the Chairman with the MD/CEO and responses documented prior to approval by Board as a whole. HRRC assists in the evaluation process, recommending a revised remuneration based on performance.

## **Governance of Group Companies**

The Board seeks to ensure adequate Corporate Governance across the Group and that there are strong governance policies and mechanisms appropriate to the structure, business and risks of the Bank and its entities. The Board is guided by the Board approved Charter for Management/Good Governance for Group Companies. Adherence to the charter is reinforced by the appointment of Directors and/or Key Management Personnel including the MD/CEO, COO, CFO, CRO and Chief Strategy Officer, to the Boards of subsidiaries. Boards are well balanced and ensure business is carried at the highest professional standards, integrity and ethics.

## **Communication**

Responsible communication supports accountability. The Bank's Corporate Communication Policy provides guidelines to ensure all communications to key stakeholders are coherent and cohesive. Covering internal and external communication, the policy has been communicated to all staff members and sets out formal areas of responsibility. A Communications Council headed by the MD/CEO and consisting of five (5) other members of the Corporate Management Team is responsible to effecting communications. The active engagement of the team is

particularly critical in a need for effective crisis management and in mitigating reputation risk.

The Board and KMP hold regular structured meetings with equity analysts who provide research to large institutional investors. They also conduct roadshows to potential overseas investors to attract foreign interest, supporting capital planning. The Board believes such communication leads to mutual respect; and accountability and trust helping to ensure sustainability of the Bank. Directors ensure the protection of share price sensitive information at these Meetings. Views of the shareholders are communicated to the Board as a whole by the Chairman.

## **Business Continuity Planning**

Today's business practices, changes in technology and increased terrorism concerns have focused greater attention on the need for effective business continuity planning. HNB's Business Continuity Plan (BCP) seeks to protect staff, minimise down time and losses, safeguard Bank's reputation and sustain customer confidence. The BCP is regularly updated, tested and strengthened for effectiveness using simulated realistic scenarios.

## CORPORATE GOVERNANCE REPORT

## Appendix I: Compliance with Banking Direction No.11 of 2007 on Corporate Governance

Section	Principle, Compliance & Implementation
3 (1)	<b>Responsibilities of the Board</b>
3 (1) (i)	<p><b>Strengthening the safety and soundness of the Bank</b></p> <p>The Board's responsibilities are set out in the Board Charter. The Board is accountable for the management of the affairs of the Bank and the safety and soundness of the Bank.</p> <p><b>a. Setting Strategic Objectives and Corporate Values - Complied <input checked="" type="checkbox"/></b></p> <p>The Bank's strategic objectives derived from the Vision and Mission Statements and its corporate values, have been determined and approved by the Board of Directors and communicated to all levels of staff. The corporate values are included in the Code of Conduct &amp; Business Ethics which is provided in hard copy to all new employees, available on the intranet, explained at orientation programmes and reinforced at Meetings.</p> <p><b>b. Approving Overall Business Strategy including Risk Policy and Management - Complied <input checked="" type="checkbox"/></b></p> <p>The 2019-2021, three-year business strategy (Corporate Strategic Plan) was approved by the Board in 2018, and subsequently reviewed in 2019 incorporating internal and external developments. The strategy and execution thereof, is regularly reviewed by the Board. The Annual budget, derived from the business strategy is approved, and monitored monthly, by the Board.</p> <p>The Board also approved the overall risk strategy of the Bank, determining the Risk Appetite, Policies and Risk Management Framework &amp; Mechanisms. The Corporate Strategic Plan is aligned to the overall risk strategy of the Bank, where Risk Appetite is considered in areas such as capital allocation and in the adoption of risk matrix to measure the risk levels. Governance and Compliance which are embedded in the Risk Management Policy Framework have also been included in the strategic plan. Further, the risk management procedures and mechanisms with time bound implementation milestones were approved and monitored by the Board Integrated Risk Management Committee (BIRMC) on a regular basis.</p> <p><b>c. Risk Management - Complied <input checked="" type="checkbox"/></b></p> <p>The Board takes overall responsibility for risk management of the Bank. The BIRMC, is tasked with assisting the Board in structuring Bank's Risk Policy, defining the risk appetite, identifying principal risks, setting governance structures and implementing systems to measure, monitor and manage the principal risks.</p> <p>The following reports provide further insights in this regard:</p> <ul style="list-style-type: none"> <li>• Risk &amp; Capital Review on CG&amp;RR pages 41 to 80.</li> <li>• Board Integrated Risk Management Committee Report on IR pages 111 to 114.</li> </ul> <p><b>d. Communication with all Stakeholders - Complied <input checked="" type="checkbox"/></b></p> <p>The Board has approved a Corporate Communication Policy to ensure effective and timely communication with all stakeholders including depositors, creditors, share-holders and borrowers. The Corporate Communication Policy, which was reformulated in August 2016 (revised in 2017), is guided by the principles of efficiency, transparency, proactivity, clarity and feedback.</p> <p>The Bank has substantially implemented the provisions of Banking Act Directions No 8 of 2011 "Customer Charter of Licensed Banks", which became effective in 2012. The Charter seeks to improve the quality and content in dispensing of customer service by enhancing customer protection and instilling trust and confidence in the Bank while incorporating a set of customer obligations generated in the interest of Bank stability.</p> <p><b>e. Internal Control System and Management Information Systems - Complied <input checked="" type="checkbox"/></b></p> <p>The Board reviews the adequacy and the integrity of the Bank's Internal Control Systems and Management Information Systems and is satisfied with same. It is assisted in this regard by the Board Audit Committee (BAC). The BAC has reviewed reports from the Internal Audit Department in carrying out this function, together with the Management responses on the same. The findings have been reported to the Board.</p> <p><b>f. Key Management Personnel (KMP) - Complied <input checked="" type="checkbox"/></b></p> <p>Key Management Personnel comprise the Corporate Management (MD/ CEO, COO, DGMs and AGMs), Chief Technology &amp; Digital Officer, Head of Custody &amp; Trustee Services and Head of Human Capital Management as per the guideline on "Key Management Personnel in Banking Act Direction for Corporate Governance" issued by the Banking Supervision Department of CBSL. All appointments of Key Management Personnel are recommended by the Nomination Committee and approved by the Board.</p>

Section	Principle, Compliance & Implementation
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***g. Define areas of authority and key responsibilities for Directors and Key Management Personnel - Complied***

Areas of authority and key responsibilities for the Board of Directors are set out in the Board Charter. Areas of authority and key responsibilities for Key Management Personnel are stated in their Job Descriptions as recommended by the Nomination Committee and approved by the Board. The delegated authority limits for Key Management Personnel have been approved by the Board.

***h. Oversight of affairs of the Bank by Key Management Personnel - Complied***

The MD/CEO and other Key Management Personnel are accountable to the Board for the Bank's operational and financial performance, in accordance with the policies set by the Board. The Board reviews the performance of the Bank against the strategic plan and receives reports from its Sub-Committees on matters delegated to them, through which the Board exercises oversight over the affairs of the Bank and the Key Management Personnel. Further, Key Management Personnel make regular presentations to the Board on matters under their purview and are also called in by the Board to explain matters relating to their areas.

***i. Assess effectiveness of own Governance Practices - Complied***

The effectiveness of the Board's own governance practices, including the process for selection, nomination and election of Directors (which is explained in detail under Rule 3 (2) (ix)) and the process for management of conflict of interest (which is explained in detail under Rule 3 (1) (xii)) are reviewed by Board on a periodic basis. Implementation of changes required is discussed and determined by the Board at year-end following the submission of the summary of annual self-evaluations.

***j. Succession plan for Key Management Personnel - Complied***

The Bank has an appropriate succession plan for Key Management Personnel aligned to the Bank's strategic objectives and Talent Management Programme. The plan is guided by the policy on Succession Planning for Key Management Personnel and Directors, last reviewed in July 2019. The Nomination Committee is responsible for the formulation, review and rollout of the plan.

***k. Regular meetings with Key Management Personnel - Complied***

The Board maintains a sound relationship with the Corporate/Senior Management led by the MD/CEO, who in turn assists the Board to formulate policies, strategies, processes and practices that fit the Bank and its business needs in achieving corporate objectives. The Management is open and transparent with the Board, bringing all significant matters to its attention. Key Management Personnel are regularly invited to attend Board and Sub-Committee Meetings for discussion on matters concerning their areas of responsibility or make presentations on key agenda items.

***l. Regulatory environment and maintaining an effective relationship with regulator - Complied***

On appointment, Directors are provided with a folder containing all relevant governance information, including regulatory laws, directions and guidelines. Directors are briefed about regulatory developments at Board and Sub-Committee Meetings by Key Management Personnel including the Heads of Internal Audit, Risk and Compliance and by attending Director Forums arranged by the Central Bank of Sri Lanka (CBSL). Further, Board Members regularly meet with CBSL officials to discuss strategic matters specific to the Bank, maintaining an effective relationship with the regulator.

***m. Hiring and oversight of External Auditors - Complied***

The External Auditor is appointed following the procedures set out in Article 53 (iv) of the Articles of Association. The Board Audit Committee makes recommendations to the Board for the appointment, re-appointment or removal of the External Auditor in-line with professional & ethical standards and regulatory requirements. A policy for Engagement of the External Auditor to provide Non-Audit Services is in place, as reviewed and recommended by the Board Audit Committee.

On the recommendation of the Board, the shareholders approved the reappointment of Messrs. Ernst & Young (Chartered Accountants) as the External Auditor of the Bank, at the last AGM. In compliance with Section 163 (3) of the Companies Act No. 07 of 2007, the External Auditors submit a statement annually confirming their independence in relation to the External Audit.

3 (1) (ii) **Appointment of Chairman and CEO and defining and approving their functions and responsibilities - Complied**

The Board has appointed the Chairman and the MD/CEO. Their roles and responsibilities are separate and set out clearly in the Board Charter, ensuring a balance of power and authority and preventing unfettered power being vested with an individual. These functions and responsibilities are in line with Direction 3(5) of the said Direction.

3 (1) (iii) **Regular Board Meetings - Complied**

Monthly Board Meetings are held regularly, and Special Meetings are scheduled based on need. Seventeen (17) Board Meetings were held in 2019. Directors actively participate in the Meetings deliberating on matters set before the Board. Attendance at Board Meetings is given in CG&RR page 21. Urgent Board Papers are approved via circular resolution only on an exceptional basis, where such resolutions are ratified by the Board at the next meeting. 7 resolutions and 546 credit papers were approved in 2019, via circulation.

## CORPORATE GOVERNANCE REPORT

Section	Principle, Compliance & Implementation
3 (1) (iv)	<p><b>Arrangements for Directors to include proposals in the agenda - Complied <input checked="" type="checkbox"/></b></p> <p>The Board Calendar with tentative dates for Board and Sub-Committee Meetings for the following year is sent to all members approximately one month before the end of the current year. The Chairman sets the Board Agenda assisted by the Company Secretary. Directors submit proposals for inclusion in the agenda up on discussion with the Chairman.</p>
3 (1) (v)	<p><b>Notice of Meetings - Complied <input checked="" type="checkbox"/></b></p> <p>Notice of Meetings, Agenda and Board Papers for the Meetings are sent generally seven (7) days before the Meeting, giving Members sufficient time to attend the Meeting and study the documents. Urgent Board Papers are included on an exceptional basis, with the consent from the Chairman.</p>
3 (1) (vi)	<p><b>Director's Attendance - Complied <input checked="" type="checkbox"/></b></p> <p>At appointment, all Directors are apprised of the regulations on attendance. Attendance at Board Meetings is given in CG&amp;RR page 21. All Directors have attended at least two thirds (2/3) of Board Meetings held during 2019, the lowest attendance being nine (9) Directors at a Meeting (including attendance of an Alternate Director). No Director has been absent from three (3) consecutive Meetings during 2019.</p>
3 (1) (vii)	<p><b>Appointment and setting responsibilities of the Company Secretary - Complied <input checked="" type="checkbox"/></b></p> <p>The Board has appointed a Company Secretary, an Attorney at Law, who satisfies the provisions of Section 43 of the Banking Act No.30 of 1988. The Company Secretary guides the Board on discharging its duties and responsibilities, facilitates adherence to best practices in Corporate Governance and apprises the Board of relevant legislative and regulatory changes.</p>
3 (1) (viii)	<p><b>Directors access to advice and services of Company Secretary - Complied <input checked="" type="checkbox"/></b></p> <p>All Board Members have full access, to the advice and services of the Company Secretary to ensure that proper Board procedures are followed and all applicable rules and regulations are complied with.</p>
3 (1) (ix)	<p><b>Maintenance of Board Minutes - Complied <input checked="" type="checkbox"/></b></p> <p>Company Secretary maintains the minutes of the Board Meetings. The Minutes are circulated to all Board Members and approved at the next Board Meeting upon incorporating any amendments proposed by other Directors. The minute book is maintained by the Company Secretary and open for inspection by any Director, at any time.</p>
3 (1) (x)	<p><b>Minutes to be of sufficient detail and serve as a reference for regulators and supervisory authorities - Complied <input checked="" type="checkbox"/></b></p> <p>Minutes of Board Meetings are recorded in sufficient detail to reflect that the Board acted with due care and prudence in performing its duties and to serve as a reference for regulatory and supervisory authorities to assess the depth of deliberations at Board Meetings.</p>
3 (1) (xi)	<p><b>Directors ability to seek independent professional advice - Complied <input checked="" type="checkbox"/></b></p> <p>Procedures are in place to allow Directors to seek independent professional advice, as and when necessary and at the Bank's expense, in discharging their duties and responsibilities. This facility is coordinated through the Company Secretary.</p>
3 (1) (xii)	<p><b>Dealing with Conflicts of Interest - Complied <input checked="" type="checkbox"/></b></p> <p>Article 40 of Articles of Association addresses the provision with regard to this requirement. The Board is conscious of its obligations to ensure that Directors avoid conflicts of interest (both real and apparent) between their duty to HNB and their other interests. The Board has taken steps to ensure that conflicts and potential conflicts of interest of Directors are disclosed to the Board. Any Director with a material personal interest in a matter being considered by the Board declares his/her interest and unless the Board resolves otherwise, he/she does not participate in discussions or vote on that specific matter. The Directors declare their interests at appointment and thereafter on a quarterly basis.</p>
3 (1) (xiii)	<p><b>Formal schedule of matters for decision making - Complied <input checked="" type="checkbox"/></b></p> <p>The Board reserves for itself a formal schedule of matters on which it takes the ultimate decision.</p>
3 (1) (xiv)	<p><b>Inform Central Bank, if there are solvency issues - Complied <input checked="" type="checkbox"/></b></p> <p>The Bank is solvent.</p> <p>In the unlikely event, the Bank is about to become insolvent, a procedure is however in place to inform the Director of Banking Supervision of same, prior to taking any decision or action to suspend payments due to depositors and other creditors.</p>
3 (1) (xv)	<p><b>Capital Adequacy - Complied <input checked="" type="checkbox"/></b></p> <p>The Board monitors capital adequacy and other prudential measures to manage risk and to ensure compliance with regulatory requirements. The Bank is in compliance with the minimum capital requirements of the Monetary Board.</p>

Section	Principle, Compliance & Implementation
3 (1) (xvi)	<p><b>Publish Corporate Governance Report in Annual Report - Complied <input checked="" type="checkbox"/></b></p> <p>This report forms part of the Corporate Governance Report of the Bank which is set out on pages 3 to 40 in CG&amp;RR.</p>
3 (1) (xvii)	<p><b>Self-Assessment of Directors - Complied <input checked="" type="checkbox"/></b></p> <p>Each Director undertakes annually, a self-assessment of the Board, to ensure responsibilities are satisfactorily discharged. The last appraisal was carried out in January 2019 for the financial year 2018 and the outcome of the assessment and areas for improvement tabled at the Board Meeting held in March 2019. The 2019 annual appraisal is currently in progress.</p>
<b>3 (2)</b>	<b>The Board's Composition</b>
3 (2) (i)	<p><b>Number of Directors - Complied <input checked="" type="checkbox"/></b></p> <p>The Board consists of twelve (12) Directors, compliant with CBSL direction which requires the number of Directors to be not less than seven (7) and not more than thirteen (13).</p>
3 (2) (ii)	<p><b>Period of service of a Director - Complied <input checked="" type="checkbox"/></b></p> <p>The total period of service of all Non-Executive Directors does not exceed nine (9) years as required by the CBSL Direction. Tenures of service of Directors are given in CG&amp;RR page 5.</p>
3 (2) (iii)	<p><b>Director Appointment of an Employee as a Director - Complied <input checked="" type="checkbox"/></b></p> <p>The single Executive Director is the MD/CEO. The Board balance is compliant with the CBSL Direction which limits the number of Executive Directors to 1/3 of the Board</p>
3 (2) (iv)	<p><b>Independent Non-Executive Directors - Complied <input checked="" type="checkbox"/></b></p> <p>The Board comprises eight (8) Independent Non-Executive Directors, in excess of the regulatory requirement. The Directors satisfy the criteria for determining independence, which is reviewed annually by the Board based on self-declaration forms submitted by the Directors.</p>
3 (2) (v)	<p><b>Alternate Independent Directors - Complied <input checked="" type="checkbox"/></b></p> <p>During the year all alternate Directors appointed to represent Independent Non - Executive Directors were Independent.</p>
3 (2) (vi)	<p><b>Criteria for Non-Executive Directors - Complied <input checked="" type="checkbox"/></b></p> <p>All Non-Executive Directors are eminent professionals in their respective fields, with credible track records and necessary skills and experience. They contribute diverse perspective to matters set before the Board, bringing independent judgment to bear on issues of strategy, performance and resource.</p>
3 (2) (vii)	<p><b>More than half the quorum to comprise Non-Executive Directors - Complied <input checked="" type="checkbox"/></b></p> <p>Majority of the Board are Non-Executive Directors.</p>
3 (2) (viii)	<p><b>Identify Independent Non-Executive Directors in communications and disclose categories of Directors in Annual Report - Complied <input checked="" type="checkbox"/></b></p> <p>The Independent Non-Executive Directors are expressly identified in all corporate communications that disclose the names of Directors of the Bank. Composition and details of the Board are given in CG&amp;RR page 4.</p>
3 (2) (ix)	<p><b>Formal and transparent procedure for appointments to the Board - Complied <input checked="" type="checkbox"/></b></p> <p>The Board has a formal and transparent process in place for the succession and appointment of Directors. The Nominations Committee processes and short-lists candidates and makes recommendations to the Board for approval. The attributes and experience required from potential appointees are identified and agreed prior to the search process considering the combined knowledge, experience and diversity of the Board in relation to the Bank's Strategic Plans and any gaps thereof. The candidate's other directorships and commitments are also considered to ensure sufficient time to discharge their role at HNB, effectively. Upon completion of this process, names are referred to the Director of the Bank Supervision Department of the Central Bank of Sri Lanka for approval as a "fit and proper" person, prior to the appointment.</p> <p>Mr Asoka Peiris and Dr Harsha Cabraal were appointed to the Board in 2019.</p>
3 (2) (x)	<p><b>Re-election of Directors filling casual vacancies - Complied <input checked="" type="checkbox"/></b></p> <p>All Directors appointed to the Board are subjected to re-election by shareholders at the first Annual General Meeting after their appointment.</p> <p>Mr Asoka Peiris and Dr Harsha Cabraal who were appointed to the Board in 2019 to fill the casual vacancies created by the retirement of Ms Rose Cooray and resignation of Mr Sujeewa Mudalige, will offer themselves for re-election at the AGM to be held in March 2020.</p>

## CORPORATE GOVERNANCE REPORT

Section	Principle, Compliance & Implementation
3 (2) (xi)	<p><b>Communication of reasons for removal or resignation of Director - Complied <input checked="" type="checkbox"/></b></p> <p>Resignations of Directors and the reasons thereof are promptly informed to the regulatory authorities and shareholders in compliance with the CSE regulations together with a statement confirming whether or not there are any matters that need to be brought to the attention of shareholders.</p>
3 (2) (xii)	<p><b>Prohibition of Directors or employees of an appointment of Bank becoming a Director at another Bank - Complied <input checked="" type="checkbox"/></b></p> <p>None of the Directors are Directors or employees at any other Bank. This is a requirement when seeking appointment of Directors.</p>
<b>3 (3)</b>	<b>Criteria to assess fitness and propriety of Directors</b>
3 (3) (i)	<p><b>Age of Director should not exceed 70 years - Complied <input checked="" type="checkbox"/></b></p> <p>There are no Directors who are over seventy (70) years of age.</p>
3 (3) (ii)	<p><b>Directors should not be Directors of more than 20 companies and not more than 10 companies classified as Specified Business Entities - Complied <input checked="" type="checkbox"/></b></p> <p>The Directors do not hold directorships of more than twenty (20) companies/entities/institutions inclusive of Subsidiaries or Associate Companies of the Bank.</p>
3 (3) (iii)	<p><b>Cooling - off period when appointing Directors or CEO - Complied <input checked="" type="checkbox"/></b></p> <p>This direction was issued on 19th December 2019. However, the Bank has complied with the directions when appointing Directors during the year.</p>
<b>3 (4)</b>	<b>Management functions delegated by the Board</b>
3 (4) (i)	<b>Understand and study delegation arrangements - Complied <input checked="" type="checkbox"/></b>
3 (4) (ii)	<b>Extent of delegation should not hinder board ability to discharge its functions - Complied <input checked="" type="checkbox"/></b>
3 (4) (iii)	<p><b>Review delegation arrangements periodically to ensure relevance to operations of the Bank - Complied <input checked="" type="checkbox"/></b></p> <p>The Board has a clear understanding of the delegation arrangements, studying, reviewing and approving the extent of delegation annually to ensure it meets the business needs of the Bank whilst enabling the Board to effectively discharge their duties.</p>
<b>3 (5)</b>	<b>The Chairman and Chief Executive Officer</b>
3 (5) (i)	<p><b>Separation of roles - Complied <input checked="" type="checkbox"/></b></p> <p>There is a clear separation of roles of the Chairman and the CEO, ensuring a balance of power for decision-making.</p>
3 (5) (ii)	<p><b>Non-Executive Chairman and appointment of a Senior Independent Directors - Complied <input checked="" type="checkbox"/></b></p> <p>The Chairman is an Independent Non-Executive Director; as such there is no requirement to appoint a Senior Independent Director.</p>
3 (5) (iii)	<p><b>Disclosure of identity of Chairman and CEO and any relationships with the Board Members - Complied <input checked="" type="checkbox"/></b></p> <p>The profiles of the Chairman and CEO are disclosed in IR page 20.</p> <p>As declared by the Directors, no relationships including financial, business, family, or any other, prevail between the Chairman, MD/CEO or among other Board Members</p>
3 (5) (iv)	<p><b>Chairman to provide leadership to the Board - Complied <input checked="" type="checkbox"/></b></p> <p>The Chairman leads the Board ensuring that it works effectively, and acts in the best interest of the Bank in a timely basis. The effectiveness of the Chairman in the discharge of the Board functions is assessed annually by Board and in his/her self-assessment.</p>
3 (5) (v)	<p><b>Responsibility for agenda lies with Chairman but may be delegated to Company Secretary - Complied <input checked="" type="checkbox"/></b></p> <p>The Chairman sets the Board agenda, assisted by the Company Secretary and MD/CEO.</p>
3 (5) (vi)	<p><b>Ensure that Directors are properly briefed and provided adequate information - Complied <input checked="" type="checkbox"/></b></p> <p>The Chairman ensures that the Board is sufficiently briefed and informed regarding the matters arising at Board.</p> <p>Board papers are circulated generally seven (7) days prior to Meeting, giving the Members adequate time to study the documents. Directors have access to Key Management Personnel to clarify matters and to external specialists for independent advice, when required.</p>
3 (5) (vii)	<p><b>Encourage active participation by all Directors and lead in acting in the interests of the Bank - Complied <input checked="" type="checkbox"/></b></p> <p>The Chairman has encouraged all Directors to actively contribute towards the best interests of the Bank.</p>



Section	Principle, Compliance & Implementation
3 (5) (viii)	<p><b>Encourage participation of Non-Executive Directors and relationships between Non-Executive and Executive Directors - Complied <input checked="" type="checkbox"/></b></p> <p>The Chairman has encouraged effective participation of all Directors and has encouraged constructive relations between the MD/CEO and the Non-Executive Directors. This function is assessed annually by the Board and by the Chairman in his self-assessment.</p>
3 (5) (ix)	<p><b>Refrain from direct supervision of Key Management Personnel and executive duties - Complied <input checked="" type="checkbox"/></b></p> <p>The Chairman does not get involved in the supervision of Key Management Personnel or any other executive duties.</p>
3 (5) (x)	<p><b>Ensure effective communication with Shareholders - Complied <input checked="" type="checkbox"/></b></p> <p>The Annual General Meeting (AGM) is the main mechanism for shareholders' views to be heard and where the Board interacts with and clarifies matter for the shareholders. The Board has formulated a formal policy to handle shareholders' complaints.</p>
3 (5) (xi)	<p><b>CEO functions as the apex executive in charge of the day to day operations and business - Complied <input checked="" type="checkbox"/></b></p> <p>As set out in the Board Charter, the responsibility for the day to day operations and business of the Bank has been delegated to the MD/CEO in his capacity as the apex executive-in-charge.</p>
<b>3 (6)</b>	<b>Board appointed Committees</b>
3 (6) (i)	<p><b>Establishing Board Committees, their functions and reporting - Complied <input checked="" type="checkbox"/></b></p> <p>The Board has appointed nine (9) Sub-Committees to ensure its oversight and control over the affairs of the bank.</p> <p>The details of Board Sub-Committees are disclosed on CG&amp;RR pages 12 to 13.</p> <p>Each Sub-Committee is governed by its own Terms of Reference and has a Secretary who arranges the Meetings and maintains minutes and records under the supervision of the Chairman of the Sub-Committee. The Sub-Committee Chairmen are accountable for the effective functioning of the Committees and reports on a periodic basis to the Board on the activities of their respective Sub-Committees, highlighting matters for Board attention. Committee mandates are reviewed regularly.</p>
<b>3 (6) (ii)</b>	<b>Board Audit Committee</b>
	<p><b>a. Chairman to be an Independent Non-Executive Director with qualifications and experience in accountancy and/or audit - Complied <input checked="" type="checkbox"/></b></p> <p>Mr Sujeewa Mudalige resigned from the BAC w.e.f. 29th March 2019. Mr Asoka Peiris has been appointed as the Chairman of the BAC with effect from 5th April 2019.</p> <p>Mr Asoka Peiris is an Independent Non-Executive Director, a member of the Institute of Chartered Accountants of Sri Lanka and a Fellow of the Chartered Institute of Management Accountants(UK). He holds over 30 years of experience in finance and management acquired both in Sri Lanka and overseas and has the required skills and experience to function effectively in the capacity of Chairman.</p>
	<p><b>b. Committee to comprise solely of Non-Executive Directors - Complied <input checked="" type="checkbox"/></b></p> <p>All members are Non-Executive Directors.</p>
	<p><b>c. Board Audit Committee functions - Complied <input checked="" type="checkbox"/></b></p> <p>In terms of its mandate, the Board Audit Committee is responsible for the following key recommendations:</p> <ol style="list-style-type: none"> <li>I. The appointment of the External Auditor for audit services in line with professional and ethical standards and in compliance with regulatory requirements. The Board Audit Committee/Board have recommended Messrs. KPMG (Chartered Accountants) as the External Auditor of the Bank for the year 2020, subject to the approval of shareholders at the next AGM as per Bank's auditor rotation policy;</li> <li>II. The service period, audit fee and any resignation or dismissal of the auditor. The Board Audit Committee ensures that the service period of the engagement of the External Audit partner shall not exceed five (5) years, and that the particular audit partner is not re-engaged for the audit before the expiry of three (3) years from the date of the completion of the previous term;</li> <li>III. The implementation of the Central Bank guidelines issued to auditors from time to time and</li> <li>IV. Monitoring and review of the adequacy and effectiveness of accounting policies and the application of relevant accounting.</li> </ol>
	<p><b>d. Review and monitor External Auditor's independence and objectivity and the effectiveness of the audit processes - Complied <input checked="" type="checkbox"/></b></p> <p>The Board Audit Committee monitors and reviews the External Auditor's independence, objectivity and the effectiveness of the audit process taking into account relevant professional and regulatory requirements.</p>

## CORPORATE GOVERNANCE REPORT

Section	Principle, Compliance & Implementation
<b>e. Provision of Non-Audit services by External Auditor - Complied</b> <input checked="" type="checkbox"/>	<p>The BAC is guided by the Board approved policy for Engagement of the External Auditor to provide Non-Audit Services.</p> <p>In assignment of non-audit services to External Auditors by the Bank, the Board/Board Audit Committee ensures that the External Auditor has the necessary skills and experience for the assignment and ascertains that independence and/or objectivity of the External Auditor in carrying out his duties and responsibilities will not be impaired. Assigning such Non-Audit Services to External Auditors is discussed at BAC Meetings and prior approval obtained. Please refer Board Audit Committee Report on IR pages 115 to 117 for further details.</p>
<b>f. Determines scope of Audit - Complied</b> <input checked="" type="checkbox"/>	<p>The External Auditor Messrs. Ernst &amp; Young (Chartered Accountants) attended nine (9) meetings during the year. The External Auditor presented to the Committee the audit approach and procedures, including nature &amp; scope of the audit and auditor's independence.</p>
<b>g. Review financial information of the Bank - Complied</b> <input checked="" type="checkbox"/>	<p>The Committee reviews the financial information of the Bank, in order to monitor the integrity of the Bank's Financial Statements, Annual Report, accounts and quarterly reports prepared for disclosure, and the significant financial reporting judgments contained therein. The review focuses particularly on the following:</p>
<ol style="list-style-type: none"> <li>I. Major judgemental areas,</li> <li>II. Any changes in accounting policies and practices,</li> <li>III. Significant adjustments arising from the audit,</li> <li>IV. The going concern assumption,</li> <li>V. Compliance with relevant accounting standards and other legal requirements.</li> </ol>	
<b>h. Discussions with External Auditor on interim and final audits - Complied</b> <input checked="" type="checkbox"/>	<p>The Board Audit Committee discusses issues, problems and reservations arising from the interim and final audits with the External Auditor. The Committee met the External Auditor on three (3) occasions in 2019, in the absence of the MD/CEO and KMP (Key Management Personnel).</p>
<b>i. Review of Management Letter and Bank's response - Complied</b> <input checked="" type="checkbox"/>	<p>The Board Audit Committee reviewed the External Auditor's management letter for the 2018 Audit and the Management's response thereto during 2019.</p>
<b>j. Review of Internal Audit Function - Complied</b> <input checked="" type="checkbox"/>	<p>During the year, the Board Audit Committee reviewed the independence, objectivity and performance of the Internal Audit Function, ensuring the function acts with impartiality, proficiency and due professional care.</p> <p>It reviewed the adequacy of coverage of the internal audit plan and approved the same. It also assessed the Department's resource requirements including succession planning, and is satisfied that the Internal Audit Department has the necessary authority to carry out its work.</p> <p>The Committee reviewed internal audit findings and management responses thereto. The Internal Audit Department's evaluation of the Bank's internal controls were reviewed by the Board Audit Committee. Results of the follow up action taken on the recommendations of the Internal Audit Department were also reviewed.</p> <p>The Committee reviewed the performance appraisal of the Chief Internal Auditor and other senior staff members of the Internal Audit Department. The Committee is kept apprised of resignations of senior staff of the Internal Audit Department together with the reasons for resigning.</p> <p>The Chief Internal Auditor directly reports to the Board Audit Committee thus ensuring the independence of the Internal Audit Department.</p>
<b>k. Internal Investigations - Complied</b> <input checked="" type="checkbox"/>	<p>Major findings of internal investigations and Management's responses thereto are reviewed by the Board Audit Committee and recommendations implemented.</p>
<b>l. Attendees at Board Audit Committee Meetings - Complied</b> <input checked="" type="checkbox"/>	<p>MD/CEO, COO, Chief Risk Officer, Chief Financial Officer, Chief Internal Auditor, Head of Compliance, Chief Technology &amp; Digital Officer, DGM Operations and a representative of the External Auditor are typically invited to attend Meetings. Other Board Members may also attend Meetings upon invitation.</p>

## Section

## Principle, Compliance &amp; Implementation

**m. Explicit authority, resources and access to information - Complied** 

The Board Audit Committee is guided by the Committee Charter which sets out authority and responsibility of the said Committee. The Charter was last reviewed in June 2019. The Board Audit Committee is authorised to obtain external professional advice and to invite outsiders with relevant experience to attend as and when necessary. The Committee also has full access to information in order to investigate into matters relating its Terms of Reference.

**n. Regular Meetings - Complied** 

The Board Audit Committee met nine (9) times during the year. Conclusions in discharging its duties and responsibilities are recorded in the minutes of the Meetings.

**o. Disclosure in Annual Report - Complied** 

Details of the activities of the Board Audit Committee, number of Meetings held and particulars of attendance are included in the Report of the Board Audit Committee on IR pages 115 to 117.

Areas of oversight of the Board Audit Committee, number of Meetings held and attendance are given in the Report of the Board Audit Committee on CG&RR page 21.

**p. Maintain Minutes of Meetings - Complied** 

Minutes of Board Audit Committee Meetings are recorded and maintained by the Secretary to the Committee. The Chief Internal Auditor serves as the Secretary to the Committee.

**q. Whistle-blowing policy and relationship with External Auditor - Complied** 

A Board approved whistle-blowing policy is in place. The whistle-blowing policy and the mechanism had been communicated to all staff members.

The Board Audit Committee reviews issues relating to breach of ethics if any and the arrangements by which the staff of the Bank may in confidence raise concerns about possible improprieties. The Committee also ensured that the procedures for the independent investigations of such matters are appropriate and are in place. The independent Director handling whistle-blowing complaints provides regular updates on the investigation results to the BAC.

The Board Charter addresses the Board's responsibility to encourage any communication regarding non-compliances and unethical behaviour within the Bank.

## 3 (6) (iii)

**Human Resources & Remuneration Committee****a. Remuneration Policy - Complied** 

The Committee reviews all significant human resource policies and initiatives, salary structures, promotions and terms and conditions relating to staff at Senior Management Level with information and recommendations from the MD/CEO and the Chief Human Resource Officer.

Separate Remuneration Policies for the Board of Directors, MD/CEO and all employees of the Bank including Key Management Personnel (KMP) are in place.

**b. Goals and Targets - Complied** 

The goals and targets of the Board of Directors have been clearly set out and evaluated at the end of the year. The goals and targets for the MD/CEO and the senior leadership team are documented under the Balance Score Card system. Further, the goals and targets for 2019 for the MD/CEO and the senior leadership team was approved at a Board Meeting.

**c. Performance Evaluation- Complied** 

The Directors are evaluated at the end of the year based on the goals and targets set out.

The Committee deliberates upon and recommends to the Board of Directors the remuneration packages, annual increments and bonuses of the MD/CEO, COO, members of the Corporate Management and Senior Management staff, having evaluated their performance against the set goals and targets.

**d. Meetings - Complied** 

The HRRC Committee met three (3) times during the year.

The MD/CEO attends Human Resources & Remuneration Committee by invitation. The MD/CEO is not present at the time his performance is being discussed.

## CORPORATE GOVERNANCE REPORT

Section	Principle, Compliance & Implementation
3 (6) (iv)	<p><b>Nomination Committee</b></p> <p><b>a. Appointment of Directors, CEO and Key Management Personnel - Complied <input checked="" type="checkbox"/></b> A formal procedure is in place to appoint new Directors, MD/CEO and Key Management Personnel. This procedure was further reviewed during 2019.</p> <p><b>b. Re-election of Directors - Complied <input checked="" type="checkbox"/></b> The Committee considers and recommends the re-election of the Directors to the Board. The Committee also set criteria of the succession of the MD/CEO.</p> <p><b>c. Eligibility criteria for appointments to key managerial positions including CEO - Complied <input checked="" type="checkbox"/></b> The Committee sets the eligibility criteria, including qualifications, experience and key attributes, for appointment or promotion to key managerial positions including the position of the MD/CEO. A Board approved procedure to appoint Directors, MD/CEO and Key Management Personnel is in place.</p> <p><b>d. Fit &amp; proper persons - Complied <input checked="" type="checkbox"/></b> Each Director including the MD/CEO carries out an assessment of "fitness and propriety" to serve as a Director of the Bank. These declarations are reviewed by the Nomination Committee prior to submission to the Director Bank Supervision of the Central Bank of Sri Lanka.</p> <p><b>e. Succession plan and new expertise - Complied <input checked="" type="checkbox"/></b> A Succession Planning Policy is in place for KMP and Directors. Each year, the Nomination Committee reviews the additional/ new expertise requirements and succession arrangements for Directors and KMP of the Bank, in line with the Strategic Plan.</p> <p><b>f. Composition of Nomination Committee - Complied <input checked="" type="checkbox"/></b> The following Non-Executive Directors served on the Nomination Committee during 2019 Mr Dinesh Weerakkody - Independent Non-Executive Director (Chairman) Ms Rose Cooray - Non-Executive Director (upto 24th January 2019) Mr Rusi Captain - Non-Executive Director Mr Palitha Pelpola - Independent Non-Executive Director</p>
3 (6) (v)	<p><b>Board Integrated Risk Management Committee</b></p> <p><b>a. Composition of Risk Management Committee - Complied <input checked="" type="checkbox"/></b> The following personnel served on the Board Integrated Risk Management Committee during 2019. Ms Rose Cooray - Non-Executive Director (Chairperson - Retired on 15th February 2019) Mr Duliksha Soosaipillai - Independent Non-Executive Director (Chairman - Appointed w.e.f. 25th January 2019) Mr Jonathan Alles - Managing Director/CEO Mr Madu Ratnayake - Independent Non-Executive Director Mr Rusi Captain - Non-Executive Director (Appointed w.e.f. 5th April 2019) Mr Damith Pallewatte - Chief Risk Officer/DGM-Risk/CISO Ms Mohini Seneviratne - Head of Compliance (Retired w.e.f. 31st July 2019) Mr Janath Ilangantileke - AGM-Compliance (Appointed w.e.f. 1st August 2019) The Chief Operating Officer, Chief Financial Officer, Chief Information Officer and Chief Internal Auditor attend Meetings on invitation. The Committee makes decisions on behalf of the Board within the framework of the authority and responsibility assigned. Terms of Reference of the Committee is described in the Committee Report, pages 111 to 114 of the IR.</p> <p><b>b. Risk Assessment - Complied <input checked="" type="checkbox"/></b> Policies on Credit Risk Management, Market Risk Management and Operational Risk Management have been approved by the Committee, providing a framework for management and assessment of risks. In discharging its responsibilities further as per the mandate, periodic reports on pre-established risk indicators prepared by the Risk Department is submitted to the Committee for review. The risk management process followed by the subsidiary companies has also been reviewed by the BIRMC during 2019.</p>

Section	Principle, Compliance & Implementation
	<p><b>c. Review of management level committees on risk - Complied <input checked="" type="checkbox"/></b></p> <p>The Committee reviews the reports of the Management Committees including the Asset and Liability Committee (ALCO) and the Executive Risk Management &amp; Credit Policy Committee to assess their adequacy and effectiveness in addressing specific risks and managing the same within the quantitative and qualitative risk limits set in the Risk Appetite Statement approved by the Board.</p> <p><b>d. Corrective action to mitigate risks exceeding prudential levels - Complied <input checked="" type="checkbox"/></b></p> <p>The Risk Dashboards, prepared on a periodic basis, reflects the actual exposure levels under each risk category against the tolerance levels, decided by the Committee on the basis of the Bank's policies and regulatory and supervisory requirements. The Committee has taken prompt corrective actions to mitigate the effects of risk indicators which have gone beyond the tolerance levels.</p> <p><b>e. Frequency of meetings - Complied <input checked="" type="checkbox"/></b></p> <p>The Committee has met twelve (12) times during the year. The agenda covers matters assessing all aspects of risk management including the updated business continuity plans.</p> <p><b>f. Actions against officers responsible for failure to identify specific risks or implement corrective action - Complied <input checked="" type="checkbox"/></b></p> <p>Such matters, if any, are referred to the Human Resources Division for necessary action.</p> <p><b>g. Risk assessment report to Board - Complied <input checked="" type="checkbox"/></b></p> <p>Detailed reports of the BIRMC Meetings are submitted to the Board at the subsequent Board Meeting.</p> <p><b>h. Compliance Function- Complied <input checked="" type="checkbox"/></b></p> <p>The Bank has established a compliance function to assess and ensure the Bank's compliance with laws, regulations, regulatory guidelines, internal controls and approved policies on all areas of business operations, headed by a dedicated Compliance Officer who reports to the BIRMC.</p>
<b>3 (7)</b>	<b>Related Party Transactions</b>
3 (7) (i)	<p><b>Avoid conflict of interest - Complied <input checked="" type="checkbox"/></b></p> <p>A Board approved policy to enhance the transparency of Related Party Transactions is in place.</p> <p>Steps have been taken by the Board to avoid any conflicts of interest, that may arise, in transacting with related parties as per the definition of this Direction. The Directors provide declarations to the Board of their outside business interests at appointment and quarterly thereafter. The Directors do not participate in, and excuse themselves from, the Meeting when the Board considers any matters in which lending to related entities are discussed and where a conflict in interest may arise.</p> <p>Transactions carried out with related parties as defined by LKAS 24 on 'Related Party Disclosures' in the normal course of business are disclosed in note 60 to the Financial Statements on 'Related Party Disclosures' on IR pages 277 to 283. Directors' interest in contracts which do not fall into the definition of Related Party Transactions as per LKAS 24 are reported separately in the Annual Report, outside the Financial Statements. The net accommodation granted to each category of related parties as a percentage of the Bank's regulatory capital is given under Rule 3 (8) (ii) (e).</p>
3 (7) (ii)	<p><b>Related Party Transactions covered by direction - Complied <input checked="" type="checkbox"/></b></p> <p>I. The Related Party Transactions Policy approved by the Board covers the following transactions:</p> <p>II. The grant of any type of accommodation, as defined in the Monetary Board's Directions on maximum amount of accommodation,</p> <p>III. The creation of any liabilities of the Bank in the form of deposits, borrowings and investments,</p> <p>IV. The provision of any services of a financial or non-financial nature provided to the Bank or received from the Bank and</p> <p>V. The creation or maintenance of reporting lines and information flows between the Bank and any related parties which may lead to the sharing of potentially proprietary, confidential or otherwise sensitive information that may give benefits to such related parties.</p>

## CORPORATE GOVERNANCE REPORT

Section	Principle, Compliance & Implementation
3 (7) (iii)	<p><b>Prohibited transactions - Complied <input checked="" type="checkbox"/></b></p> <p>The Bank's Related Party Transactions Policy prohibits transactions which would grant related parties more favourable treatment than that accorded to other customers. These include the following:</p> <p>I. Granting of "Total Net Accommodation" to related parties, exceeding a prudent percentage of the Bank's regulatory capital. Refer Rule 3 (8) (ii) (e) in CG&amp;RR page 37;</p> <p>II. Charging of a lower rate of interest than the Bank's best lending rate or paying more than the Bank's deposit rate for a comparable transaction with an unrelated comparable counterparty;</p> <p>III. Providing of preferential treatment, such as favourable terms, covering trade losses and/or waiving fees/commissions, that extend beyond the terms granted in the normal course of business undertaken with unrelated parties;</p> <p>IV. Providing services to or receiving services from a related-party without an evaluation procedure and</p> <p>V. Maintaining reporting lines and information flows that may lead to sharing potentially proprietary, confidential or otherwise sensitive information with related parties, except as required for the performance of legitimate duties and functions.</p>
3 (7) (iv)	<p><b>Granting accommodation Director or close relation to a Director - Complied <input checked="" type="checkbox"/></b></p> <p>A formal procedure is in place for granting accommodation to Directors or to close relatives of Directors. Such accommodation must be sanctioned at Board Meetings, by not less than 2/3 of the number of Directors excluding Director concerned, voting in favour of such accommodation or through circulation of papers which requires approval by all. The terms and conditions of the facility include a provision that it will be secured by such security as may from time to time be determined by the Monetary Board.</p>
3 (7) (v)	<p><b>Accommodations granted to persons, or concerns of persons, or close relations of persons, who subsequently are appointed as Directors of the Bank - Complied <input checked="" type="checkbox"/></b></p> <p>As at the Balance Sheet date no accommodations were granted to the newly appointed Directors.</p>
3 (7) (vi)	<p><b>Favourable treatment or accommodation to Bank employees or their close relations - Complied <input checked="" type="checkbox"/></b></p> <p>No favourable treatment or accommodation is provided to Bank employees or their relatives, other than staff benefits.</p>
3 (7) (vii)	<p><b>Remittance of accommodations subject to Monetary Board approval - Complied <input checked="" type="checkbox"/></b></p> <p>No such situation has arisen during the year.</p>
<b>3 (8)</b>	<b>Disclosures</b>
3 (8) (i)	<p><b>Publish annual and quarterly Financial Statements - Complied <input checked="" type="checkbox"/></b></p> <p>Annual Audited Financial Statements and Interim Financial Statements of the Bank were prepared in accordance with the formats prescribed by the Supervisory and Regulatory Authorities and applicable accounting standards and have been published in the newspapers in all three (3) languages.</p>
3 (8) (ii)	<p><b>Disclosures in Annual Report</b></p> <p><b>a. A Statement to the effect that the Annual Audited Financial Statements have been prepared in line with applicable accounting standards and regulatory requirements, inclusive of specific disclosures - Complied <input checked="" type="checkbox"/></b></p> <p>Disclosures on the compliance with the applicable accounting standards and regulatory requirements in preparation of the Annual Audited Financial Statements have been made in the 'Statement of Directors' Responsibility for Financial Reporting' in IR page 136, 'Chief Executive Officer's and Chief Financial Officer's Statement of Responsibility' in IR page 135 and note 2.1.1 Statement of Compliance to the Financial Statements in IR page 149.</p> <p><b>b. Report by the Board on the Bank's internal control mechanism - Complied <input checked="" type="checkbox"/></b></p> <p>A confirmation by the Directors on the effectiveness of the internal control system over financial reporting is given under the Directors' Statement on Internal Control over Financial Reporting on pages 120 to 121 in IR.</p> <p><b>c. External Auditor's certification on the effectiveness of the internal control mechanism - Complied <input checked="" type="checkbox"/></b></p> <p>The Assurance Report issued by the External Auditor on the Internal Control over Financial Reporting based on "SLSAE 3050 – Assurance Reports for Banks on Directors' Statement on Internal Controls" issued by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) is given in IR page 122. The recommendations made by the Auditors where relevant, will be dealt with in 2020.</p>

Section	Principle, Compliance & Implementation
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**d. Details of Directors, including names, fitness and propriety, transactions with the Bank and the total of fees/remuneration paid by the Bank - Complied**

Profiles of Directors are given on pages 20 to 23 in IR.

Directors' transactions with the Bank are disclosed in note 60 to the Financial Statements on pages 277 to 283 in IR.

Remuneration paid by the Bank to the Board of Directors (which includes the remuneration of the Executive Director) is disclosed in note 70 to the Financial Statements in IR page 197.

**e. Total accommodations granted to each category of related parties and as a percentage of the Bank's regulatory capital - Complied**

The net accommodation granted to each category of related parties is given below as a percentage of the Bank's regulatory capital.

Category of Related Party Transactions	Rs Mn	%
Non-Executive Directors and their close family members	4.4	0.00
Key Management Personnel* and their close family members	271.0	0.19
Subsidiaries	2,449.4	1.70
Joint Venture	4,240.3	2.94
Entities which Directors and their close family members have a substantial interest	123.5	0.09
Government of Sri Lanka/Entities Controlled, Jointly Controlled, Significantly Influenced by the Government of Sri Lanka	55,489.9	38.45

\*includes the Executive Director

**f. Aggregate values of remuneration to, and transactions with Key Management Personnel - Complied**

The aggregate amount of remuneration paid during 2019 to Key Management Personnel and the transactions with Key Management Personnel are given below

Remuneration and transactions with the Key Management Personnel	Rs Mn
Remuneration Paid	433.4
Loans and Advances	471.5
Deposits	446.6
Investments	76.0

**g. External Auditor's certification of compliance - Complied**

The External Auditors have performed procedures set out in Sri Lanka Standards on Related Service 4400 issued by the Institute of Chartered Accountants of Sri Lanka (SLSRS 4400), to meet the compliance requirement of the Corporate Governance Directive. Their findings presented in their report addressed to the Board are consistent with the matters disclosed above and did not identify any inconsistencies to those reported above by the Board. The recommendations made by the Auditors where relevant will be dealt with in 2020.

**h. Report confirming compliance with prudential requirements, regulations, laws and internal controls - Complied**

There were no material non-compliance to prudential requirements, regulations, laws and internal controls affecting the Bank.

**i. Non-compliance Report - Complied**

There were no supervisory concern lapses in the Bank's Risk Management Systems or non-compliance with the said Direction that have been pointed out by the Director of the Banks Supervision Department of the CBSL, which has been directed to be disclosed to the public. Hence, there are no disclosures in this regard.

**3 (9) Transitional and Other General Provisions**

**Transitional and other general provisions - Complied**

Transitional provisions have been complied with.

## CORPORATE GOVERNANCE REPORT

**Appendix II: Compliance with the Code of Best Practice on Corporate Governance issued by the Institute of Chartered Accountants of Sri Lanka in 2017**

This table summarises compliance with the Code, providing details where it has not been explained in the Corporate Governance Report or Appendix I: Compliance with Banking Direction No.11 of 2007 on Corporate Governance.

Code Ref.	Requirement	Reference	Complied	Page Ref
<b>A</b>	<b>Directors</b>			
A.1	The Board	Board Composition Governance Structure	☑	CG&RR 5 CG&RR 8
A.1.1	Board Meetings	Board Meetings	☑	CG&RR 20
A.1.2	Role & Responsibilities of the Board	Key Responsibilities	☑	CG&RR 9
A.1.3	Compliance Independent Professional Advice	Compliance Access to Information	☑	CG&RR 19 CG&RR 17
A.1.4	Access to advice and services of Company Secretary and Insurance Cover	Company Secretary Insurance Cover The Bank has obtained adequate insurance cover for the Board, Directors and KMP in accordance with the recommendations of the Nominations Committee. The Directors and Officers Liability Policy is renewed annually.	☑	CG&RR 12
A.1.5	Independent Judgement	Independent Judgement	☑	CG&RR 19
A.1.6	Dedicate Adequate Time and Effort Board Pack	Conflict of Interest Board Meetings	☑	CG&RR 21 CG&RR 20
A.1.7	Calls for Resolutions	Board Meetings - Resolutions	☑	CG&RR 20
A.1.8	Board Induction and Training Annual Assessment of Training Needs	Informed Decision Making - Knowledge Development Board Appraisal	☑	CG&RR 17 CG&RR 24
A.2	Chairman & Chief Executive Officer	Balance of Power	☑	CG&RR 19
A.3.	Chairman's Role in Preserving Good Corporate Governance	Key Leadership Roles and Responsibilities - Chairman and MD/CEO	☑	CG&RR 11
A.4	Availability of Financial Acumen	Board Composition	☑	CG&RR 5
A.5	Board Balance	Board Composition Independent Judgement Board of Directors Board Meetings - Meetings, Minutes Alternate Directors are not executives of the Bank.	☑	CG&RR 5 CG&RR 19 CG&RR 4 CG&RR 20
A.6.	Provision of Appropriate and Timely Information	Informed Decision Making - Supply of Information The Board - Key Leadership Roles & Responsibilities Board Meetings	☑	CG&RR 17 CG&RR 11 CG&RR 20
A.7	Appointments to the Board	Board Invigoration Nomination Committee report Board Appraisal	☑	CG&RR 10 IR 109 - 110 CG&RR 24
A.8	Re-election of Directors	Board Invigoration	☑	CG&RR 10
A.9	Appraisal of Board & Sub Committees -Review at Re-Election	Board Appraisal Board Invigoration	☑	CG&RR 24 CG&RR 10



Code Ref.	Requirement	Reference	Complied	Page Ref
A.10	Annual Report to Disclose Specified Information Regarding Directors	Profiles Directorships in Other Companies Board Sub- Committees Attendance at Meetings	<input checked="" type="checkbox"/>	IR 20 - 23 CG&RR 22 CG&RR 12-13 CG&RR 21
A.11	Annual appraisal of the CEO	Board Appraisal	<input checked="" type="checkbox"/>	CG&RR 24
<b>B.</b>	<b>Directors' Remuneration</b>			
B.1	Directors' & Executive Remuneration - HRRC	Fair and Responsible Remuneration Board Sub-Committees	<input checked="" type="checkbox"/>	CG&RR 22 CG&RR 12-13
B.2	Level & Make up of Remuneration	Fair and Responsible Remuneration	<input checked="" type="checkbox"/>	CG&RR 22
B.3	Disclosures related to Remuneration in Annual Report	Fair and Responsible Remuneration Financial Statements HRRC report	<input checked="" type="checkbox"/>	CG&RR 22 IR 140 - 288 IR 107 - 108
<b>C.</b>	<b>Relations with Shareholders</b>			
C.1	Constructive use of the AGM & Other General Meetings	The Annual General Meeting (AGM)	<input checked="" type="checkbox"/>	CG&RR 23
C.2	Communication with shareholders	Balancing Stakeholder Interests Reporting and Disclosure Communication Company Secretary	<input checked="" type="checkbox"/>	CG&RR 17 CG&RR 23 CG&RR 25 CG&RR 12
C.3	Disclosure of Major and Material Transactions	There were no such major or material transactions during the year.	<input checked="" type="checkbox"/>	
<b>D.</b>	<b>Accountability &amp; Audit</b>			
D.1	Present a balanced and understandable assessment of the Company's financial position, performance and prospects	Accountability Chief Executive Officer's and Chief Financial Officer's Responsibility Statement Annual report of the Board of Directors on the affairs of the Bank Directors Responsibility for Financial Reporting Directors' Statement on Internal Control over Financial Reporting Management Discussion and Analysis Statement of going concern of the Bank on note 2.3.1, to the Financial Statements Related Party Transactions (i) Note 60 in the Financial Statements (ii) Report of the RPTRC In the unlikely event of the net assets of the Bank falling below 50% of Shareholders Funds, the Board will summon an Extraordinary General Meeting (EGM) to notify the shareholders of the position and to explain the remedial action being taken.	<input checked="" type="checkbox"/>	CG&RR 23 IR 135 IR 98 - 106 IR 136 IR 120 - 121 IR 44 - 97 IR 151 IR 277 - 283 IR 118 - 119
D.2	Process of Risk Management and a sound system of internal control to safeguard shareholders' investments and the Company's assets	Risk Management and Internal Control Risk & Capital Review  Directors' Statement on Internal Control over Financial Reporting	<input checked="" type="checkbox"/>	CG&RR 24 CG&RR 41 - 80 IR 120 - 121

## CORPORATE GOVERNANCE REPORT

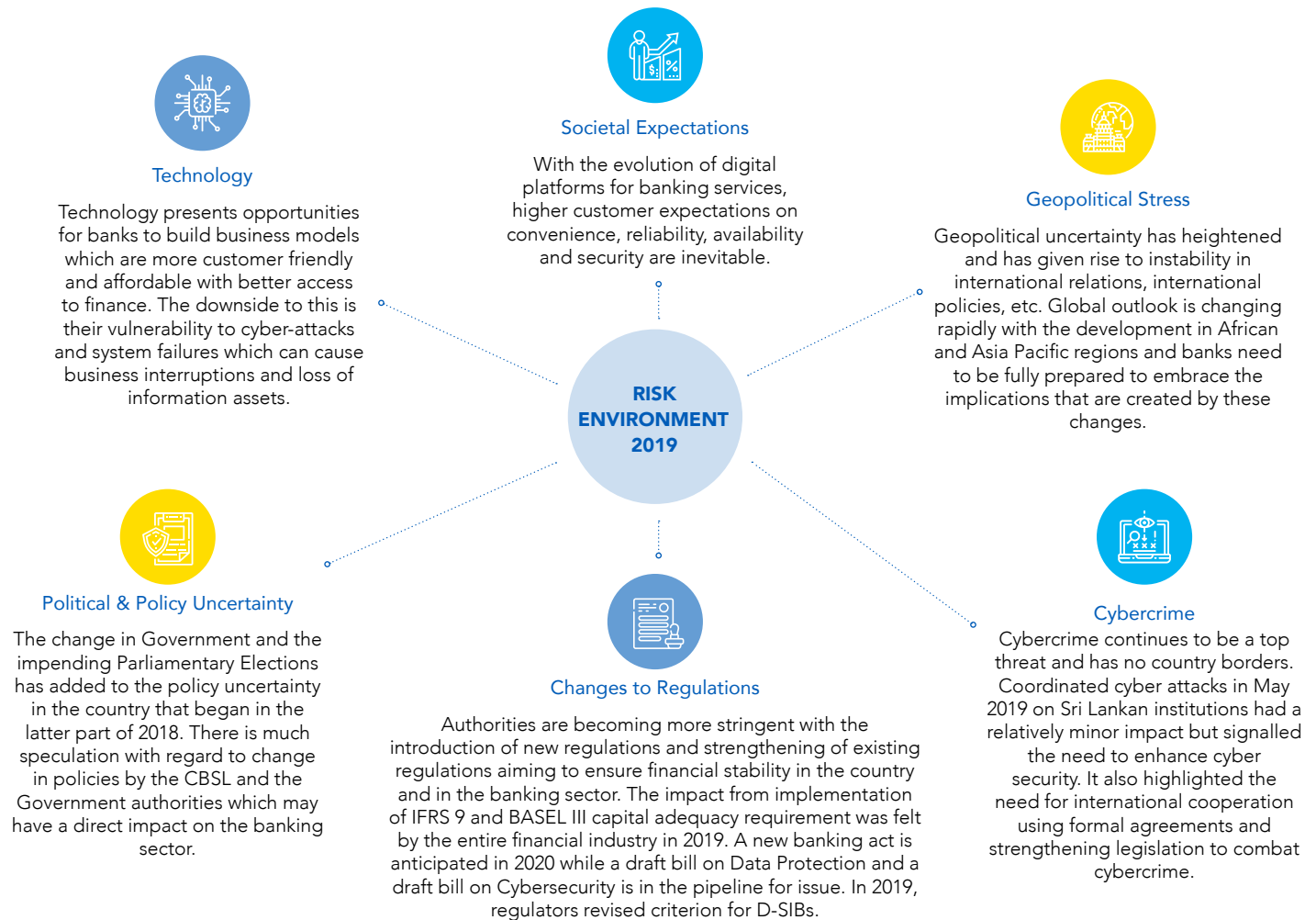
Code Ref.	Requirement	Reference	Complied	Page Ref
D.3	Audit Committee	Board Audit Committee Report	<input checked="" type="checkbox"/>	IR 115 - 117
D.4	Related Party Transactions Review Committee	Board Related Party Transactions Review Committee report	<input checked="" type="checkbox"/>	IR 118 - 119
D.5	Code of Conduct and Ethics	Chairman's Message Communication Conflict of Interest Values and Culture Code of Conduct and Ethics	<input checked="" type="checkbox"/>	CG&RR 3 CG&RR 25 CG&RR 21 CG&RR 19 CG&RR 19
D.6	Corporate Governance Disclosures	Corporate Governance Report	<input checked="" type="checkbox"/>	CG&RR 3-40
<b>E/F</b>	<b>Institutional and other Investors</b>			
	Encourage voting at AGM – institutional and other investors	Communication The Annual General Meeting	<input checked="" type="checkbox"/>	CG&RR 25 CG&RR 23
<b>G.</b>	<b>Internet of Things &amp; Cybersecurity</b>			
G.1	Identify connectivity and related cyber risks	Technology Governance and Security	<input checked="" type="checkbox"/>	CG&RR 24
G.2	Appoint a CISO and allocate budget to implement a cybersecurity policy	Technology Governance and Security	<input checked="" type="checkbox"/>	CG&RR 24
G.3	Include cyber security on Board agenda	Technology Governance and Security	<input checked="" type="checkbox"/>	CG&RR 24
G.4	Obtain periodic assurance to review effectiveness of cybersecurity risk management	Technology Governance and Security	<input checked="" type="checkbox"/>	CG&RR 24
G.5	Disclosures in Annual Report	Technology Governance and Security	<input checked="" type="checkbox"/>	CG&RR 24
<b>H.</b>	<b>Environment, Society &amp; Governance</b>			
H.1	ESG Reporting	Focus on Environment, Social and Governance (ESG) considerations	<input checked="" type="checkbox"/>	CG&RR 17

# RISK & CAPITAL REVIEW

The risk landscape continues to increase in complexity as technological, social, market and regulatory developments combine to blur the landscape. As volatility and uncertainty become the new normal, risk management needs to evolve rapidly, building resilience against external threats and adapting to changing business models. Consequently, we invested in developing new tools and identifying emerging metrics early to identify, measure, monitor and manage risk which is vital to ensure sustainable growth, profitability and resilience of the Bank during the reporting period. Simultaneously, we reassessed our risk management structures, processes and culture to enhance the competencies of our people to successfully navigate the emerging risk landscape. This report seeks to provide an overview of our key activities during the year and where we stand at the end of the year.

## Risk Landscape

Key factors affecting the risk landscape for the banking industry are summarised below.



Over and above these trends that had a gradual albeit fast-paced impact on the risk landscape, there were major risk events of high severity during the year that had a high impact on our operations.

The Easter Sunday terror attacks had a wide-ranging impact over the entire country, evident in the sharp decline in GDP growth from 3.7% in Q1 to 1.5% in Q2 2019. The country's resilience is evinced in the GDP growth in Q3 despite the significant political uncertainty that prevailed during the second half of the year, culminating in Presidential Elections in November 2019. New investments such as the Port City project were launched during the year providing growth opportunities for many businesses.

Liquidity risk to banks that began with the repayment moratoriums to Tourism sector in 2019 and is envisaged to be extended in 2020 to the SME sector will be monitored and managed.





## RISK &amp; CAPITAL REVIEW

## Our Material Risks

Our material risks are summarised below in Figure 1: Material Risks and signposted to the respective detailed discussion for those who require more detailed information.

Figure 1: Material Risks

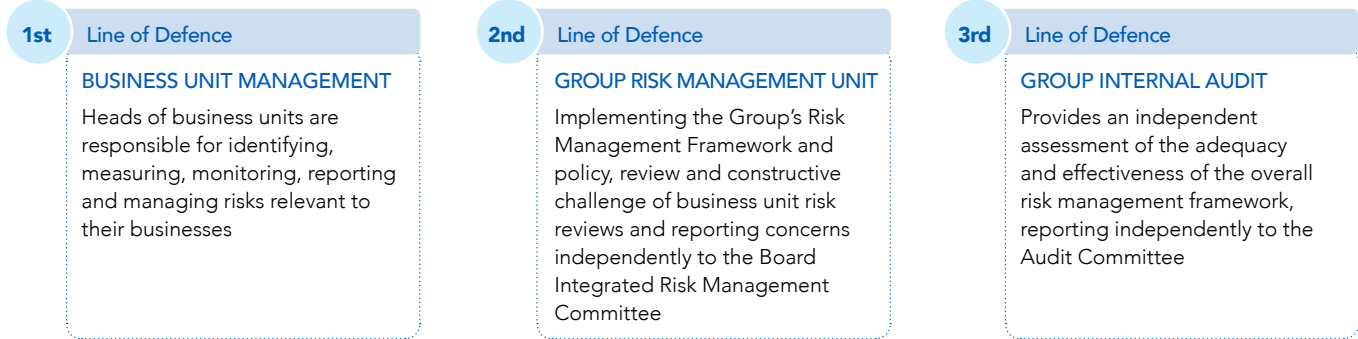
	 Information & Cyber Risk	 Credit Risk	 Operational Risk
<b>Definition</b>	Risk of financial loss, disruption or damage to the reputation of the Bank from any sort of compromise of information to unintended parties and unauthorised access to our systems or data/information. It also arises from failure of the Bank's information technology systems.	The risk of losses due to one or more counterparties failing to meet all or part of their contractual obligations towards the Bank in accordance with agreed terms.	The risk of loss due to inadequate or failed internal processes, people and systems or from external events. This definition includes legal risk but excludes strategic and reputational risk.
<b>Drivers</b>	Arises from the integration of information technology in to all aspects of banking operations which facilitate convenience, scalability and capability but also makes the Bank vulnerable to unauthorised access to systems and information assets.	Arises from concentration of portfolio by product, business sector, geography, etc., deterioration of economic conditions, rigour of credit evaluation and monitoring processes, Bank's credit risk appetite, internal risk goals and tolerance level, Expectation on Government concessions to postpone repayment.	Arises from day-to-day operations and external events.
<b>Measured</b>	Reference to cyber risk loss limits and cyber risk matrix, hacking attempts for a month.	Based on credit exposure, Probability of Default (PD), expected losses, Loss Given Default (LGD) and recovery rates. NPA ratios, stress testing on concentration, large borrower default, increase in provision etc. Additional capital under Pillar 2 risk is assessed by ICAAP as per Basel III.	Measured using operational losses, loss events/near misses, key risk indicators, overall risk grid matrix, risk ranking and prioritising, risk heat map, capital allocation under CAR as per Basel III.
<b>Monitored</b>	By Information and cybersecurity risk vertical through a cyber risk dashboard presented to BIRMC and ISSC monthly, Monitoring of Privileged User Activities on a periodic basis and report to CISO and BIRMC.	By Credit Risk Vertical using the Credit Risk Dashboard which provides metrics on a number of parameters including analysis of arrears, collateral, concentration, etc. submitted to BIRMC, BCC and the executive committees.	By Operational Risk management vertical under the guidance of ORSC with input from business units through Risk and Control Self Assessments. Operational risk monthly Dashboards are submitted to ERM, BIRMC and Board.
<b>Managed</b>	Through the Bank's action plan for digital resilience, awareness programs for staff, business continuity plans, use of physical controls, technical and logical access and administrative controls.	In accordance with Credit Risk management policy suite supported by dedicated resources for monitoring of arrears, strong documentation and a proactive approach to resolving issues.	Managed through a sound Operational Risk Management Framework by the ORSC with the participation of all business/support units.  Availability of comprehensive Business Continuity Plan (BCP) covering all mission critical units and conduct BCP drills periodically.
<b>Key Information</b>	Assessment: High Trend: <span style="color: red;">↑</span> Page 62	Assessment: High Trend: <span style="color: red;">↑</span> Page 54	Assessment: Moderate Trend: <span style="color: red;">↑</span> Page 60

 Liquidity Risk	 Market Risk	 Strategic Risk	 Reputation Risk
<p>The risk that the Bank is unable to meet its debt obligations associated due to lack of funds or having to meet these obligations at excessive cost.</p>	<p>The risk that movements in market factors could reduce our income or value of portfolios.</p>	<p>Refers to uncertainties and untapped opportunities embedded in our strategic intent and how well they are executed.</p>	<p>The loss resulting from damages to a firm's reputation, in lost revenue; increased operating, capital or regulatory costs; or destruction of shareholder value.</p>
<p>Arises from mismatches in cash flow due to potential short-term cash demands placed upon the Bank, by depositors, borrowers, the Bank's own borrowing activity, trading activities and counterparty interactions.</p>	<p>Arises from movement in market factors such as foreign exchange rates, interest rates, credit spreads, equity prices and commodity prices.</p>	<p>Arises from external developments in technology, products, business models.</p>	<p>Arises from events that could adversely impact public perception of the Bank as a responsible corporate citizen.</p>
<p>Measured using a range of metrics including regulatory limits such as the LCR, internal model and balance sheet based measures and stress testing on interest rate sensitivity, probabilistic analysis, NII analysis.</p>	<p>Measured using Value at Risk, Sensitivity analysis and stress testing on open positions, mark to market on daily basis to identify the trading book position, capital is allocated under CAR as per Basel III.</p>	<p>Measured using a scorecard approach to quantify strategic risk under the Basel III Pillar 2 calculation.</p>	<p>Measured using a scorecard approach by assessing underlying risk drivers of reputational risk due to qualitative nature of the risk.</p>
<p>By ALCO and Treasury Middle Office (TMO) using a matrix of regulatory and prudential limits and gaps using both stock and flow approaches, dashboards submitted to ALCO, BIRMC and Board.</p>	<p>By ALCO using Market Risk Dashboards supported by an independent Treasury Middle Office (TMO) which reports to CRO. Internal and regulatory limits and exceptions are immediately reported to ALCO.</p>	<p>By the Integrated risk management unit through a scorecard and evaluated for any additional capital requirement through the annual ICAAP submission to Board.</p>	<p>By the Integrated risk management unit through a scorecard and evaluated for any additional capital requirement through the ICAAP submission to Board annually.</p>
<p>Managed through a strong liquidity risk management framework which includes contingency plans with both contracted and un-contracted liquidity positions. Liquidity buffers, liquidity ladders.</p>	<p>Managed by Treasury within a robust market risk management framework, market risk limits, through diversification and hedging strategies.</p>	<p>Managed at corporate management and Board level with reference to market developments and potential disruptions to current business model assessments.</p>	<p>Managed by setting the tone at the top and reinforcing its core values and purpose. A Reputation Risk Task Force was established as a sub-committee of ORSC to manage risk in case of trigger events.</p>
<p>Assessment: Moderate Trend: ↑ Page 71</p>	<p>Assessment: Moderate Trend: ↑ Page 64</p>	<p>Assessment: High Trend: ↑ Page 73</p>	<p>Assessment: Moderate Trend: → Page 73</p>

## RISK & CAPITAL REVIEW

### Enterprise Risk Governance

The Bank's risk governance structure is based on the three Lines of Defence in line with best practice.



The Board of Directors defines the Bank's Risk Envelope for the ensuing year and carries ultimate responsibility for oversight of the risk management in the Bank during the year. A governance structure apexed by the Board Integrated Risk Management Committee facilitates the discharge of this responsibility.

The Bank's CRO is a member of Board Risk committees of all group companies and Group companies report to the Bank on risk related activities on a predefined format given by the bank.

Figure 2: Risk Governance Structure

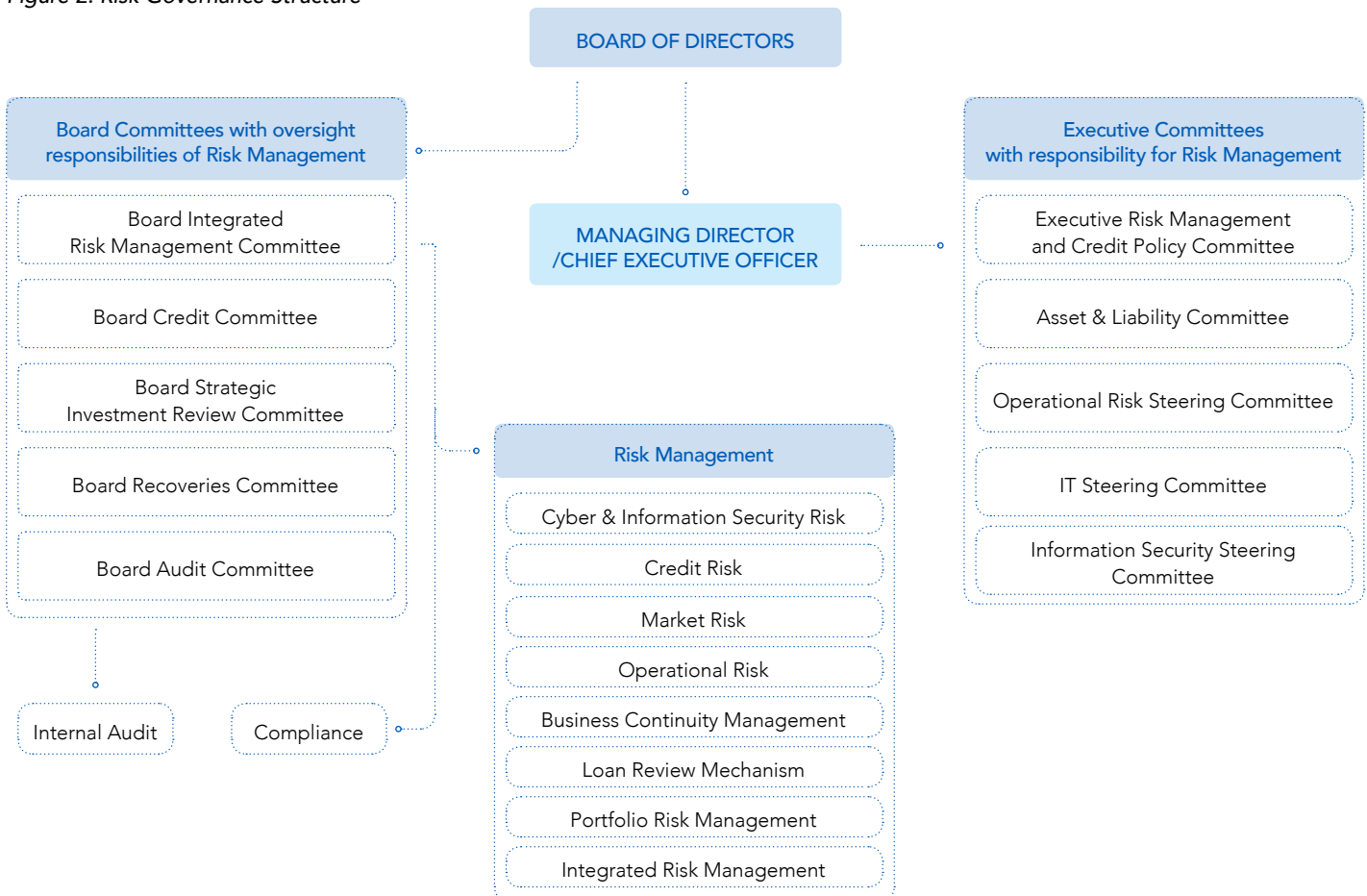


Figure 3: Roles & Responsibilities of Committees in Relation to Risk Management

Board Committees	Role of Committee in Relation to Risk Management
Board Integrated Risk Management Committee (BIRMC)	This Committee has oversight responsibility for Risk Management and makes recommendations to Board on Risk Management Policy, setting the Bank's Risk Appetite and monitoring the material risks of the Bank through risk dashboards. The Risk Management Department and Compliance Department of the Bank report to BIRMC.
Board Credit Committee (BCC)	BCC has oversight responsibility for management of Credit Risk, supporting BIRMC in discharging their duties. BCC reviews the Credit Risk dashboards and makes recommendations on Credit Risk Management policies and processes to BIRMC and Board.
Board Recoveries Committee (BRC)	This is a new committee of the Board formulated to address this key function of the Bank. BRC has oversight responsibility for recoveries of non-performing advances and migration management when Recoveries segregated as a separate vertical in 2019.
Board Audit Committee (BAC)	BAC has oversight responsibility for Reporting Risk and effective operation of internal controls which plays a key role in risk management and compliance. Their functions are more fully described on page 12 of the Governance Report.
Board Strategic Investment Review Committee (BSIRC)	As this Committee exercises oversight of strategy for the Bank, there is a significant congruence between BIRMC and BSIRC in determining strategic direction, goals and KPIs.

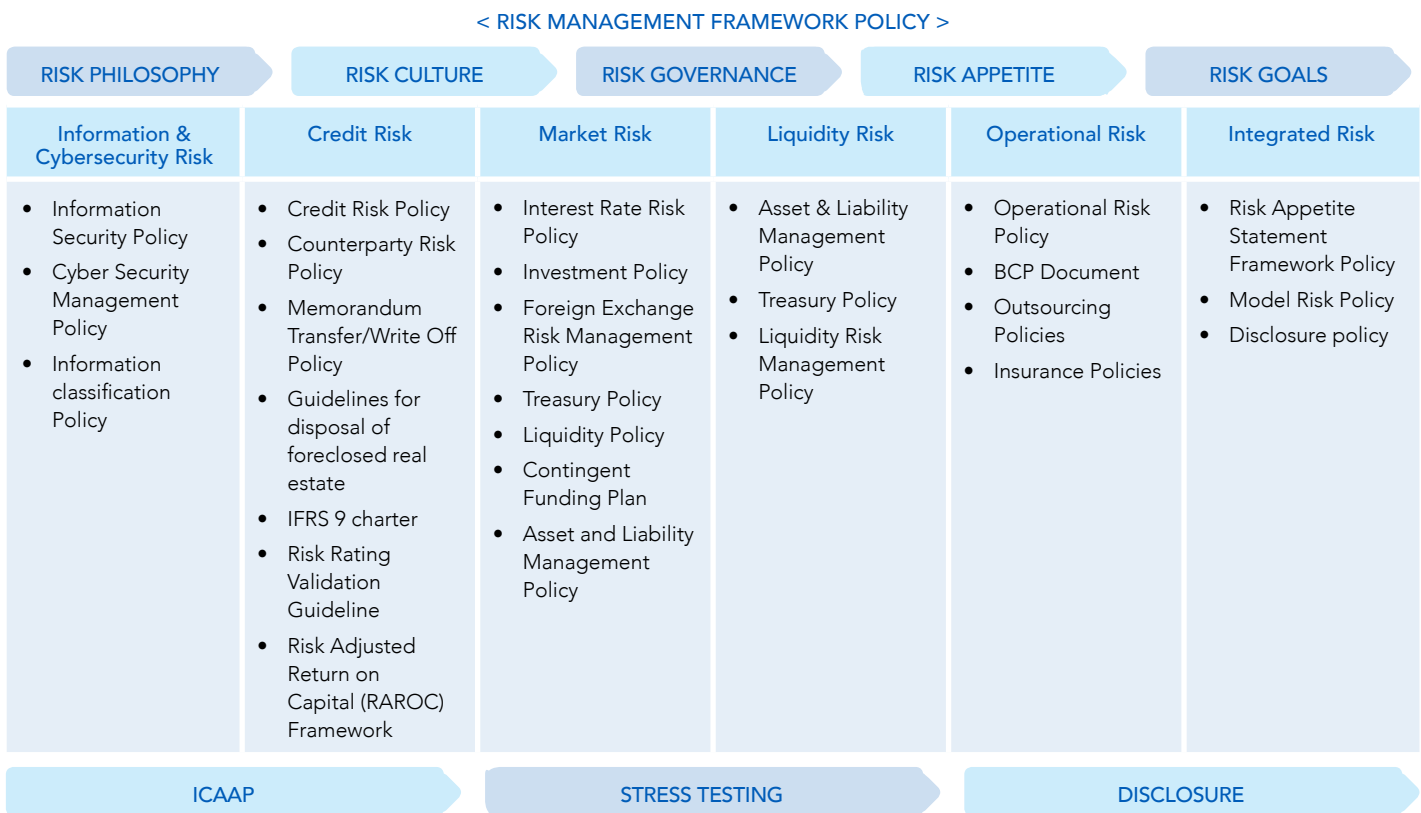
Executive Committees	Role of Committee in Relation to Risk Management
Executive Risk Management and Credit Policy Committee (ERMCP)	ERMCP is the apex executive committee for risk management and supports BIRMC in effective implementation of the policy framework in monitoring and managing risk. This key committee is chaired by MD/CEO and comprises heads of key business lines and operating units of the Bank ensuring shared ownership of responsibility for managing risk, a common understanding of the Bank's risk philosophy and awareness of current challenges.
Asset & Liability Committee (ALCO)	ALCO plays a key role in managing liquidity risk and financial stability of the Bank. It reviews liquidity forecasts to manage gaps, adequacy of contingency funding plans and stress testing results in achieving its objectives.
Operational Risk Steering Committee (ORSC)	Focused on managing operational risk, this committee is chaired by CRO and comprises Heads of operations, Audit, IT, HR and Network Management
IT Steering Committee (ITSC)	This committee drives the IT strategy of the Bank and supports management of information and cybersecurity risk. It is chaired by MD/CEO and comprises COO, CRO, CFO, DGM-Operations DGM-HR, CIA, CSO, CIO, DGM-Corporate Banking and DGM-Retail
Information Security Steering Committee (ISSC)	Focused on providing the Bank wide framework for institutional governance of information risk and provide recommendation to BIRMC. It is chaired by MD/CEO and comprise of COO, DGM Risk/CRO/CISO, DGM-Operations, DGM-Retail, AGM-Network Management DGM-Treasury, DGM-IAD, DGM-Legal, AGM-IT, Head of HR, AGM-Banking Services

## RISK & CAPITAL REVIEW

### Policy Framework

The Bank's policy framework was re-evaluated and updated in 2019 to ensure that the entire suite of policies addressed the changing needs of the Bank. Based on the COSO framework for enterprise risk management and Basel III regulatory framework, it aims to establish a process to effectively identify, measure, manage, control and monitor risks faced by the Bank and determine its Risk Appetite in line with the overall strategy of the Bank. These Board approved policies provide guidance to the management on the processes in place within the Bank to manage risk in line with the Bank's own requirements which are more prudent in many areas.

Figure 4: Risk Management Framework



### Risk Culture

The risk culture of the Bank is shaped by a comprehensive risk management policy framework, robust corporate and risk governance, mandatory training, skills and competencies of the risk department and a remuneration framework that rewards a balanced approach to risk. It is reinforced by a code of conduct applicable to all employees, the Whistle Blowing Policy to ensure confidentiality and provisions against retaliation. These key drivers shape the Bank's attitudes, norms, and behaviours in relation to risk awareness, acceptance and management which is the key to sustainable growth and profitability.

Policies and guidelines are framed using clear and precise language enabling easy understanding of our risk philosophy, approach and appetite as articulated in our policies. Guidelines are issued to further clarify matters where ambiguity is manifest in the application of policies. The risk management department works with the HR team in ensuring that the scope and coverage of risk related training is appropriate to ensure compliance with the Bank's strategic objectives.

The key factors influencing the environment that HNB wishes to achieve are:

- A set of shared beliefs and attitudes throughout the organisation characterising how HNB considers risks throughout its operations.
- Operating consistently within the Board approved Risk Appetite Statement.
- Operating policies that are approved by the BOD set guidelines for how risk shall be managed across the HNB and aggregated at group level.
- A commitment by everyone in the organisation to embrace the risk management framework, to share a common language of risk, to work in accordance the Bank's Code of Conduct and to seek to continuously improve the way in which we manage risk.
- An investment in the training of staff to develop skills and experience to make risk management a core competency across the Bank.



Figure 5: HNB Philosophy in Managing Risk

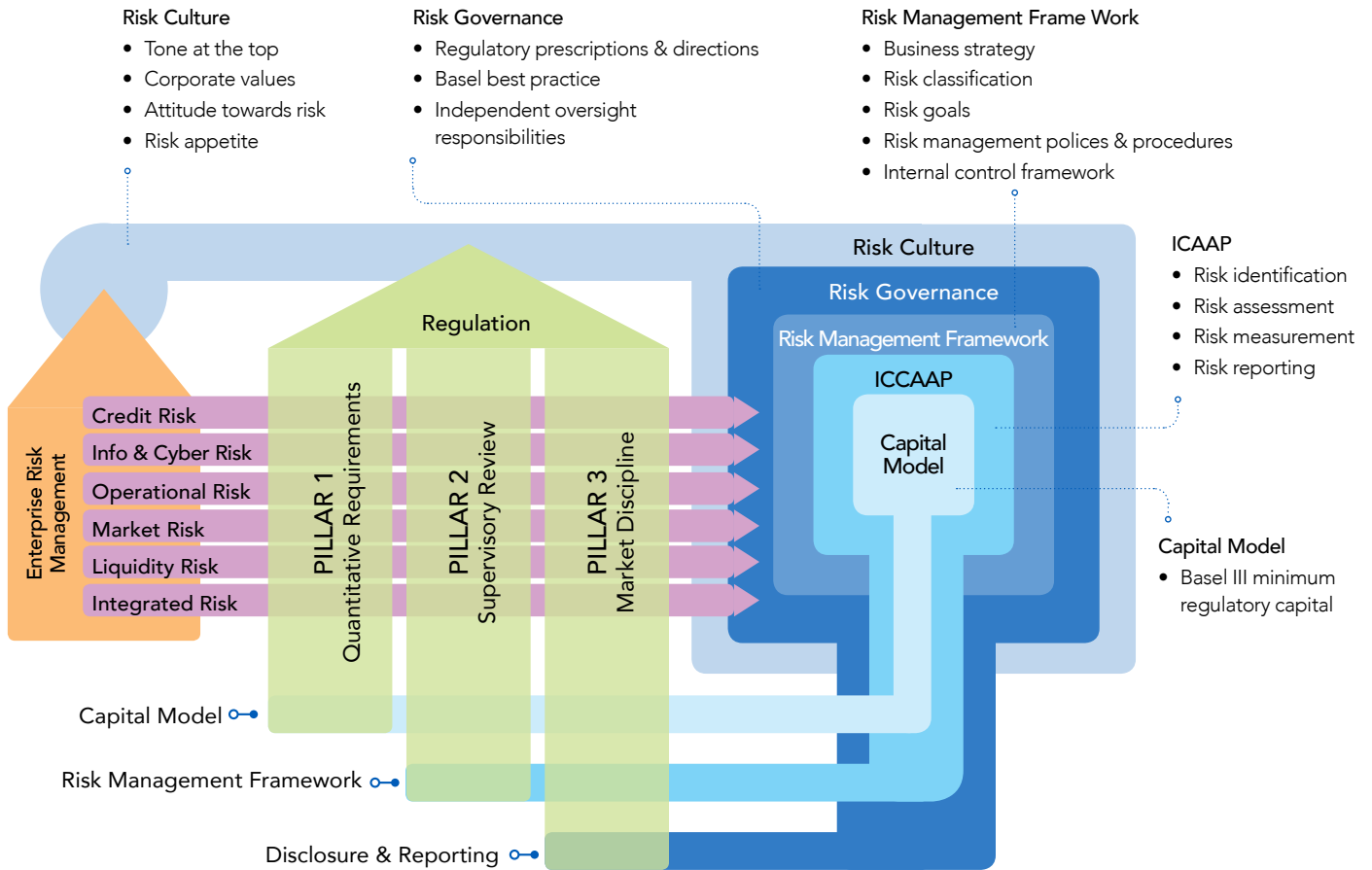
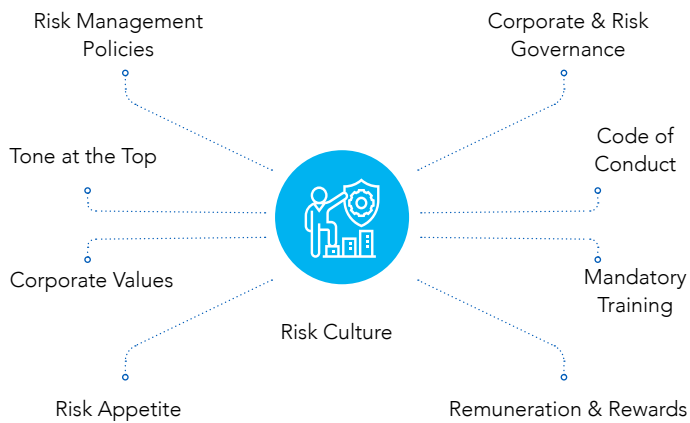


Figure 6: Key Determinants of our Risk Culture



## RISK & CAPITAL REVIEW

### Risk Appetite

The Risk Appetite Framework (RAF) of the Bank aims to achieve the following objectives:

- Align the Bank's business strategy, products and processes with associated Risk levels and Risk Appetite
- Design Risk Appetite and thresholds in line with the Risk Management framework of the Bank
- Enable the Senior Management and the Board of Directors (BOD) to effectively monitor the material risks across various businesses of the Bank, and take corrective actions, as and when required
- Compliance with regulatory requirements on Risk Appetite underpinned by senior management monitoring of risks.

The Risk Appetite Statement sets targets for quantitative elements such as Capital Adequacy, Rating, profitability and efficiency, Concentration limits, Liquidity positioning and other risk type limits. Limits are set considering economic and market conditions and familiarity of business. The basis and rationale of the Bank's Risk Appetite Statement is that risk shouldn't be dealt with in silos but should be considered in terms of Risk-Reward trade off and should provide for flexibility to the senior management in taking conscious decisions to protect the interests of shareholders. The risk appetite is cascaded down to each business line by risk type with risk goals and thresholds which are linked to specific performance measures linked to business or operations of the Bank which eventually aggregates to define the Risk Appetite Statement at the bank level.

### Stress Testing

Stress testing is an integral part of the HNB's risk management framework, which assess the vulnerability and movements in key financial variables, which could impact the Bank's profitability, liquidity and capital adequacy and results are designed to indicate the resilience of the Bank to face potential and future risks.

The Bank has set up a centrally coordinated, top-down stress-testing policy guideline, under the purview of the Risk Management Division to

test the resilience of the Bank to withstand severe but plausible shocks and setting up prudential policy limits where necessary. Constructing, conducting and monitoring stress tests are the primary responsibility of the Integrated Risk Management Unit.

The Bank's stress testing framework has been developed based on the guidelines on stress testing by CBSL and the Basel Committee and encompasses all significant and high impact risk areas of the Bank. Appropriate stress test or scenario development methodologies applicable to each risk area has been clearly specified. The identification of key macroeconomic factors impacting the Bank, methodologies for assessing stress conditions and the feedback from key business drivers form critical areas of the stress testing framework.

A comprehensive framework of assumptions for stress testing covering Credit, Market and Operational Risk verticals, differing in severity and covering all stages and areas of the risk verticals, is in place.

The Bank has also linked its current stress test framework to IFRS9 Impairment models by considering specific IFRS 9 stress implications. The ICAAP of the Bank has introduced additional stress tests to factor in the Pillar II requirements of the CBSL directive on ICAAP.

The stress tests gauge the impact of adverse scenarios on the Bank's Capital Adequacy Ratio (CAR) which is impacted by the change in P&L as well as changes in Bank's capital requirements.

## An Evolving Function

Our responses continue to evolve to ensure that our structures, policies and processes manage emerging risks and that sufficient resources are allocated to manage them. The table below sets out the key improvements embarked on or delivered during the year.

Figure 7: Key Initiatives to Strengthen Risk Management in 2019

	Project/Initiative	Impact
Risk Governance	Strengthen and Update Risk Management Policies	<ul style="list-style-type: none"> <li>Information classification according to a new policy</li> <li>Expanded coverage of Stress Testing Policy</li> <li>A Disclosure Policy to ensure compliance on Financial and Risk related disclosures</li> <li>A model Risk Policy to provide guidelines for development of models, managing their lifecycle, validation requirements and maintaining oversight to ensure their efficacy in assessing specific business estimates, valuations or risk</li> <li>Revised lending policy guidelines for promoting better quality credit</li> </ul>
	Strengthen and review the risk assessment and governance process assessing real estate assets	<ul style="list-style-type: none"> <li>Conduct a Building Risk assessment of HNB Towers with view of protecting and safeguarding the Bank from possible security threats.</li> </ul>
	Initiation of dashboards to highlight and escalate high level risks to Board and BIRMC	<ul style="list-style-type: none"> <li>Submission of Key Risk Indicators of each risk dashboard to the Board to supplement the reporting by the risk dashboards</li> <li>A Human Capital Risk Dashboard covering the Bank's culture, employee performance, unethical behaviours, grievances and disputes, noncompliance, employee wellness and turnover is being developed</li> <li>A Strategic Risk Dashboard is being developed</li> <li>The Everest Dashboard highlights risks associated with the Bank Transformation project principally focusing on people, technology/digital and execution related risks</li> </ul>
	Refining the existing ICAAP methodology	<ul style="list-style-type: none"> <li>Improve pillar II risk assessment criteria and methodologies</li> <li>Expand the assessment period of stress testing to the next three years</li> <li>Align ICAAP as per SLFRS 9 impairment process</li> <li>Improve qualitative risk parameters by refining existing scorecards and introducing new parameters and scorecards for model risk and group risk assessment</li> </ul>
Information & Cyber Risk	Strengthen Data Management	<ul style="list-style-type: none"> <li>External consultancy to gain objective advice</li> <li>Clear classification of information using new software tool in accordance with policy</li> <li>Improved data loss prevention capability using Data Loss Prevention (DLP) tools</li> <li>Monitor and prevent sensitive data leakages.</li> <li>Monitoring of Privileged user activities via Privilege Access Management (PAM) solution</li> </ul>
	Review on system functionalities and Vulnerability Assessment & Penetration Testing (VAPT)	<ul style="list-style-type: none"> <li>Engagement of external cyber security consultants to carry out systemic functionality reviews, Vulnerability Assessments and Penetration Testing (VAPT) in order to strengthen the security control environment of the systems, applications and IT infrastructure.</li> </ul>
	Establish an Information Security Steering Committee (ISSC)	<ul style="list-style-type: none"> <li>Enabled proper segregation of duties between Information Technology Steering Committee (ITSC) and ISSC</li> <li>Review of information and technology risk-related policies, procedures and controls</li> </ul>

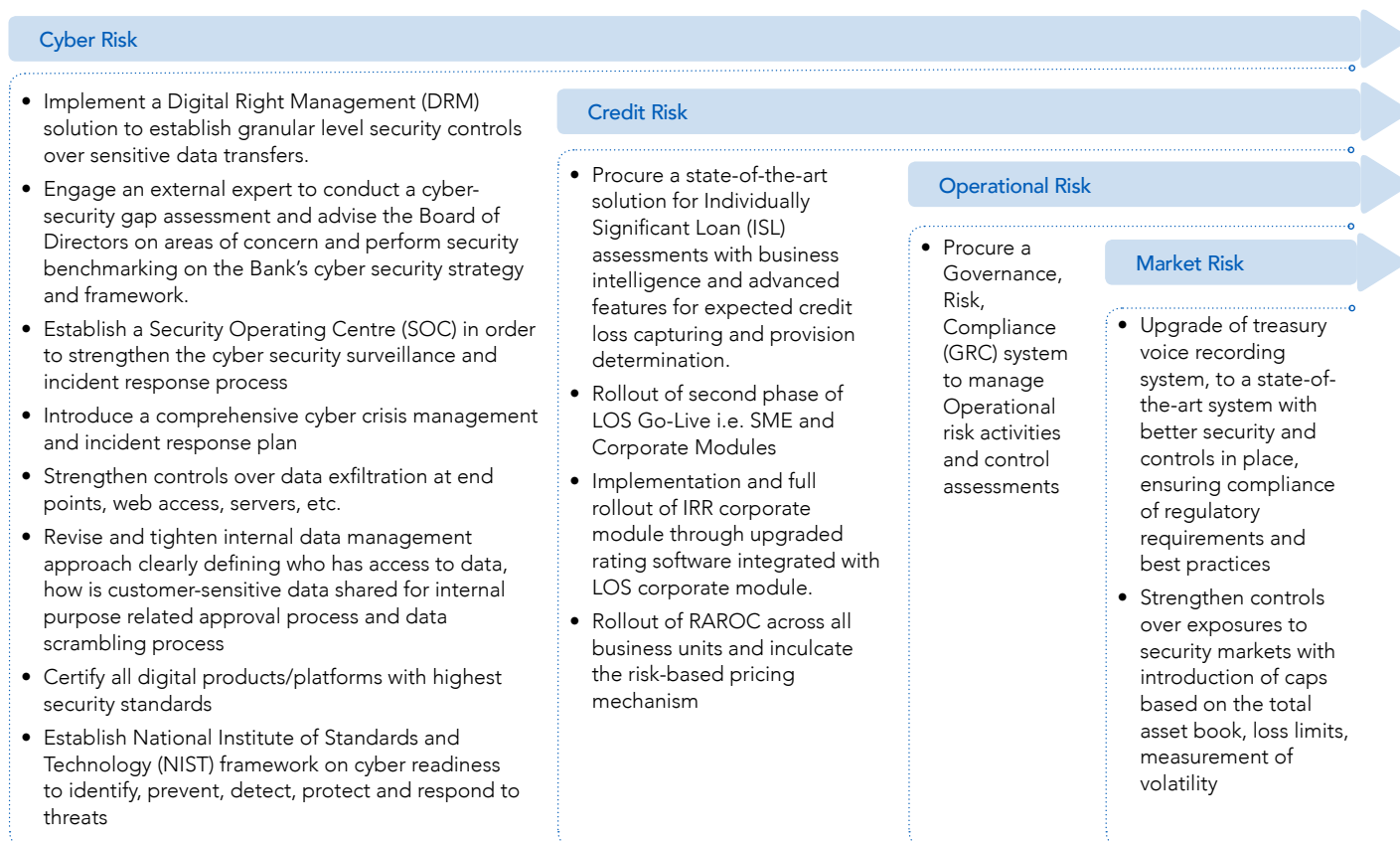
## RISK &amp; CAPITAL REVIEW

	Project/Initiative	Impact
Credit Risk	Separation of Credit Underwriting from Relationship Management	<ul style="list-style-type: none"> <li>• Establishment of role of Chief Credit Officer</li> <li>• Credit administration done by the regional offices whereby branch managers were eased off from this function</li> </ul>
	Implementation of Loan Origination System	<ul style="list-style-type: none"> <li>• Streamlined credit approval process</li> <li>• 360° of customer evaluation</li> <li>• Reduced turnaround times</li> <li>• Enhance compliance and risk culture</li> <li>• Paperless process</li> </ul>
	Strengthening Portfolio Risk Management	<ul style="list-style-type: none"> <li>• Streamline watch listing and management review listing classifications</li> <li>• Improved information to business verticals</li> <li>• Strengthening Loan Review Mechanism by expanding its application to NPA cases and Watch listed cases</li> <li>• Enhanced credit risk dashboards to management and Board/Board Committees</li> <li>• Support the Bank's BOM rollout by realigning its processes</li> </ul>
	Refining of Risk Models SLFRS 9	<ul style="list-style-type: none"> <li>• Implementation of Expected Credit Loss (ECL) models</li> <li>• Compliance with SLFRS 9 framework and Basel approaches</li> </ul>
	Validation and Recalibration of Internal Risk Rating Models	<ul style="list-style-type: none"> <li>• Expanding coverage to small SME, microfinance, project finance and individuals with new risk rating models</li> <li>• Validation of existing internal risk rating models large corporate, SME, mid-market, and financial institutions to assess the model accuracy and recalibration existing rating</li> </ul>
	Review of Industry Sectors and Country Risk assessments	<ul style="list-style-type: none"> <li>• Periodic review of 17 Industry Risk sectors in an ongoing basis</li> <li>• Country Risk Assessment based on the Bank's existing exposure and potential opportunities</li> </ul>
Market Risk	Treasury Systems Upgrade Monitoring and Controls	<ul style="list-style-type: none"> <li>• Strengthen the limit management structure</li> <li>• Improve counterparty credit risk monitoring</li> <li>• Revise the tolerance and haircut limits to address the market volatility</li> <li>• Increased automation of market risk controls</li> <li>• Improved processing times</li> </ul>
Operational Risk	Risk & Control Self-Assessment covering all Mission Critical Units	<ul style="list-style-type: none"> <li>• Enhanced risk awareness and risk culture</li> <li>• Review and constructively challenge each RCSAs by RMD</li> </ul>
	Streamline Root Cause Analysis of Operational Loss event including near misses	<ul style="list-style-type: none"> <li>• Improved internal controls</li> <li>• Enhanced efficiency and effectiveness of process</li> </ul>
	Board-approved Policy Document and Business Continuity Plan	<ul style="list-style-type: none"> <li>• High level of preparedness of the Bank in an emergency situation to continue its mission critical units</li> <li>• Improved disaster recovery capability</li> <li>• Clear benchmarks set for recovery times and recovery points</li> <li>• Improved Business Impact Assessment process</li> </ul>
	Strengthen Monitoring of Outsourced Activities	<ul style="list-style-type: none"> <li>• Improved alignment to Bank goals and objectives</li> <li>• Improved management of operational risk</li> </ul>

## Plans for 2020

Resources have been allocated for the following projects which are scheduled for completion in 2020.

Figure 8: Planned Initiatives to Strengthen Risk Management in 2020



## Integrated Risk & Capital Management

### Regulatory Capital

ICAAP is managed in compliance with the Banking Act Direction No. 1 of 2016 Capital Requirements under Basel III for Licensed Commercial Banks and Licensed Specialised Banks which specifies the minimum capital ratios and buffers in respect of total risk weighted assets phased out between 1st July 2017 and 1st January 2019. In December 2019, CBSL issued three directions on reclassification of Domestic Systemically Important Banks and revision to the compliance requirement of Basel III direction namely, No 10, 11 and 12 of 2019, and thereby amended the composition of D-SIBs and revised the requirement of applicable Higher Loss Absorbency (HLA). Accordingly, HNB is required to maintain a CET1 1.0% of Risk-Weighted Assets as HLA as oppose to 1.5% as per Direction No 01 of 2016. Requirements relevant to HNB are given below:

Figure 9: Regulatory Capital Requirements

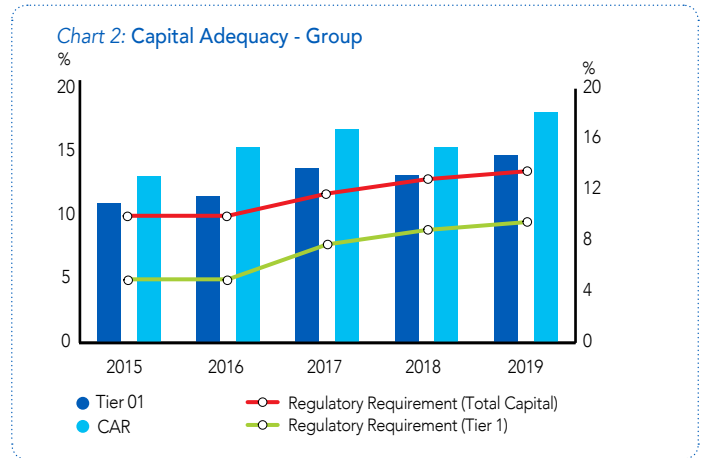
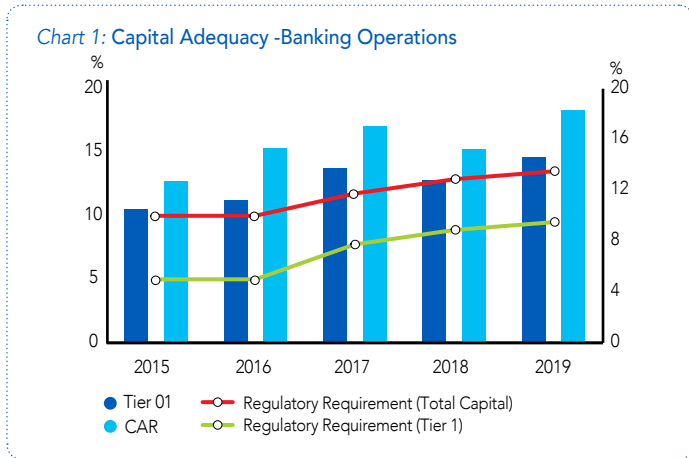
Components of Capital	Regulatory Requirement as at				Bank's Position as at		
	1.7.2017	1.1.2018	1.1.2019	31.12.2019	31.12.2017	31.12.2018	31.12.2019
Common Equity Tier (CET) 1 (a)	6.25%	7.375%	8.5%	8.0% (7%+ HLA of 1%)	13.72%	12.80%	14.57%
Total Tier 1 (a)	7.75%	8.875%	10%	9.5% (8.5+ HLA of 1%)	13.72%	12.80%	14.57%
Total Capital (a)	11.75%	12.875%	14%	13.5% (12.5%+ HLA of 1%)	17.04%	15.22%	18.28%

(a) Including Capital Conservation Buffer and Capital Surcharge on Domestic Systemically Important Banks

## RISK & CAPITAL REVIEW

In October 2017, CBSL enhanced the minimum capital required for Bank by Direction No. 5 of 2017 with locally incorporated Licensed Commercial Banks required to have a minimum of Rs.20 bn including equity, reserves and other qualifying Tier I capital instruments. Chart 1 depicts the components of the Bank's capital and compliance with regulatory requirements. Basel III Market Discipline, Minimum Disclosures under Pillar 3 are given on page 81 as required by Direction No.1 of 2016.

In order to strengthen its capital, the Bank has issued Basel III compliant subordinated debentures of Rs. 10 Bn during 2019.



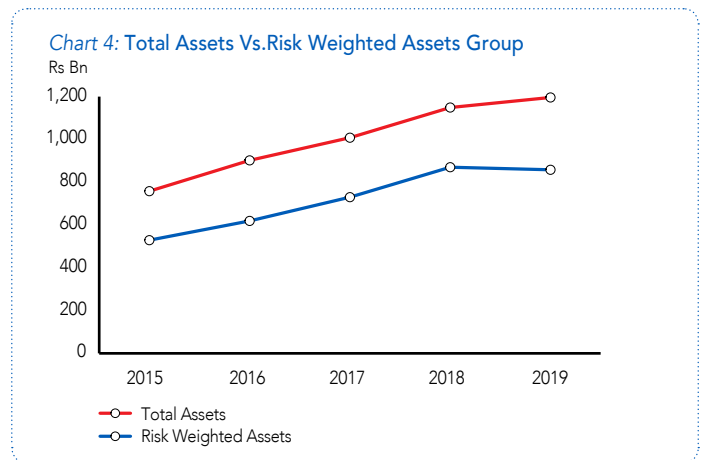
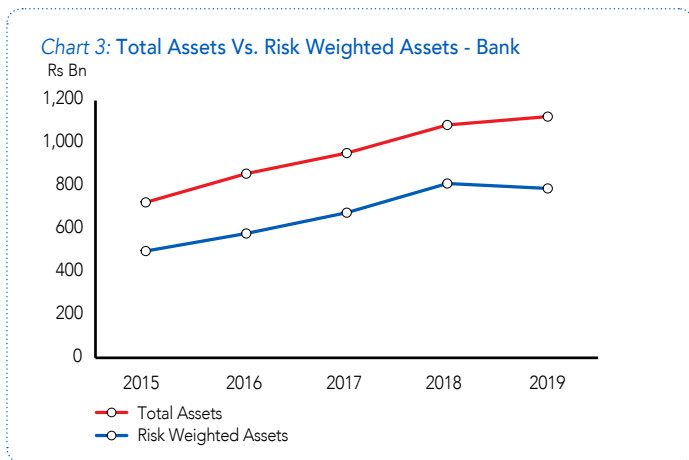
### Risk Weighted Assets

Capital requirements are measured as a percentage of Risk Weighted Assets which are calculated on the following basis as per CBSL direction No.1 of 2016:

- Credit Risk – Standardised Approach
- Market Risk – Standardised Measurement Method
- Operational Risk – Basic Indicator Approach

Figure 10: Risk Weighted Assets & Capital Charge

Item	Bank	
	Risk Weighted Assets	Capital Required
Credit Risk	725,747,553	97,975,920
Market Risk	606,406	81,865
Operational Risk	63,185,465	8,530,038
<b>Total</b>	<b>789,539,424</b>	<b>106,587,822</b>



The Bank's RWAs decreased by Rs 23 Bn during the year due to reductions in RWA for credit risk and market risk. The difference between Total Assets and Risk Weighted assets increased during the year by 23%.

## Stress Testing

Stress testing is a key component of Capital Planning as detailed on page 48. Extracts from the Bank's comprehensive stress tests on the Bank's CAR are given below for the highest risk indicator in each major risk category. Results are based on the stress test conducted for 2018 under moderate stress scenarios.

Figure 11: Stress Testing Results on a moderate stress scenario

		Impact on CAR as at 31.12.18		
		Minor Impact	Moderate Impact	Severe Impact
NPL Stress	Increase in NPL ratio for different portfolio and thereby increase in provision	✓		
Credit Risk – Asset Downgrade	Increasing the direct non-performing facilities over the direct performing facilities balance for the entire portfolio	✓		
Credit Concentration Risk – Large Borrowers Default	Default of the higher borrowers by classifying the credit granted to them as non-performing		✓	
Credit Concentration Risk – HHI	% increase in HHI under stress		✓	
Interest Rate Risk in Banking Book (IRRBB,) EAR and EVE (LKR)	To assess the long-term impact of changes in interest rates on Bank's Economic Value of Equity (EVE) through changes in the economic value of its assets and liabilities and to assess the immediate impact of changes in interest rates on Bank's earnings through changes in interest rates on Bank's earnings through changes in its Net Interest Income (NII)			✓
Foreign Exchange Risk	% shock in the LKR exchange rate against all other currencies	✓		
Liquidity Risk	Deposit runs and rollovers	✓		
Global Financial Crisis (Multiple Scenarios)	Adverse changes in Foreign Exchange Rates Interest Rate Risk Liquidity			✓
Overall Credit Portfolio Deterioration	NPL Stress Asset Downgrade Concentration Increase			✓

## RISK &amp; CAPITAL REVIEW

## Credit Risk

Credit Risk is the largest risk exposure for the Bank stemming from its portfolio of lending products that account for 70% of the Total Assets of the Bank. Managed in line with the Credit Risk Policy suite, significant resources are allocated to monitor this key risk as we continue to strengthen our credit risk management capabilities to meet the challenges posed by the evolving business model and risk landscape.

## Credit Risk Components

- Default Risk
- Counterparty Risk
- Concentration Risk
- Residual Risk
- Recovery Risk



**Dedicated Centre**  
for early delinquency  
management

Chart 5: Credit Exposure

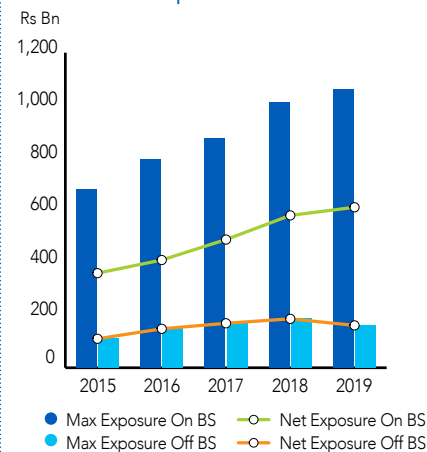


Figure 12: Credit risk Exposure

Audited	2019		2018	Increase %
	Maximum Exposure			
	Rs.000's		Rs.000's	
Maximum Credit Exposures	1,223,591,938		1,201,196,636	2%
• Total Assets subject to Credit Risk	1,061,024,557		1,011,017,440	5%
• Off Balance Sheet Commitment subject to Credit Risk	162,567,381		190,179,196	(15%)
• Max Exposure to credit risk Gross Loans & Receivables to customers	771,939,001		771,692,625	0%
Net exposure to credit risk of Loans & Receivables to Customers	321,419,306		340,295,895	(6%)
Impaired Loans	58,996,841		32,614,427	81%
Provisions for Impairment	30,169,928		22,643,805	33%
• Individual Impairment	15,779,696		9,946,260	59%
• Collective Impairment	14,390,232		12,697,545	13%
Impaired Loans as a % of Gross Loans and Receivables	7.64%		4.23%	81%
NPA (Gross)	5.91%		2.78%	113%



Established a  
**Board Committee**  
for oversight of recoveries



Strengthened  
**Credit Processes**



## Credit Risk Review

Maximum and net exposures to credit risk were relatively flat over the year as the Bank adopted a prudent growth strategy in response to tightening macroeconomic conditions and a lacklustre demand for credit. Allowance for individual impairment increased by 59% while the allowance for collective impairment increased by 13% during the year due to prevailing macroeconomic conditions. Consequently, overall provisions for impairment increased by 33% to Rs. 30 Bn. Impairment allowance coverage is maintained above the Bank's risk appetite threshold of 45%. Of note is the NPA percentage of the bank at year end, is below the industry average of 4.7%.

904 loans were rescheduled in the aftermath of the terror attacks which virtually crippled the tourism industry and the SME sector in the interests of our customers and in line with CBSL directives. Facilities rescheduled for this purpose have been maintained in the same categories prior to reschedulement in line with the directive No.7 of 2019 issued by CBSL which permits this treatment up to June 2020. Total loans rescheduled under this directive was Rs.45 Bn of which Rs.28 Bn remains outstanding at the close of the year.

## Activities in 2019

- Reinforcement of the segregation of duties along the credit chain with the implementation of a new branch operating model (BOM) enabling segregation of operations, sales & servicing, relationship management, credit appraisals, approvals and security documentation functions. Credit underwriting has been made independent of business development and relationship management.
- Centralisation of credit administration functions facilitating preparation and safe custody of security documents. Centralisation significantly improved the control and compliance activities related to credit whilst standardising related activities. The Bank also outsourced safe custody of security documents, generating noteworthy efficiencies and cost benefits.

- Revision of delegated authority to sanction credit whereby authority was granted to accommodate overdrafts on a temporary basis to branch managers have been entrusted to ten regional credit heads covering ten regions demarcated internally.
- Review of following Credit Policies in accordance with the Risk Appetite in order to improve the credit culture of the Bank
  - Personal loans
  - Leasing
  - Credit cards
  - Housing loans
  - SME lending
- Entering into a formal training agreement with Manipal University, India to train credit underwriters on advanced Credit Evaluation Skills. This program has been conducted as a certification program in batches covering all credit underwriters as a five day class room session supported with an online learning portal.
- Launch of a project to implement a next generation Loan Originating System (LOS) consisting of both Retail and Corporate Modules in year 2018 which has made significant progress in 2019. Retail module has been moved to live operations 4Q 2019 enabling superior customer service and efficient credit approval process.
- Strengthening of credit guidelines and introduction of a new process for effective management of temporary overdraft facilities for businesses in need of such accommodation given the prevailing circumstances in the business environment.
- Establishment of a Special Asset Management (SAM) unit to manage accounts with early signs of stress with appropriate financial solutions to prevent further deterioration of credit quality.
- Validation of existing risk rating models, i.e. Large Corporate, Mid-Market, SME and Financial Institutions, by an external expert as a part of the risk model validation exercise and based on validation results and recommendations, prevalent internal risk rating models were recalibrated.

## KEY INITIATIVES IMPLEMENTED IN 2019

- Implemented a new Branch Operating Model (BOM)
  - Centralised the Credit Administration functions
  - Revision to credit policies in order to improve the credit culture
  - Launched a project to implement a next generation Loan Originating System (LOS)
  - Established a Special Asset Management (SAM) Unit
  - Existing Internal Risk Rating models were validated and recalibrated
  - New risk rating models were introduced to assess obligors covering retail, micro finance, small-SME and project finance business segments.
  - Introduced a mechanism to implement a risk-based pricing model and a Risk Adjusted Return on Capital (RAROC) framework
  - Engaged an external consultant for SLFRS 9 impairment modelling and advisory services to deliver Risk Estimates (PD, LGD & EAD) as inputs for impairment provision determination
- 
- Introduction of new risk rating models to assess obligors covering retail, micro finance, small-SME and project finance business segments. All models recalibrated and newly developed has been hosted on an upgraded rating system interphase with new LOS implementation.
  - Introduction of a mechanism to implement Risk-based Pricing Model, Risk Adjusted Return on Capital (RAROC) framework. The Bank plans to fully rollout the RAROC mechanism in 2020.

## RISK & CAPITAL REVIEW

### Credit Risk Governance

The Credit Governance structure was strengthened during the year with the new Board Recoveries Sub-Committee, the new Branch Operating Model and the establishment of a separate Credit Management vertical. The functions within the Risk Management Department have been streamlined to monitoring and advisory functions, enhancing objectivity.

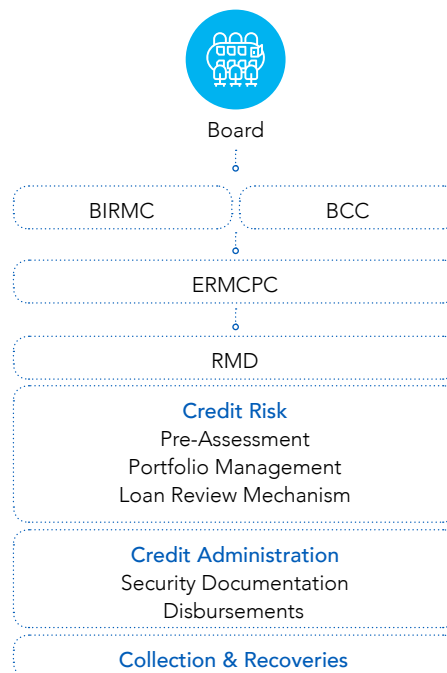
### Approved Regulatory Capital Approach

The Bank uses the Standardised Approach to measure the capital charge for Credit Risk as required by CBSL Direction No.1 of 2016. Accordingly, calculation of regulatory capital is based on specified risk weightings applied to net counterparty exposures in defined categories after recognising a limited set of qualifying collateral. Template 8: Credit Risk under Standardised Approach: Exposures by Asset Classes and Risk Weights on page 86 provide details according to risk weights while Template 7: Credit Risk under Standardised Approach on page 85 details the computation of Risk Weighted Assets for Credit Risk. The overall RWA Density for the Bank is 70% at the close of the year compared to 75% in 2018.

### Key portfolio models

The Bank has developed its own Basel III compliant Internal Risk Rating with a view to moving towards the more advanced Internal Ratings based approach to computing the charge for Credit Risk and also to manage default risk. In 2019, the Bank completed the validation of the internal risk rating models, i.e. Large Corporate, Mid-Market, Financial Institutions and SME, and recalibrated with recommendations suggested by the consultants and vendor. New Risk Rating scorecards for the Retail umbrella model has been developed and integration with new LOS is due in 2020. The Bank further developed new Risk Rating scorecards covering Micro Finance and Small- SME and will be integrated with new LOS during 2020. A new rating model was developed for Project Finance rating assessment and will be implemented along with recalibrated existing corporate models in new LOS during year 2020.

Figure 13: Credit Risk Governance



### Credit Risk Management Processes

The Bank's processes facilitate management of Credit Risk throughout the life cycle of the loan as depicted in the table below and in Figure 15: Segregation of Duties for Credit Risk Management.

Figure 14: Credit Risk Management Process

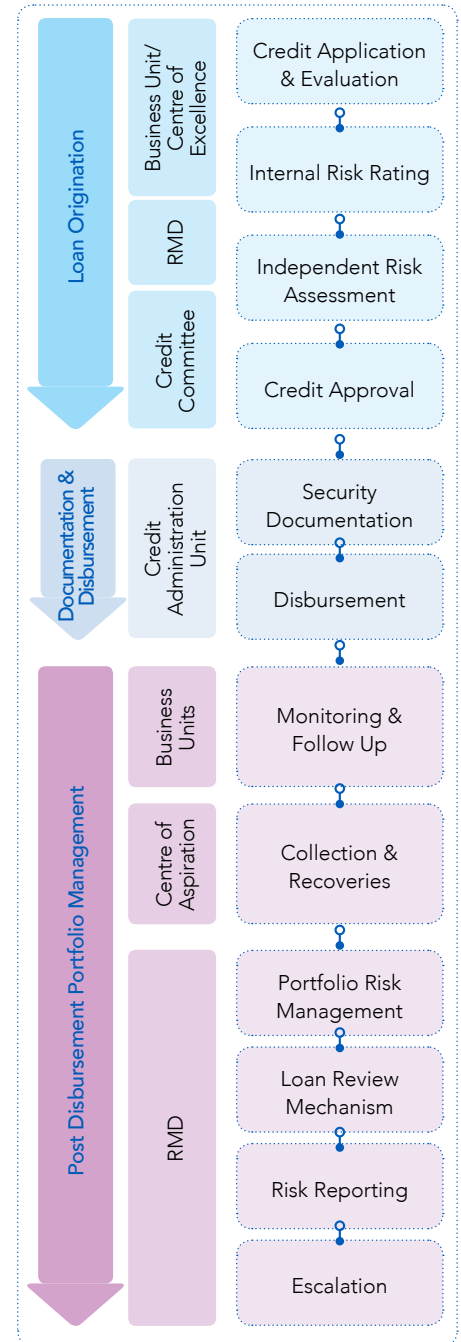
Description of the process	Risk Governance/Oversight
Business Development	Developed policy framework within which business development activities are to be carried out
Credit Evaluation/Assessment	Established a separate vertical under Chief Credit Officer for objective credit assessment
Underwriting/Approval	Delegation of approval authority segregated from Business Development team
Security Documentation/Collateral Valuations/Compliance with Approval conditions	Segregation of duties under DGM – Operations ensuring compliance with credit approval conditions, valid security documentation and credible collateral valuations.
Monitoring and Follow Up	Tightened at Relationship Manager level to get closer to customer at ground level with PRMU oversight supported by LRM function.
Collection	Migration Matrix/Segregation of Responsibilities for different time buckets
Recoveries	Strengthened under COO and Board Recoveries Committee.
Litigation	More efficient case management process implemented with regular monitoring of progress

Key credit risk management tools, controls and processes in place are briefly described below.

- **Segregation of credit risk management tasks** - Facilitates objective review from both business and risk management perspectives throughout the lifecycle of the loan as set out in Figure 15 with high levels of specialisation at each stage.
- **Internal Risk Ratings** - Risk rating are assigned to borrowers above a certain threshold agreed internally using the Internal Risk Ratings which have been approved/accepted by the regulator.
- **Independent Risk Assessment** - Corporate, Mid-Market and SME facilities are independently reviewed by the pre-assessment division of the credit risk management function. Retail facilities are reviewed by the Centre of Excellence (COE) enabling high levels of specialisation, and improved turnaround times.
- **Delegation of Authority** - Approval of credit facilities above a specified threshold have been assigned to committees. Prior to final approver/approving committee risk management division provides its assessment to facilitate a well-informed credit decision.
- **Loan Origination System (LOS)** - The bank kicked off a state-of-the-art LOS enabling a paperless workflow for evaluation and approval with faster turnaround times and enhanced information security. LOS is scheduled for completion in 2Q of 2020 and the retail segment has gone live in 4Q 2019. LOS facilitates the following:
  - Managing all credit approvals within one system
  - Integrating with the core banking system & other peripheral systems to minimize duplication of data entry
  - Integrating the security documents preparation process with the credit approval process
  - Timely updating of information and facilitating management information
- **Collateral** - The Bank obtains collateral as a secondary recourse through mortgage bonds over movable and immovable property, guarantees and liens over financial assets and assignments of receivables. Regular valuations are carried out to ensure adequacy of collateral cover throughout the lifecycle of the loan.

- **Security Documentation & Compliance with approval conditions and Disbursement** - the Centralised Security Repository centre checks completeness and authenticity of documentation including security documentation and compliance with pre-disbursement conditions. This function supports compliance and recovery processes with required documentation while the pre-disbursement function ensures that correct limits and rates are marked in the system facilitating accurate billing, monitoring and recovery processes as are approval conditions satisfied.
- **Loan Review Mechanism** - The LRM function carries out post reviews of credit facilities covering all business lines in order to identify qualitative improvements in credit evaluation and administration processes and gain insights regarding the effective functioning of processes and controls in place. Reports from LRM are submitted to BIRMC and Board.
- **Management of Large Exposures** - Large borrower exposures are maintained within internal risk limits of 20 largest exposures and bank monitors material exposures and substantial exposures as a part of the Bank's internal risk goals. Further, Industry risk limits are set to ensure close monitoring over concentration in a given industry or to take early action on any identified industries with elevated risk. Proactive action initiated on identification of concerns impacting the credit quality.
- **Early Warning Signs (EWS)** - The portfolio risk management unit and collections and recovery divisions together with business units monitor credits to identify early warning signs of credit deterioration. EWS and watch lists and Management review lists, report likely to fall in to NPA and are used to initiate remedial action and alert Business Units, Committees and the Board facilitating rehabilitation or minimal loss exits.
- **Special Asset Management (SAM)** - The Bank has established a SAM Unit to manage accounts with Early Warning indications with appropriate financial solutions to prevent further deterioration of credit quality.

Figure 15: Segregation of Duties for Credit Risk Management



## RISK & CAPITAL REVIEW

### Concentration Risk

The Bank maintains a diversified portfolio, managing concentrations across products, industry sectors, counterparties, and geographies in line with its risk appetite. Credit Risk Dashboards prepared by the Portfolio Management Unit of RMD are reviewed by ERMCP, BIRMC and the Board to manage potential risks. Additionally, credit concentration risk is quantified using a HHI model to derive additional capital requirement under Pillar 2 during the ICAAP computation.

Chart 6: Exposure by Product

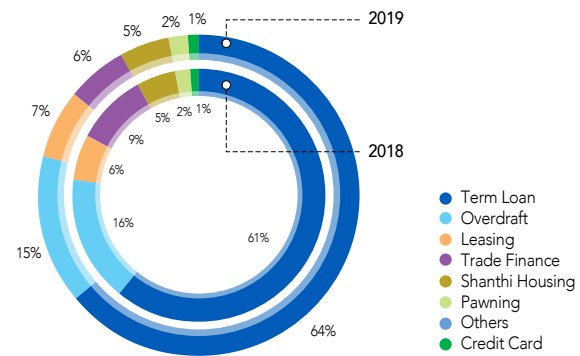


Chart 7: Exposure by Counterparty

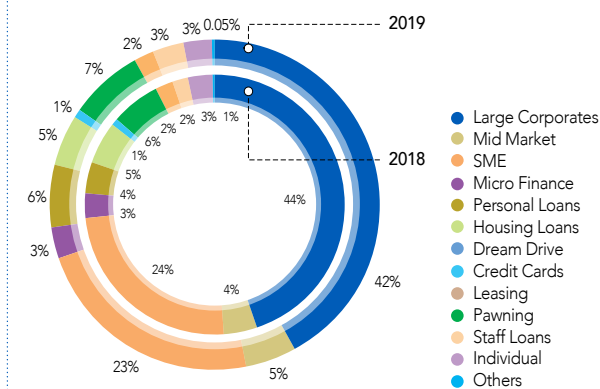


Chart 8: Industry-wise Exposures

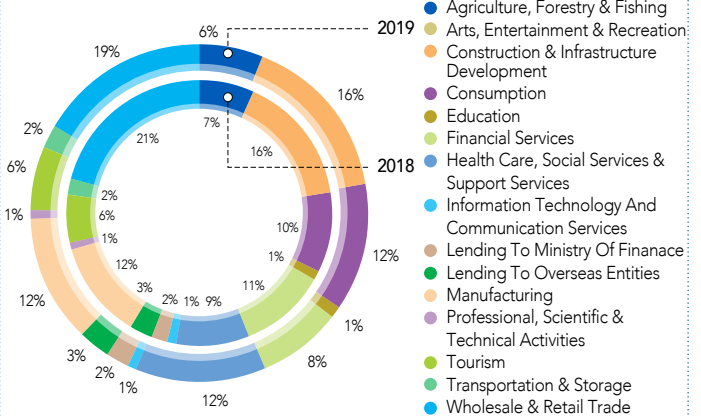


Chart 9: Exposure by Geography

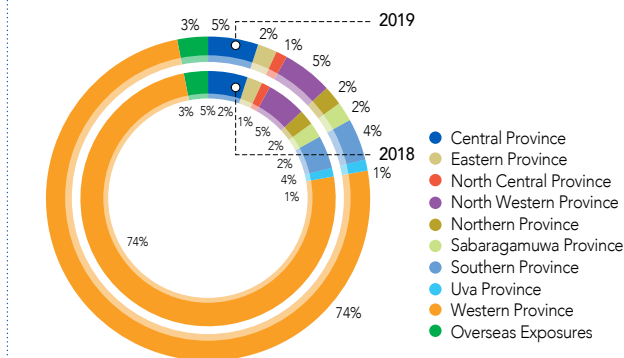
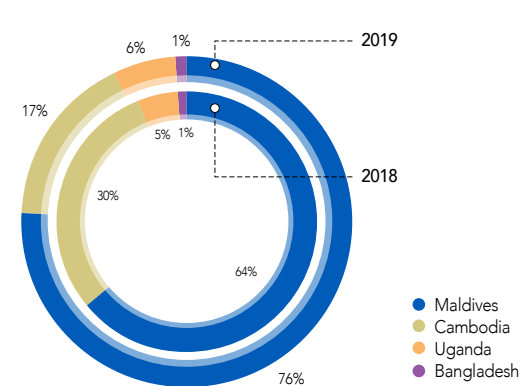


Chart 10: Overseas Exposure



## Default Risk

Default risk indicators include non-performing ratios and ageing of exposures as given below. Uncertainty, terror attacks, subdued economic conditions and climate change impacts contributed to elevate default risk during the year. The Bank has strengthened credit processes to holistically mitigate the defaults risk as described in Credit Risk Governance and Credit Risk Management Processes.

- Current dues increased from 71% in 2018 to 75% in 2019.
- Non-performing advances increased beyond the Bank's risk appetite during the year.

Chart 11: Non-Performing Advances

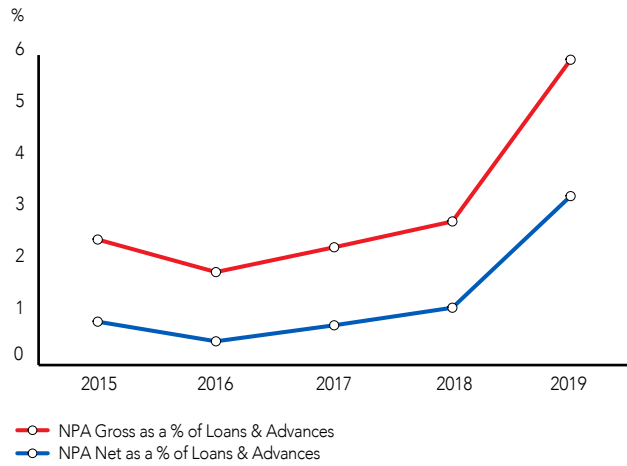
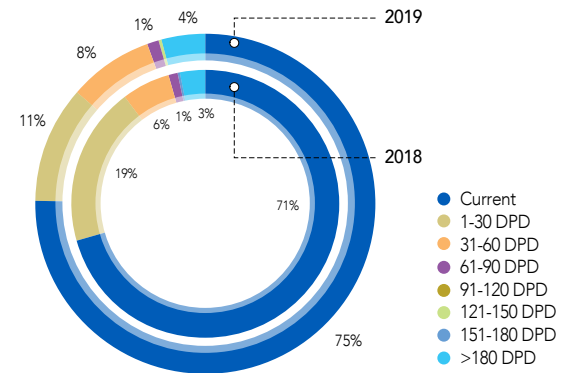


Chart 12: Ageing of Past-due Loans



## RISK & CAPITAL REVIEW

### Operational Risk

Operational Risk is the risk of loss resulting from inadequate or failed internal processes, people or systems, or from external events. It is inherent in all banking activities and the Bank continuously adopts best practices to minimise losses. It also plays a key role in optimising economic capital allocation to support the business growth of the Bank.

#### Operational Risk Components

- Compliance Risk
- Legal Risk
- Financial Crimes Risk
- Technology Risk
- Information & Cyber Risk
- Business Continuity Management

#### Operational Risk Review

- Operational Risk Policy Review
- Risk Control Self-Assessment reviews based on the criticality of the Business Unit/ Support Function
- New Product & Process reviews on need based
- Business Impact Analysis (BIA) reviews

Chart 13: Operational Losses and Recoveries

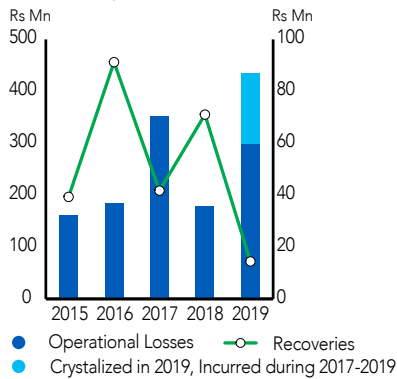


Chart 14: No. of Incidents

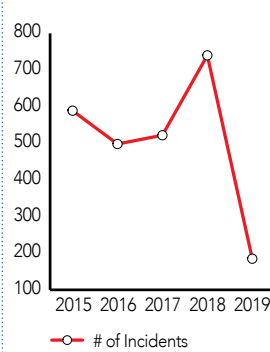
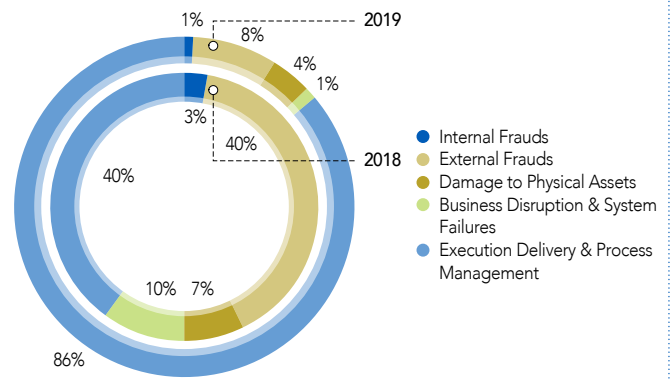


Chart 15: Operational losses by type



### Operational Risk Governance

The Bank's Operational Risk Policy provides guidance on the management of operational risk including the governance structure as set out in Figure 16. The Board approves policy and sets the tone at the top, shaping the risk culture of the Bank. BIRMC has oversight responsibility for management of Risk including operational risk and assists the Board in the discharge of their duties of risk management. The audit committee plays a key role through oversight of the implementation of sound internal controls and obtaining assurance on the effective operation of the same through internal and external audits.

A dedicated Operational Risk Steering Committee (ORSC) supports ERMCP in monitoring Operational Risk and recommending initiatives to strengthen operational risk. The Business Operational Risk Sounding Board comprising representatives from key business lines supports the Risk and Control Self-Assessment

process, facilitating higher levels of awareness of operational risk management across the Bank. The Operational Risk Unit of the RMD supports the Executive and Board level committees and is organised in to two focus areas, Preventive Measures and Detective Measures.

### Approved Regulatory Capital Approach

The Banking Act Direction 1 of 2016 allows the use of the Basic Indicator Approach, the Standardised Approach and the Advanced Measures Approach for calculation of regulatory capital for operational risk. The Standardised Approach and the Advanced Measures Approach are considered advanced approaches requiring regulatory approval. The Bank uses the Basic Indicator Approach for calculation of regulatory capital at present as set out in Template 10 on page 87.

The Bank is in the process of moving into advanced approaches with capital calculations in line with the Basel guidelines.

### Managing Operational Risk

The ORM framework sets out the following specific tools for managing operational risk:

- **Risk & Control Self-Assessment (RCSA)** - The RCSA process is forward looking and requires business units to assess their own processes and controls on a quarterly basis. These are reviewed, validated and consolidated by the Operational Risk Unit to assess the operational risk profile of the entire Bank, facilitating prioritisation and resource allocation for strengthening operational risk resilience.
- **Key Risk Indicators (KRI)** - Key risk indicators provide early warnings of escalations in risks identified by the Bank which are monitored continuously. Triggers and thresholds are reviewed regularly and updated to reflect regulatory requirements and internal benchmarks which reflect trends observed externally and internally. The Bank focuses primarily on lead

indicators and secondarily on lagged indicators.

- **Internal Loss Data Capturing & Reporting**

- Loss data indicating internal losses including potential losses and “near misses” for material risks are categorised according to Basel guidelines in the Operational Risk Dashboard. This is reviewed by ORSC, ERMCP and BIRMC to identify escalation of threats and the appropriate action to manage the same. External loss events and incidents are captured on a best effort basis and reviewed in relation to the internal control environment. Findings and control improvements are effected with escalation to Board and Executive Committee overview. Such loss events are captured periodically in a homegrown IT solution. However, bank has also implemented a Daily Incident Tracker (DIT) to escalate material incidents taking place.

- **Root Cause Analysis** - Material loss events and incidents are subjected to analysis to ascertain the root cause learning which is then used to improve the control environment under the Operational Risk Management function.

- **Risk Matrices** - The Bank uses risk matrices to consolidate and prioritise risks considering the potential impact and likelihood of occurrence.

- **Risk review of New Products & Processes** - Policy and procedure, for introducing a new product or amending or discontinuing existing product or delivery channel is in force.

### Mitigating Operational Risk

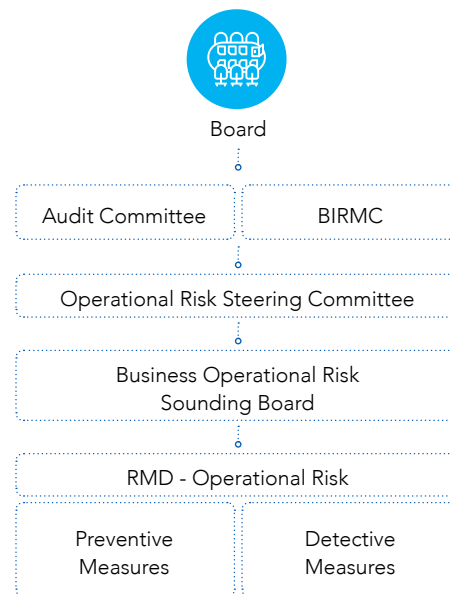
Operational risk is mitigated through both pre and post operational risk event analysis. Preventive risk tools of the Bank include establishing risk management frameworks, policies and guidelines, training and development to strengthen the first lines of defense, making strategic changes in products and business practices and implementing a sound system of internal controls. Post event mitigation mechanisms rely on our ability to respond to operational risk events in time and effectively, containing losses to lives and assets of the Bank. The following tools are key to mitigating operational risk:

- **Insurance** – This tool is used judiciously to mitigate the financial impact of risk events that could result in or trigger a potential loss to the Bank. A comprehensive insurance cover is in place securing the Bank from low frequency-high severity and high frequency-low severity loss events. Adequacy and effectiveness of insurance cover is reviewed periodically with the assistance of market expertise retained by way of an insurance intermediary.
- **Scenario planning** - The operational risk unit uses scenario planning mainly in its BCM and related activities to demonstrate and make uses of the development of appropriate responses to a few potential loss events that can or are likely to take place together such as fire, security breaches, etc.
- **Outsourcing** - A comprehensive Outsourcing Policy and guideline sets out the activities, terms and conditions relating to outsourced activities and the Compliance Division monitors the same. Outsourced activities include Document Archiving, Total Cash Management and selected recovery functions which are managed within the policy and specific service level agreements. Detailed KYC and due diligence tests are conducted prior to engagement or renewal of existing contracts to assess the AML/CFT risks that may arise with regard to the outsourcing arrangements. The Operational Risk Unit carries out a risk based review of critical outsourcing activities on a need basis and a complete report on outsourced activities is submitted to CBSL periodically as required for review. The Operational Risk Unit will also ensure that all critical outsourcing service providers have a satisfactory BCP and they perform regular tests on its BCP to ensure readiness against the effects of disruptive events and return to normal operations as quickly as possible.

### Business Continuity Planning & Disaster Recovery

The Bank has a comprehensive and well defined Business Continuity plan, which comprises clearly defined procedures, roles and responsibilities, Crisis Management, Emergency Response, Business Recovery and IT Disaster Recovery Planning to ensure continuity in operations in the event of

Figure 16: Operational Risk Governance



### KEY INITIATIVES IMPLEMENTED IN 2019

- Conducted a comprehensive Business Impact Analysis (BIA) covering all the departments of the Bank and the results were used to complete a comprehensive Bank-wide BCP document
- Established the Recovery Time Objectives (RTO) and Recovery Point Objectives (RPO), of the critical Bank processes and IT systems
- Enhanced the coverage of Risk Control Self-Assessment (RCSA) process by on boarding critical business units and support functions and covering all major units of the Bank
- Standardisation of the root cause analysis process
- Dedicated program was designed and conducted, with a comprehensive coverage of Risk Management for the Network of Branches and Support functions in cultivating the Risk culture in the Bank

## RISK & CAPITAL REVIEW

emergency or disaster. During the year the Bank's Business Continuity Plan was updated, reviewed and approved by the Board of Directors.

The Bank's Business Continuity plan has been developed to manage the impact of significant disruptions and to resume business functions at an acceptable level within a reasonable time. The Bank has appointed a Business Continuity Steering Committee (BCSC) and a Disaster Management Team (DMT) to oversee the BCP strategy and to provide an effective, predefined structure to enable the Bank to

respond to a crisis and stabilize until the situation returns to normalcy.

A systematic Business Impact Analysis (BIA) process was initiated for departments and critical processes, resources, and all other relevant information have been identified and documented for mission critical units. Recovery Time Objectives (RTO), Recovery Point Objectives (RPO) and Recovery Strategies have been defined and documented in the BCP documents to ensure continued operations, minimal downtime and to mitigate negative impact on revenue and reputation.

Regular BCP and Disaster Recovery drills are conducted to cover all critical systems and the Mission Critical Units (MCUs) of the Bank. Bank's Internal Audit department reviews the BCP tests and makes recommendations while learning and improvements to disaster recovery activities are ratified by the BIRMC. Further, the Bank conducts awareness sessions and publishes Newsletters amongst the staff to enhance the knowledge of Business Continuity Management process.

### Information and Cyber Risk

Technology continues to be the main driver of transformation within the banking industry as we move to a platform economy, necessitating a sharper focus on Information Risk and Cyber Risk. Cybercrime continues to evolve at a rapid pace making these the leading risks for many businesses as gleaned from global surveys, necessitating investments in sophisticated tools for managing this omnipresent threat. The Bank continues to invest in this vital area, segregating it as a separate pillar although it is a part of Operational Risk as per Basel III definitions.

#### Components of information & cyber risk

- Information risk
- Cyber risk
- Financial crime risk
- Technology risk

#### Key initiatives

- Implementation of Information Classification Policy & classification tool across the bank
- Implementation of Data Leakage Prevention (DLP) Solution
- Engagement of external cyber security consultants to conduct Vulnerability Assessment & Penetration Testing (VAPT)

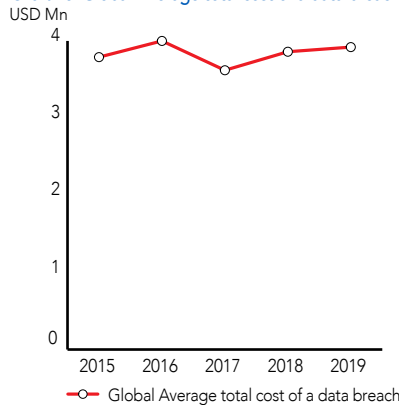
#### Information & cyber risk review

- Information Security Policy & procedure review
- Privilege user activity review
- Removable media access review
- Internet access review

### Global Cyber Security Trends

- Changes in phishing landscape
- Increasing use of mobile as an attack vector
- Targeting of local governments and enterprises via ransomware attacks
- Increasing emphasis on data privacy, sovereignty, and compliance
- Increasing investments in cybersecurity automation

Chart 16: Global Average total cost of a data breach



#### Top cyber risks impacting financial sector in 2019

- Advanced social engineering
- Attacks on mobile banking applications
- Attacks on online payments /PoS
- Attacks on wireless network
- Supply-chain attacks
- Attacks on biometric systems
- Attack on unencrypted data
- Advanced spoofing attacks



### Information & Cyber Risk Governance

- Appointment of CISO who is responsible for defining the Information Security framework, overall security governance of the bank and maintenance of the security policies and procedures. An Information & Cyber Security risk management unit was established under the direct purview of CISO to assist the security governance function of the bank from a Risk Management perspective.
- Board approved Information Classification Policy was implemented across the Bank and the classification tool was rolled out to all the users where classification of information was enforced as a mandatory control
- Implementation of Data Leakage Prevention (DLP) which is a key security project of the Bank that will prevent data leakages to a greater extent by strengthening the control framework
- Engagement of external cyber security consultants to carry out system functional reviews and Vulnerability Assessment & Penetration Testing (VAPT) on critical banking systems.
- Involvement in various IT/InfoSec projects providing independent inputs and suggestions from Cyber & Information Security risk perspective.

### Information Security Management

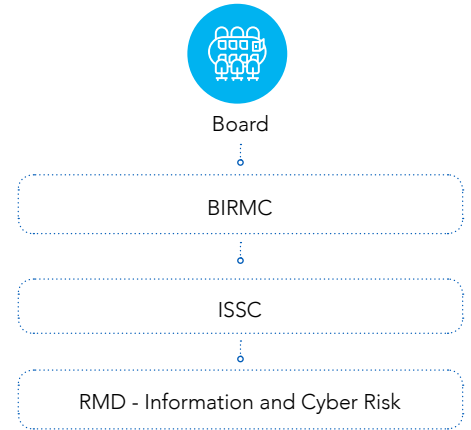
The Cyber Security Policy and the Information Security Policy set out the framework for management of the Bank's vital strategic information assets. The objective of the policy framework is to protect information assets from identified internal and external threats to ensure that the all statutory and contractual obligations are met, and the brand is protected. It sets out guidance for systematic management of information assets throughout its lifecycle supporting the operational and strategic needs of the Bank in compliance with regulations and internal risk appetite.

Additional tools used to ensure continuous protection of its information assets from emerging threats include the following:

- Layered Defence Model - The Bank has implemented a layered defence model to support management of Information Security.

- Third Party Vulnerability Assessments and Third Party Security & Compliance Reviews - Carried out to manage risks arising from connectivity with third parties.
- Periodic reviews of the effectiveness of the Bank's Internal IT/IS Management by IT Security Team - Internal Audit and CISO carry out separate reviews to assess the effectiveness of the Information and Cyber Risk Management processes and controls.
- Monitoring cyber threat intelligence - Review up to date information on current and emerging cyber threats with a view to initiating necessary action in a timely manner.
- Data Classification methodology - This initiative supports safeguarding of information assets through clear categorisation of access to documents and uses leading IT tools
- Controls over Data in transit, at rest and in use - Email flow and USB/CD ROM restrictions implemented together with organisation wide awareness campaigns enhance levels of information security
- Security Information & Event Management (SIEM) Solution - All critical systems and databases are integrated for log analysis enhancing capabilities of identifying IT and cyber risks.
- Continuous upgrade of Antivirus/Malware/Ransomware protection.
- Cyber Risk Dashboard - Communicates developments in Information & Cyber Risk to Executive and Board Committees on a monthly basis. This dashboard includes a tracker of information and cyber risk related incidents, Top 10 cyber risks, cybersecurity incidents reported during six months, IS audit findings, Adherence level of security standards, cybersecurity awareness activities, risk update on key IT projects, update on BCP and DR drill, update on endpoint exposed with risks, etc.
- IT disaster recovery plan - A key component of the Bank's Business Continuity Plan, this is tested regularly and amended as appropriate.
- Privilege Access Management (PAM) - provide granular level visibility over activities carried out by privileged users in the banking systems.

Figure 17: Information and Cyber Risk Governance



## RISK & CAPITAL REVIEW

### Market Risk

The Bank's profitability is impacted by movements of market factors which are beyond the Bank's control. Most transactions involve at least one element of market risk, movements in which, can also impact the valuations of portfolios of assets and liabilities. Bank's exposures and responses to movements are managed within the Bank's Risk Appetite Statement to optimise profitability and maintain financial stability.

#### Components of Market Risk

- Interest Rate Risk
- Foreign Exchange Risk
- Equity Price Risk
- Liquidity Risk
- Commodity Price Risk

#### Market Risk Review

The Bank's market risk exposures arise mainly from the Bank's Non-Trading Portfolio (Banking Book) which accounts for 23.38% of Total Assets and 26.37% of Total Liabilities. Accordingly, Interest Rate Risk (IRR) and Foreign Exchange (FX) Risk are the most significant components of market risk as the Bank has minimal exposure to commodity price risk and equity risk accounting for less than 5% of the total risk weighted exposure for market risk at the close of the year.

Figure 18: Market Risk Exposure

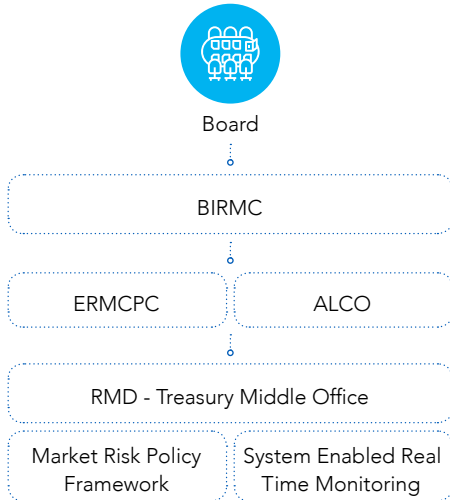
	Audited (Rs.Mn)	
	Carrying Amount	
	2019	2018
<b>Assets Subject to Market Risk</b>		
Cash & Cash Equivalents	29,089	25,142
Balances with Central Bank of Sri Lanka	22,795	33,907
Placements with Banks	7,603	3,293
Reverse repurchase agreements	-	90
Derivative financial instruments	527	4,508
Financial assets recognised through profit or loss - measured at fair value	1,013	100
Financial assets at amortised cost - loans and advances	149,721	160,146
Financial assets at amortised cost - debt and other instruments	741,769	749,049
Financial assets measured at fair value through other comprehensive income	127,695	69,437
<b>Liabilities subject to Market Risk</b>		
Due to Banks	86,406	77,493
Derivative Financial Liabilities	573	2,519
Securities sold under repurchase agreements	17,569	16,679
Financial liabilities at amortised cost - due to depositors	810,035	799,975
Financial liabilities at amortised cost - other borrowings	22,604	24,894
Subordinated term debts	32,695	22,230

### Market Risk Governance

The governance structure for market risk reflects the responsibility of the Board for approving policy, risk appetite and monitoring. BIRMC has oversight responsibility and assists the Board in discharge of their duties with due diligence and care. ERMCP formulates policy and makes recommendations to strengthen and manage the same. ALCO manages market risk exposures and profitability, ensuring that risks taken are commensurate with the rewards and managed within the RAS.

Treasury plays an important role in managing both banking/trading book and the asset and liability position of the Bank. Accordingly, duties are segregated in line with best practices in to front office, middle office and back office. Treasury Middle Office (TMO) ensures that Treasury Front Office deals within limits set out in the Bank's risk appetite and Treasury Back Office reconciles and escalates key issues promptly. The Market Risk Management Unit of RMD independently measures, monitors and reports on market risk exposures using Market Risk Dashboards and assists in review of the Bank's market risk related policies and exposure limits, supporting ALCO, ERMCP, BIRMC and the Board with information required for decision making.

Figure 19: Market Risk Governance



**Approved Regulatory Capital Approaches**

The Bank uses the Standardised Measurement method as required by CBSL Direction No.1 of 2016 in line with Basel III requirements for computing regulatory capital for Market Risk. Consequently, the calculation of regulatory capital is based on specified risk weightings applied to net exposures in defined categories as set out in Template 9: Market Risk under Standardised Measurement Method. The Bank is moving towards the more advanced Internal Model Approach.

**Market Risk Management**

Market Risk is managed in accordance with the Asset and Liability Management (ALM) policy and Treasury Policy which will manage Interest Rate Risk, Investment and the Foreign Exchange Risk. The trading and investment portfolios are managed by Treasury while the Banking Book is impacted by the Bank’s business lines. The Balance Sheet and Income Statement implications of market risk are summarised below.

Figure 20: Balance Sheet and Income Statement implications of Market Risk

Portfolio	Banking Book "Hold Until Maturity" and "Available for Sale"	Trading Book "Intend to Actively Trade"
Line Items	<ul style="list-style-type: none"> <li>• Deposits</li> <li>• Loans</li> <li>• Bonds(Investment Portfolio)</li> </ul>	<ul style="list-style-type: none"> <li>• Bonds (Treasury Portfolio)</li> <li>• Derivatives (Forward, Options,)</li> </ul>
Balance Sheet Value	Historical Cost	Fair valued through OCI/Mark to market daily
Income Statement	Net Interest Margins	Net Interest margins + Net Change in Value (mark to market)
Risk exposure	<ul style="list-style-type: none"> <li>• Repricing risk</li> <li>• Basis risk</li> <li>• Foreign Exchange Risk</li> </ul>	All components of market risk

Market risk management is a critical aspect in implementing Asset and Liability Management (ALM) framework of the Bank.

Key tools and processes used to manage market risk include the following:

- **Market Risk Limits** - Limits contain trading activities within a specified range in line with the Bank’s Risk Appetite Statement. These are reviewed and approved by the BOD and are regularly reviewed by ALCO and ERMCP.

## RISK &amp; CAPITAL REVIEW

Figure 21: Market Risk Limits

Limit Type	Activity Limit	Target Risk Area
Exposure	Trading/Investment in foreign currency fixed income securities (excluding investment in Sri Lanka Government Treasury Bills & Bonds)	Governs the trading/investment in long-term securities with reputed issuers, with minimum credit ratings of A or equivalent.
	Investment in Sri Lanka Government Treasury Bills & Bonds/ CBSL Securities	Governs trading & investments in Sri Lanka Government Treasury Bills & bonds that are denominated in Sri Lanka Rupees and US Dollars.
	Cap on total investment on Gov. Securities	Will govern overall exposure to Government securities in terms of balance sheet exposure.
	Standing Deposit Facility (SDF) With CBSL	Governs money market deals with CBSL
	Interbank money	Limits the Bank's exposure to liquidity risk arising from funding mismatches and over reliance of FC borrowings to generate liquidity
	Market/trade borrowings in foreign currency both in Sri Lanka and outside	Limits the Bank's exposure to adverse fluctuations in inter-bank call money rates and liquidity risk arising due to market liquidity
Tolerance	Cap on inter-bank call borrowing/Call lending	Limits the Bank's exposure to adverse fluctuations in inter-bank call money rates and liquidity risk arising due to market liquidity
	Rate tolerances	Governs minimum/maximum deviation from market rates on interest/ exchange rates to ensure no undue risks are undertaken
	Amount tolerances	Govern maximum transaction size undertaken on a currency, instrument or by a dealer.
	Tenor tolerances	Protects the Bank from both market and counterparty risk that could arise with time.

- **Value at Risk (VaR)** - The VaR of a portfolio is the estimated loss that will arise on the portfolio over a specified period of time (holding period) from an adverse market movement with a specified probability (confidence level). The VaR model used by the Bank is based upon a 99% confidence level and assumes 1-day and a 10-day holding period. The VaR model used is based mainly on historical simulation. Taking in to account market data from the previous two years and observed relationships between different markets and prices, the model generates a wide range of plausible future scenarios for market price movements.

- **Stress Testing** - The Bank conducts stress testing on key components of market risk including interest rate, foreign currency, equity and gold to understand the potential impacts. This information is used to provide direction in managing portfolios, optimising profitability and liquidity.

The Bank also periodically conducts simulation on severe liquidity crisis events which can be triggered off by any one or more of the following events taking place:

1. Loss of reputation due to rumours of a large loss, fraud, management misdemeanour etc.
2. Severe rating downgrade (3-4 notches or to below investment grade)
3. Adverse news/speculation of an impending takeover/merger.
4. Large regulatory penalty/qualification of accounts by Auditors/other compliance related loss of reputation.

The following stress scenarios were applied to assess the impact of a liquidity squeeze on the Bank:

1. A run on the Bank by depositors
2. Loss of short term interbank LKR liquidity
3. A global banking crisis which could affect short term interbank foreign currency liquidity
4. Worst case scenario comprising of the above stress situations (scenarios 1,2 and 3)
5. Loss of wholesale savings and deposits

Results tables at ERMCP/ALCO/BIRMC for their reference on ALM decisions

### Stress Testing On Projected NII

The Bank carries out stress tests on Interest Rate Risk for its Loans and Advances portfolio and the Fixed Income Securities portfolio as given below.

Figure 22: Loans and Advances

	2019		2018	
	100 bp Parallel Up Rs. '000	100 bp Parallel Down Rs. '000	100 bp Parallel Up Rs. '000	100 bp Parallel Down Rs. '000
As at December 31st	5,207,963	(5,424,645)	3,333,856	(3,391,804)
Average for the Year	3,821,677	(3,922,997)	3,011,707	(3,062,507)
Maximum for the Year	5,264,583	(5,471,901)	3,398,939	(3,457,578)
Minimum for the Year	2,347,052	(2,331,461)	2,466,813	(2,502,481)

Figure 23: Fixed Income Securities

Magnitude of shock	Original CAR	1%	2%	5%
Fixed Income Risk		CAR after Change		
Fixed Income Total Portfolio	18.28%	18.01%	17.73%	16.90%
Fixed Income Trading Portfolio	18.28%	18.28%	18.28%	18.28%

## RISK &amp; CAPITAL REVIEW

## Interest Rate Risk in Banking Book

IRRBB arises due to the differences in re-pricing of Rate Sensitive Assets (RSA) and Rate Sensitive Liabilities (RSL), which impact future interest income and expenses and its economic value. The Bank's interest rate sensitive assets and interest rate sensitive liabilities are analysed by different maturity buckets to determine suitable strategies to optimise earnings based on identified gaps and future interest rate forecasts. The Bank uses modified duration gap approach for analysing the changes in economic value of equity, which requires the mapping of assets and liabilities into different time buckets based on their residual maturity as set out below depicting an increased/decreased sensitivity.

Figure 24: Interest Rate Sensitivity Analysis for local and foreign currency denominated assets and liabilities as at 31 December 2019 (in Rs. Mn)

	Upto 1 Month	1-3 Months	3-6 Months	6-12 Months	1-3 Years	3-5 Years	Over 5 Years	Non- Sensitive	Total (Rs. Mn)
<b>Assets and Off Balance Sheet Exposures</b>									
Balances due from Head Office, Affiliates and Own Branches	-	-	-	-	-	-	-	3,772	3,772
Bills of Exchange	1,213	921	279	-	-	-	-	-	2,413
Cash on hand	-	-	-	96	-	-	-	27,895	27,991
Deposits with Central Bank	-	-	-	-	-	-	-	22,795	22,795
Investments (Net of provisions)	4,089	26,420	72,718	20,538	77,949	44,221	26,670	-	272,606
Loans and Advances	347,695	51,540	27,609	43,469	79,997	42,617	25,141	-	618,069
Non-Performing Loans	-	-	-	1,036	-	-	3,108	-	4,144
Net Inter-Branch Transactions	-	-	-	-	-	-	-	(1)	(1)
Other Assets	-	-	-	-	-	-	-	12,334	12,334
Overdrafts	67,585	8,361	6,118	7,757	4,910	4,836	4,729	-	104,296
Accrued Interest	-	-	-	-	-	-	-	5,905	5,905
Balances due from Other Banks	6,529	-	-	1,000	-	-	332	-	7,861
Fixed Assets	-	-	-	-	-	-	-	22,630	22,630
Reverse Repo	-	-	-	-	-	-	-	-	-
<b>Total</b>	<b>427,112</b>	<b>87,242</b>	<b>106,725</b>	<b>73,897</b>	<b>162,856</b>	<b>91,673</b>	<b>59,979</b>	<b>95,332</b>	<b>1,104,816</b>
<b>Liabilities and Off Balance Sheet Exposures</b>									
Balances due to Other Banks	4,793	39,813	15,616	18,812	23,576	-	-	-	102,610
Bills Payable	1,195	-	-	-	-	-	-	-	1,195
Demand Deposits	-	-	-	-	-	-	-	50,796	50,796
Interest Payable	-	-	-	-	-	-	-	18,636	18,636
Other Liabilities	-	-	-	-	-	-	-	46,763	46,763
Savings Deposits	234,677	-	-	-	-	-	-	-	234,677
Time Deposits	66,202	138,232	121,034	156,459	11,479	11,856	-	-	505,261
Bonds Issued	-	-	-	-	16,152	4,533	8,077	-	28,762
Borrowings	595	214	277	788	2,424	1,236	256	-	5,789
Capital	-	-	-	-	-	-	-	33,485	33,485
Certificates of Deposits	-	-	-	-	-	-	-	-	-
Repo	16,710	725	77	11	-	-	-	-	17,523
Reserves	-	-	-	-	-	-	-	97,380	97,380
<b>Total</b>	<b>324,173</b>	<b>178,984</b>	<b>137,004</b>	<b>176,069</b>	<b>53,630</b>	<b>17,624</b>	<b>8,333</b>	<b>247,060</b>	<b>1,142,877</b>
Period Gap	102,939	(91,742)	(30,280)	(102,172)	109,227	74,049	51,646	-	-
Cumulative Gap	102,939	11,197	(19,082)	(121,255)	(12,028)	62,021	113,667	-	-
RSA/RSL	1.32	0.49	0.78	0.42	3.04	5.20	7.20	-	-

Notes:

- 1) The above figures have been prepared as per SLAS and may differ from SLFRS figures given in the Statement of Financial Position
- 2) Prepared as per requirement given in the Banking Act Direction No 7 of 2011 on "Integrated Risk Management Framework".

## Foreign Exchange Risk

Foreign Exchange Risk is managed using currency swaps, exposure limits and VaR. Market risk exposure of the Bank's overnight foreign exchange positions is measured using 10 day VaR, at 99% confidence level. TMO monitors limits in real time and at specified frequencies in accordance with the Bank's comprehensive market risk management limit structure to ensure compliance with Bank's risk appetite. Trigger points are escalated to CRO, MD/ CEO or Board of Directors depending on the potential loss that may arise. The Bank's exposure to FX risk as at the end of the reporting period is given below and it is noteworthy that over 92.56% of the Bank's foreign currency exposure is in US dollars.

Figure 25: The Banks exposure to Foreign Exchange Risk

	Net Open Position (NOP) '000	Overall Exposure in Respective Foreign Currency '000	Overall Exposure in LKR '000
United States Dollar	3,362	2,193,658	397,819,828
Great Britain Pound	(3)	82,137	19,580,926
Euro	6	161,742	32,895,790
Japanese Yen	2,142	1,230,829	2,055,607
Singapore Dollar	7	4,258	573,829
Other currencies in USD	246	80,766	14,647,002
Total Exposure in USD 000	3,636	2,578,291	
Total Exposure in Rs 000	659,443	467,572,982	-
Total Capital Funds as at December 31, 2019		144,326,073	
Total open exposure as a % of Capital Funds as at December 31, 2019		0.46%	
VaR (99%, 1 day) 31st December 2019		0.52%	
VaR (99%, 1 day) 31st December 2018		0.55%	

Foreign exchange exposures are subject to stress testing by applying shocks between 5% to 15% to estimate the impact on profitability and capital adequacy of the Bank. Accordingly, a 5% change in exchange rate has a minimal impact on CAR as given in the table below.

Figure 26: Stress Testing on foreign Exchange Risk

Magnitude of shock Foreign Currency Risk	Original CAR	5%	10%	15%
		CAR after Change		
All foreign currencies	18.28%	18.28%	18.27%	18.27%
USD/LKR		18.28%	18.27%	18.27%

## RISK & CAPITAL REVIEW

### Equity Price Risk

The Bank's equity portfolio amounts to a mere Rs.105 mn and is managed taking a long term view. Stress testing conducted at 10% to 40% change in equity prices indicate no change in CAR. The Bank conducts mark-to-market calculations on a daily basis for held-for-trading and available-for-sale portfolios and VaR calculations on a 10 day basis. Year-end positions are summarised below.

Figure 27: Exposure to Equity

	Dec 2019		Dec 2018	
	Exposure Rs.mn	VaR (99%, 10 day)	Exposure Rs.mn	VaR (99%, 10 day)
Equity (MV)	105Mn	4.64Mn	99 Mn	3.46Mn

Figure 28: Equity Risk Stress Testing

Equity Risk	Original CAR	CAR after Change		
		10%	20%	40%
Equity Prices	18.28%	18.28%	18.28%	18.28%

### Commodity Risk

Commodity risk of the Bank is limited to the extent of the Pawning portfolio which is impacted by movements in the price of gold. The Bank's exposure amounts to less than 5% of Total Market Risk exposures due to the Bank's cautious approach to managing risks associated with the Pawning portfolio. The Bank also uses conservative loan to value ratios to manage its exposures to commodity price risk. It is noteworthy that the regulatory approach is to treat the exposure in line with Foreign Exchange Risk as described in the Approved Regulatory Capital Approach on Market Risk.

Figure 29: Computation Of Market Risk Charge

	Item	Computation of Market Risk Charge
Interest Rate Risk	General Interest Rate Risk	Uses the duration method which computes market risk charge by calculating the price sensitivity of each instrument in the trading book separately and adding the resulting price sensitivities based on a maturity ladder, subject to disallowances if any.
	Specific Interest Rate Risk	Uses rates specified by CBSL for different categories of assets which consider the type of asset, risk ratings (if available) and their duration
Equity Risk	General Equity Risk	A specified capital charge is applied to net open positions in equity markets
	Specific Equity Risk	Applies a capital charge to gross equity positions with equities not in S&P SL Index requiring a capital charge plus buffers
Foreign Currency & Gold	Calculate net open positions for each currency including on and off balance sheet items	
	Convert net positions in each currency/gold using spot rates into reporting currency (LKR)	
	Aggregate and apply specified capital charge	



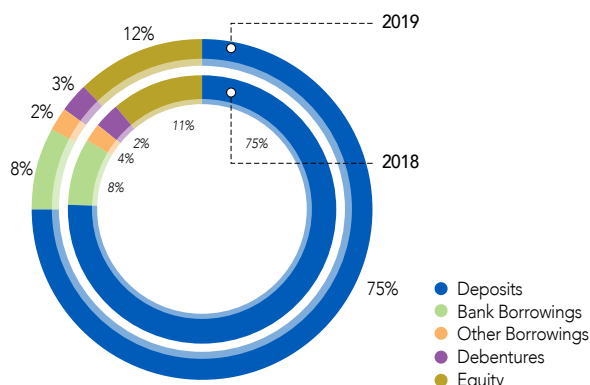
## Liquidity Risk

Liquidity risk arises from the possibility that counterparties who provide short-term funding, withdraw or do not roll over that funding, or normally liquid assets become illiquid as a result of a generalised disruption in asset markets. Liquidity risk management ensures that the Bank has the appropriate amount, diversification and tenor of funding and liquidity to support its asset base and strategic goals at all times.

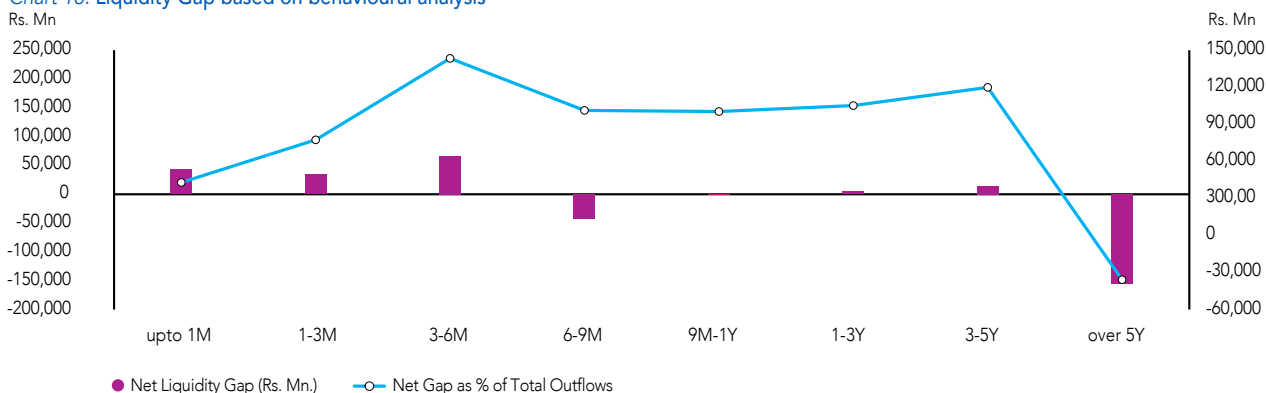
**Figure 30 : Liquidity Ratios**

	2019	2018
SLAR	29.55%	24.40%
LCR	251.07%	103.85%
Net Loans to Total Assets	66.12%	69.16%
Loans to Customer Deposits	98.27%	99.50%
Liquid Assets to Short Term Liabilities	72.25%	61.32%
Commitments to Liquid Assets	124.73%	165.14%
Commitments to Total Loans	53.76%	60.17%

**Chart 17: Funding Diversification**



**Chart 18: Liquidity Gap based on behavioural analysis**



## Liquidity Risk Governance

A comprehensive liquidity risk management framework is in place which includes a contingency plan encompassing both contracted and un-contracted liquidity positions as summarised in Figure 31. The column on the extreme right reflects the governance structures identifying roles of those with responsibility for managing liquidity risk. The Board, BIRMC, ERMCP and ALCO regularly review reports on the Bank's liquidity indicators to ensure that they are managed within agreed parameters.

## RISK &amp; CAPITAL REVIEW

Figure 31: Liquidity Risk Management Framework

Regulatory Limit	Hard Limits & Ratios Boundaries & Prudent Risk Management Guidelines					Decision Limit Adjustment
	Bank-wide limits per Legal Entity	<ul style="list-style-type: none"> <li>Internal Model Based Measures</li> <li>Cumulative Gap Limits</li> <li>Long term funding limits</li> </ul>		<ul style="list-style-type: none"> <li>Balance Sheet Based Ratios</li> <li>Loan:Asset Ratio</li> <li>B/S Turnover</li> <li>Deposits to purchased funds ratio</li> <li>Limits on committed lines</li> </ul>		
Operational Limits for steering of liquidity risk position	Max unsecured Funding Limits	Max Cash Outflow limit net securities	Secured Funding Limits	Limits on large transactions	Etc.	Proposed by Treasury/ ALM Decision by ALCO
Limits for Trading Units	Max Unsecured Lending	Max Cash Outflow	Liquidity Gap Profiles	Total Foreign Currency Funding		Set by CRO/Treasury decision by ALCO

**Regulatory Updates & Impact on Bank**

Limit on Foreign Currency borrowings ST/LT, CBSL direction 11, 2018 dated 30th November 2018, restrict the Bank to borrow Short Term for liquidity through foreign markets

**Liquidity Risk Management**

Liquidity risk is managed by monitoring key risk indicators to assess the liquidity position and shifting of assets and liabilities, obtaining interbank loans and drawing down credit lines. Liquidity ladders, probabilistic analysis and stress tests are undertaken to evaluate liquidity requirements of the Bank using both stock and flow approaches. Internal limits in place are more stringent than the regulatory requirements in line with the Bank's overall approach to risk management. Liquidity gaps are monitored based on the behavioural analysis of the Bank's assets and liabilities, historical rollover patterns, drawdown of unutilised overdrafts and disbursement of approved but undisbursed loans.

Figure 32: Managing Liquidity Risk

Funding Plan	Managing Liquidity Risk	Managing intra day liquidity risk	Identify Contingent Funding Requirement	Managing Regulator
Identify concentration risk in banking book	Establish liquidity policy and appetite	Maintain liquidity buffers	Early warning indicators	Maintaining LCR
Pricing liquidity risk via transfer pricing mechanism within the bank	Monitor intra day limits and carry out stress testing	Daily clearing and settlement	Conduct liquidity simulations	Reporting on liquidity assets and reserves

The Bank also measures its liquidity position in all major currencies at both individual and aggregate levels to maintain potential risks within specified limits. Potential liquidity commitments resulting from loan disbursements and undrawn overdrafts are also monitored to assess adequacy of funding sources. Liquidity risk is mitigated by maintaining an adequate margin in high quality liquid assets and diverse funding sources. Contingency funding agreements with peer banks are in place ensuring availability of sufficient liquidity buffers in accordance with the Bank's Contingency Funding Plan.

Competition among financial institutions and market interventions, challenge the mobilising of low cost LKR customer deposits. Moreover, with the dearth of lending opportunities in foreign currency and access to low cost foreign currency funding lines the bank has taken a strategic decision to generate low cost LKR funding through foreign currency swaps for short to medium term liquidity. Exposure limits in terms of regulatory and internal, regular management information to ALCO/BIRMC/BOD manages the liquidity risk that could arise from overreliance of borrowings and cross currency liquidity generation, are actively managed.

**Funding Diversification**

Deposits from customers' account for 75% of funds making it the primary source of funding for the Bank. Borrowings consist of long-term multilateral borrowings and short-term money market and REPO which constitute 13%. Shareholder funds grew significantly to 12% as the Bank increased equity to comply with regulatory capital requirements at the close of the year.

## Credit Ratings

The following credit ratings stand as at the close of the year.

Figure 33: Bank's Credit Ratings

Rating Type	Counterparty Risk Rating	Long Term National Rating
Issuer	Moody's Investor Service Singapore Pte Ltd.	Fitch Ratings Lanka Ltd.
Rating	B2 (international rating)	AA- (lka)
Outlook	Not Applicable	Stable
Date Issued	June 2018 and revised in October 2019	January 2019
What can change rating up	The Negative Outlook on the Sovereign Rating of Sri Lanka was downgraded from B1 to B2 (negative), and as a result the Bank's International Rating also was revised as local currency deposit ratings of HNB are positioned at the same level	Moderation of its risk appetite and the Bank achieving sustained improvements in its financial profile, particularly in its funding and liquidity
What can change the rating down	<ul style="list-style-type: none"> <li>Downgrade of Sri Lanka's Sovereign Rating</li> <li>Material deterioration in solvency factors, such as asset quality, profitability, and capital; and/or</li> <li>Tighter liquidity and an increased reliance on market funding.</li> </ul>	<ul style="list-style-type: none"> <li>Aggressive risk taking while the operating environment remains weak, unless sufficiently mitigated through capital and financial performance.</li> <li>Weakening in the liquidity position would also be negative for the rating.</li> </ul>

## Reputation Risk

Reputation risk refers to the potential adverse effects which can arise from the Bank's reputation being tarnished due to factors such as unethical practices, regulatory actions, customer dissatisfaction, complaints, negative/adverse publicity and inability to meet obligations.

During recent times negative publicity through social media activities have emerged as a source of reputation risk. However, the past year witnessed a more matured social media audience where acceptance of such broadcasts were more curated.

### Mitigation

The leadership of the Bank set the tone at the top, nurturing the right behaviour and creating an environment of transparency and accountability across the Bank. Other mechanisms in place to safeguard the reputation of the Bank include:

- A Code of Ethics issued to all employees ensures that corporate values and expectations of conduct are clearly communicated throughout the Bank.
- Employees are further encouraged and incentivised to safeguard the Bank's reputation by making this a criteria for performance assessment.

- Comprehensive customer engagement mechanisms in place including contact centre which enable us to understand their concerns and address them promptly.
- Print and electronic media exposure is monitored
- A comprehensive training and development plan facilitates employee learning on the subject and sharing of learnings while supporting competency development in this area.
- Response plans and identification of spokespersons in event of crisis supports organisation readiness to handle reputation risk events, supporting initiating of timely and effective action to minimise potential impacts.

### Monitoring

The Bank uses a scorecard approach to assess Reputation Risk. The Reputational Risk Task Force (RRTF) which operates with the supervision of ORSC reviews reputational risk trigger events and manages attributes that impact the reputation of the Bank, reducing the capital requirement. These pre-emptive measures support scoring, reducing capital allocation under reputational risk. The RRTF committee refined the reputation risk scorecard parameters and looked at more granular level details to make the best use of parameters applicable to HNB.

## Strategic Risk

Strategic risk is the risk that the Bank's future business plans and strategies may be inadequate to prevent financial loss or protect the Bank's competitive position and shareholder returns. The leadership of the Bank is collectively responsible for providing strategic direction, mitigating strategic risk and undertaking evaluation of alternative strategies which are deliberated in depth to chart its course.

### Mitigation

A robust strategic planning process supports the testing of key assumptions and analysis to identify and assess potential areas of concern. Care is also taken to ensure compliance with all regulatory requirements and monitoring trends to identify potential areas of regulation, facilitates early understanding of related impacts and issues.

Optimising risk and return with a thorough understanding of risks and opportunities is key to managing strategic risk. The Bank engaged external resources to support its strategic planning processes, bringing in global expertise to support management of strategic risk, recognising the systemic importance of the Bank to the country's economy.

## RISK & CAPITAL REVIEW

### Monitoring

The Bank carries out strategic risk assessment in both quantitative and qualitative dimensions using a scorecard to compute capital allocation for strategic risk as a part of Pillar II risk assessment under ICAAP. The Bank plans on operationalising a strategic risk dashboard through which major strategic risks can be escalated to BSIRC through BIRMC which would support the BSIRC in reviewing macroeconomic strategic opportunities available and risks inherent within and outside of Sri Lanka.

### Conduct Risk

Conduct risk in banking business can be defined as any action of a bank or the banking industry that leads to customer detriment or negatively impacts market stability due to unacceptable or unexpected behaviour in meeting a bank's obligations towards its stakeholders.

Non conduct risks are risks of operational losses other than conduct risk.

Sustainably managing conduct risk has become increasingly critical in the banking industry as the number of risk events continues to rise. Underlying factors contributing to elevated conduct risk include failures in internal controls, noncompliance, negligence, etc. Consequently, banking and financial sector have been penalized by regulators globally with hefty penalties resulting in loss of stakeholder confidence and trust in both the global and local context during last two decades.

### Mitigating

Understanding what has driven poor conduct in the past helps the Bank in estimating and preventing poor conduct in the future. Accordingly, the Bank has defined its key risk drivers to this key risk area.

### Monitoring

Lines of defence in managing conduct risk:

- **Operational:** Day-to-day monitoring, and daily management of information. This line of defence remains with the respective business unit itself.
- **Compliance:** Implementation of policies and procedures as prescribed by regulator. The Operational Risk Management Department is under the purview of

RMD, and the Audit and Compliance Department ensures the management of the risk control framework and ongoing compliance monitoring.

- **Board:** Management of conduct risks through review and analysis of periodic management information.

### Compliance Risk

Compliance risk is defined as the risk of legal or regulatory sanctions, financial loss, or loss to reputation that a bank may suffer as a result of its failure to comply with all applicable laws, regulations and codes of conduct and standards of good practice. The Bank has zero tolerance for non-compliance with regulatory requirements and keeps pace with the evolving regulatory landscape to facilitate compliance.

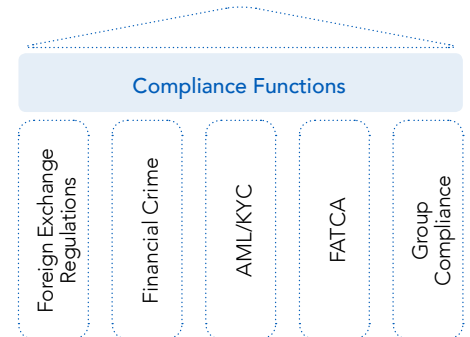
### Mitigation

A dedicated compliance function headed by the Head of Compliance reports independently to the Board Integrated Risk Management Committee. The Compliance Division is staffed by specialists and supports implementing the Bank's compliance program, thereby ensuring that business-and industry-specific standards are met.

The Compliance Division contributes towards knowledge enhancement and awareness on statutory regulations, internal policies and best practices in the industry, by integrating these into the training programs held at the Bank's Head Office and regional centres situated across the country. The purpose of these training sessions is to ensure that employees do not overstep boundaries as a result of ignorance or uncertainty. New recruits and promoted employees receive a compliance training tailored to meet the demands of their new role and function. An e-learning AML module further supports knowledge enhancement on Anti Money Laundering areas.

The Bank's policies are updated regularly, incorporating any change in the economic and regulatory landscape, internal business processes and technological advances. All policies are reviewed and approved by HNB's Board of Directors on the recommendations of the relevant Board Sub Committee.

Figure 34: Compliance Functions



### Key initiatives in 2019

The following key initiatives were implemented in 2019.

- Implementation of the SWIFT screening tool from 'SWIFT Alliance' to screen all incoming and outgoing message on a real-time basis.
- Using the Dow Jones system to carry out Enhanced Due Diligence on customers/ transactions
- AML system upgrading

### Monitoring

The Compliance Division continuously work on enhancing the monitoring process of various functions of regulatory importance and relevance. Areas such as monitoring of High Risk customers, Remittance, Dual use goods and Vessel tracking were further enhanced and required technology as well as processes were put in place during the year.

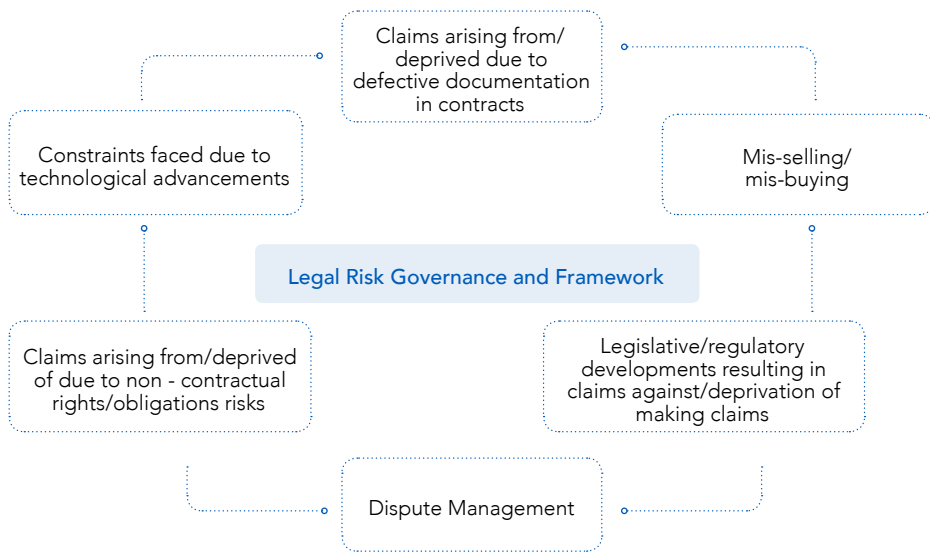
### Legal Risk

Legal risk is the current and potential risk to earnings or capital arising from violations of, or non-conformance with laws, rules, regulations, prescribed practice, or ethical standards issued by the regulator from time to time. As per ISO 31000 Legal Risk can be of following types:

- Litigation Risk
- Contract Risk
- Regulatory Risk
- Structural Risk

Legal risk also can be defined as the risk of financial or reputational loss that may result from lack of awareness or misunderstanding of, ambiguity in, or reckless indifference to, the way law and regulation apply to your business, its relationships, processes, products and services.

Figure 35: Legal Risk Drivers



**Mitigation**

A legal risk scorecard was introduced as a part of improvements made to the ICAAP document of the Bank and considered as a quantitative risk assessing parameter to be used in our Pillar 2 risk assessment. The Bank looks at risk drivers shown in above figure in assessing legal risk.

The Legal Department of the Bank carries out a comprehensive due diligence assessment prior to entering in to an agreement with any third party service providers. The Bank retains the best legal counsels to safeguard the Bank’s interest in dealing with litigations against the Bank.

**Monitoring**

The Bank conducts a comprehensive analysis on its legal risks through a scorecard approach to ascertain the additional capital requirement under Basel III, pillar 2 calculation. The major factors considered for the assessment of reputation risk include, legal risk governance and framework, claims arising fro/deprived due to defective documentation in contracts, legislative/regulatory developments resulting in claims against/deprivation of making claims, etc.

A quarterly compliance assessment report is prepared based on a comprehensive checklist covering the broader spectrum of the Bank’s litigation and related functionalities which every member of the Legal Department will

go through and sign off and submit to the Compliance Division.

**Model Risk**

The model risk management framework is a critical element for managing the risks pertaining to the models used by the Bank, ensuring that the Bank’s business projections, financial analysis and risk management capabilities are sufficiently robust to support its business strategies, risk assessment and measurement capabilities. Model risk would potentially lead to over/under estimating future gains and losses and leaves no room for suboptimal strategic decisions at best and disastrous consequences at worst.

Model risk is termed as the risk of loss that an institution may incur as a consequence of the decision that could be primarily based on the output of the internal models, as a result of the errors in the development, implementation or use/maintenance of the models. Therefore, it is critical to deploy a strong model governance framework in order to effectively manage and mitigate the model risk. During the year the Bank engaged with an external risk consultant and established a Model Risk Policy and framework to govern all material models used by the Bank.

The governance principles for models’ lifecycle are prescribed below:

- Compliance to model development rules and risk estimation methodologies prescribed by Basel principles and leading

model development practices across the globe

- Maintain data for models in line with the Risk Data Aggregation (and Reporting) Principles prescribed by the Basel Committee on Banking Supervision through the BCBS 239 principles
- Distinct models to be developed for portfolios of HNB with unique characteristics (such as Retail, Corporate, etc. for credit portfolios and loss data for market risk and operational risk)
- Models are to be parsimonious, taking into account the appropriateness of variables, data length, ease of availability, with the aim to maximise performance with resources available
- Independent validation of models to be carried out to effectively manage the model risk emanating from use of such models, with the aim of ensuring accuracy of models

Maintaining strong governance over models development and their lifecycle is fundamentally important to their effectiveness and risk control.

The governance of the Bank’s model management framework is characterised by cross-departmental involvement in various stages of model development, implementation and review; with the oversight of the Board of Directors, through the Board Integrated Risk Management Committee (BIRMC).

The following are some of the areas which are managed through specific models in the Bank.

- Gauging the market risk parameters for the Bank, assessment and monitoring methodology
- Non statistical models (such as Pillar 2 risk assessment models)
- Models for assessment of obligors or facilities, to gauge the creditworthiness and risks involved with the same
- Bank’s credit risk models as per the IFRS 9 stipulations of impairment and provision computation

**Monitoring**

The Bank has a process to carry out independent validation of data quality and model inputs in order to ensure applicability and reliability of models.

## RISK & CAPITAL REVIEW

### Managing Group Risk

The Bank has nine subsidiaries four of which are held directly while the remainder are held indirectly. All subsidiaries are engaged in providing financial services except for Sithma Development Ltd., which is the real estate arm of the HNB Group. Only HNB Assurance PLC is listed on the Colombo Stock Exchange at present while HNB Finance Co. Ltd. postponed its scheduled listing in 2019 to 2020 due to subdued market conditions.

### Mitigation & Monitoring

Performance of subsidiaries is closely monitored with the presence of the Corporate Management on the Boards of the same. Risk management divisions of the subsidiaries forward Risk Management Review Reports to the IRM function, identifying key risks faced by each entity, trends and measures taken to manage or mitigate the same together with financial statements of the preceding month.

Subsidiaries of the Bank are in diversified sectors and risk aggregating is a challenge due to their differing operating models and the Bank is addressing this to facilitate assessment of the Bank's material group risks. Moreover, the Bank's Risk Management Department developed a Group risk dashboard to closely monitor subsidiary specific financial and non-financial risk parameters covering changes to Group structure, general and specific financial highlights of each subsidiary, adherence to respective governing authorities, compliance breaches if and non-financial risks faced by respective subsidiaries on quarterly basis

The following factors provide assurance on management of Group risk:

- Performance of Group Companies as reported from page 90 to 97 indicate healthy financial positions at the close of the year.
- HNB's capital at risk is limited to amount invested in these companies in the form of equities at the time of companies were incorporated or acquired
- Key Management Personnel/Director representation on boards of Group Companies ensuring adherence to core values, alignment of business strategy and a sufficient information flow as given in figure 36.

*Figure 36: HNB representation in subsidiaries*

Group Company	Board Representation	Chairman	Board Risk Committee Representation
HNB Assurance PLC	✓		✓
Acuity Partners (Pvt) Ltd	✓	✓	✓
Sithma Development (Pvt) Ltd	✓	✓	✓
HNB Finance (Pvt) Ltd	✓	✓	✓

- Subsidiaries engaged in insurance, finance business and stock broking are subject to regulatory oversight and have structures in place to ensure compliance.

## HNB Assurance

HNB Assurance PLC (HNBA) and its fully-owned subsidiary HNB General Insurance Limited (HNBGI) have established compliance and risk management systems in place to manage its fiduciary obligations to its customers and comply with the regulations of the Insurance Regulatory Commission of Sri Lanka. As a listed company, HNBA also complies with the continuing listing requirements of the Colombo Stock Exchange and was included in the prestigious S&P20 index in 2019 in testimony to its performance and governance.

### HNB Assurance PLC

Key Risk Indicator	2019	2018
Gross Written Premium (Rs Mn)	5,175	4,421
Profits After Tax (Rs Mn)	827	2,475
Claims Ratio (without policy maturities)	9%	8%
Expense Ratio	49%	49%
Combined Ratio	58%	57%
Capital Adequacy Ratio	309%	319%

### HNB General Insurance Limited

Key Risk Indicator	2019	2018
Gross Written Premium (Rs Mn)	4,819	4,341
Profits After Tax (Rs Mn)	250	230
Claims Ratio	64%	66%
Expense Ratio	37%	36%
Combined Ratio	101%	102%
Capital Adequacy Ratio	223%	200%

### Capital Adequacy Ratio



HNBA  
**309%**



HNBGI  
**223%**

### KEY INITIATIVES IMPLEMENTED IN 2019

- Updated the Company's Anti-Money Laundering Policy in compliance with Rules cited as the Insurers (Customer Due Diligence) Rules, No.1 of 2019.
- Risk Management Policy updated and additional areas have included such as fraud risks, reputational risk, and fraud risk register.
- Complaint Handling Policy updated based on the IRCSL guidelines and circuited to all the branches.
- Title insurance claim procedure implemented.
- ISO audit performed on life new business underwriting and life MRP products.
- Procedure checklist updated for the General Insurance operations.
- Reviewed key operational risks and actions based on inputs from the risk register, external assessments, Internal Audit findings and incidents.
- Road Map developed for IT Audit and Compliance issues and Company has developed Privileged user access monitoring policy and Internet usage policy.
- Branch Procedure manuals have been updated.

### HNB Assurance PLC

National IFS Rating & National Long Term Rating

**A(Ika)** Outlook: Positive



### HNB General Insurance PLC

National IFS Rating & National Long Term Rating

**A(Ika)** Outlook: Positive



**Included in S&P 20**

HNBA has its own Risk Governance structure which includes a Board Level Risk Management Committee and the Board Audit Committee and the Company Risk management policy framework which is in line with the Risk Management Framework of the parent HNB PLC. The Company reports the details of the risk management activities carried out by HNBA and HNBGI to the Board Integrated Risk Management Committee (BIRMC) of Hatton National Bank PLC on a quarterly basis. Further, in order to manage the compliance risk, confirmation on compliance is submitted to the compliance division of HNB on a quarterly basis. The following officials of the Bank are Directors of HNBA facilitating alignment of values and culture.

Figure 37: HNB representation in HNBA

Name	Role in HNBA	Role at the Bank
Mr Dilshan Rodrigo	Non-Executive Director	Chief Operating Officer
Mr Damith Pallewatte	Invitee - Board Risk Committee	DGM – Risk/CRO/CISO
Mr Kalum Wijesooriya	Alternate Director to Mr Dilshan Rodrigo	Assistant General Manager - Deposits & Remittances /Chief Employee Experience Officer

## RISK &amp; CAPITAL REVIEW

## HNB Finance Ltd.

HNB Finance Ltd. transitioned from a micro finance company in 2017 to a fully-fledged finance company and plans to be listed in 2020. As a regulated finance company, HNB Finance Ltd. has a comprehensive Risk Management Framework aligned with the Bank's risk objectives and parameters.

Capital Adequacy Ratio

13%

HNB Finance Ltd.

A(Ika)

Outlook: Stable

Rs 1.2 Bn

raised in debentures in 2019

Key Risk Indicator	2019	2018
Deposit Growth	31%	4%
Advances Growth	21%	34%
Profitability (Rs. Mn)	114.85	847.78
Total Assets (Rs. Mn)	36,664.71	29,808.93
Shareholder Funds (Rs. Mn)	4,802.27	4,323.09
CAR	13.00%	10.23%
Impairment Charge (Rs. Mn)	1,771.04	490.12
NPA Ratio	11.12%	9.13%

NPAs increased during the year in step with the NBFI sector due to subdued economic conditions, impact of terror attacks across the tourism and related industries and climate change. Interest rate caps of 35% for micro finance loans continues to impact profitability, skewing market equilibrium as elevated levels of risk are not reflected in pricing. CBSL has also introduced caps on deposits during the year which eased the competitive pressures within the industry to some extent but HNB Finance Ltd. remained largely unaffected due to its ability to raise funds within the required rates.

The CSO of HNB Finance Ltd. serves on the Board of HNB Finance Ltd. and acts as the Chairman of Board risk committee of HNB Finance Ltd., providing guidance on its Risk Management policies, structures, processes and controls. RMD comprehensively assesses the quality of the loan book inclusive of NPA ratio, portfolio quality indicators, risk coverage ratios, etc., due to elevated risk levels stemming from the operating environment. As a part of continuous improvements to risk management processes, HNB Finance Ltd. progressively develops tools and techniques to assess the credit risk, operational risk, strategic risk, market risk, liquidity risk, etc and monitoring and reporting of its material risks.

Figure 38: HNB representation in HNBFI

Name	Role in HNBFI	Role at the Bank
Mr Jonathan Alles	Chairman/Non-Independent Non-Executive Director Member - HR/Remuneration Committee Member - Nomination Committee	MD/CEO
Mr Rajive Dissanayake	Non-Independent Non-Executive Director Chairman - BIRMC Chairman - BAC Member - Strategic/Investment Committee	Chief Strategy Officer
Mr Damith Pallewatte	Permanent Invitee	DGM – Risk/CRO/CISO

As a regulated industry, HNB Finance Ltd. complies fully with the regulatory requirements for Non-Bank Financial Institutions including publishing its financial statements biannually.

## KEY INITIATIVES IMPLEMENTED IN 2019

- Established IT Steering Committee (ITSC)
- Reviewed and enhanced operational and credit risk strategies.
- Ensured Key Operational Risk Controls (KORCs) are documented, compiled and revised in a timely manner
- Introduced the Business Continuity Management (BCM) framework for duly implementation
- Improved and upgraded risk management framework of the Company
- Initiated action to implement an IT system towards identification of suspicious transactions from a ML/FT perspective.
- Risk identification, assessment and measurement covering credit, operational, strategic, financial and liquidity risks including the risks related to IT operations
- Conducted training to enhance risk awareness and to develop a risk culture within HNBFI.
- Commenced assessment of all credit facilities above Rs 5 Mn and providing recommendation for risk mitigation and/or clearance.
- Commenced assessment of all rescheduling/restructuring facilities pertains to SME, SSE and leasing facilities and providing recommendation for risk mitigation and/or clearance.
- Commencement of LRM function.
- Commenced capturing of operational losses and near misses on a periodic basis.
- Development of a comprehensive risk management structure, policy and processes for HNBFI which included Risk Management Policy, TOR for BIRMC/ERMC, IRM Framework, Risk Appetite Statement, Risk Dashboards, Risk Register and Heat Map.
- Developed a Risk Heat Map covering key risk areas and reviewed same on a quarterly basis at BIRMC



## Acuity Partners

APL Group Risk exposure is monitored and given oversight by the APL Group's Audit Committee with oversight by HNB BIRMC. APL Group submits a quarterly report on risk management activities to the Board Integrated Risk Management Committee of Hatton National Bank PLC.

Material risks identified by the APL are market risk, compliance risk and liquidity risk. Those risks are assessed and mitigated through laid down procedures based on regulatory and internal procedures.

Debt: Equity Ratio  
**38%**

Profit After Tax  
Attributable to Equity Holders  
**Rs 380 Mn**

The following officials of the Bank are Directors of Acuity Partners facilitating oversight and alignment of values and culture.

Figure 39: HNB representation in APL

Name	Role in Acuity Partners	Role at the Bank
Mr. Jonathan Alles	Member of the Board of Directors	MD/CEO
Mr. Rajive Dissanayake	Member of the Board and Audit Committee	Chief Strategy Officer
Mr. Damith Pallewatte	Member of the Board of Directors	DGM - Risk/CRO/CISO

## KEY INITIATIVES IMPLEMENTED IN 2019

- Overall the Group maintained and continued existing control and risk mitigating process.
- Conducted annual review and updating of internal controls and procedures.
- Setting up a Group HR and Remuneration Committee.
- Setting up a company level Audit Committee for the Primary dealer.

## RISK &amp; CAPITAL REVIEW

**Sithma Development (Pvt) Ltd.**

Sithma Development owns and manages the building that houses the Bank's Head Office and manages branch premises owned by the Bank. Risks related to Sithma are monitored by the Bank's Audit Committee and BIRMC in addition to the Board of the subsidiary and the Bank in its role as the parent company.

The main risks faced by the subsidiary are Market Risk and Compliance Risk. The value of its assets and rental revenues are impacted by real estate market movements which have not been favourable during the period under review and are expected not to improve in 2020 as well due to the advent of new office spaces in the central business district of Colombo.

As the building houses over 2,000 people, compliance with best practice in health and safety standards including fire detection and prevention is a key aspect of risk that is monitored.



All Audit Committee members of Sithma Development which is not a listed company are employees of HNB PLC and the following officials of the Bank are directors of Sithma Development.

Figure 40: HNB representation in Sithma

Name	Role in Sithma Developers	Role at the Bank
Mr Dilshan Rodrigo	Director	Chief Operating Officer
Mr Chandana Panditharathne	Director/CEO	AGM - Services
Mr Roshan Fernando	Director/COO	Senior Manager - FM
Ms Anuradhi Delage	Director	Senior Manager - Finance

# MARKET DISCIPLINE

## – DISCLOSURE REQUIREMENTS UNDER PILLAR III

With the implementation of Basel III directives w.e.f 1st July 2017, all licensed banks are required to disclose pillar III disclosure requirements in order to complement the minimum capital requirements and supervisory review process by developing a set of disclosure requirements which will allow the market participants to gauge the capital adequacy and risk exposures of licensed banks.

These requirements will improve the comparability and consistency of disclosures among licensed banks and facilitate assessment of the banks by others, including investors, analysts, customers, other banks and rating agencies which leads to good corporate governance.

### Template 1

#### Key Regulatory Ratios - Capital and Liquidity

Item	Bank		Group	
	2019	2018	2019	2018
<b>Regulatory Capital (LKR '000)</b>				
Common Equity Tier 1	115,072,496	104,029,151	126,475,924	114,423,431
Tier 1 Capital	115,072,496	104,029,151	126,475,924	114,423,431
Total Capital	144,326,073	123,724,773	155,544,360	134,011,553
<b>Regulatory Capital Ratios (%)</b>				
Common Equity Tier 1 Capital Ratio (Minimum Requirement - 2019-8% ; 2018-7.375%)	14.57%	12.80%	14.74%	13.16%
Tier 1 Capital Ratio (Minimum Requirement - 2019-9.5% ; 2018 - 8.875%)	14.57%	12.80%	14.74%	13.16%
Total Capital Ratio (Minimum Requirement - 2019-13.5% ; 12.875%)	18.28%	15.22%	18.12%	15.41%
Leverage Ratio (Minimum Requirement - 3%)	8.14%	8.33%	8.51%	8.78%

Item	Bank	
	2019	2018
<b>Regulatory Liquidity</b>		
Statutory Liquid Assets (LKR'000)	281,521,339	225,544,960
<b>Statutory Liquid Assets Ratio (Minimum Requirement – 20%)</b>		
Domestic Banking Unit (%)	27.09%	22.03%
Off-Shore Banking Unit (%)	53.01%	43.52%
Liquidity Coverage Ratio (%) – Rupee (Minimum Requirement - 2019-100% ; 2018-90%)	465.37%	153.16%
Liquidity Coverage Ratio (%) – All Currency (Minimum Requirement - 2019-100% ; 2018-90%)	251.07%	103.85%

## MARKET DISCIPLINE

### – DISCLOSURE REQUIREMENTS UNDER PILLAR III

#### Template 2

#### Basel III Computation of Capital Ratios

Item	Bank 2019 (LKR '000)	Group 2019 (LKR '000)
<b>Common Equity Tier 1 (CET1) Capital after Adjustments</b>	115,072,496	126,475,924
<b>Common Equity Tier 1 (CET1) Capital</b>	118,734,417	129,178,231
Equity Capital (Stated Capital)/Assigned Capital	33,820,906	33,820,906
Reserve Fund	7,060,000	7,060,000
Published Retained Earnings/(Accumulated Retained Losses) (Note 1)	20,001,415	25,185,402
Published Accumulated Other Comprehensive Income (OCI)	-	-
General and other Disclosed Reserves	57,852,097	58,147,100
Unpublished Current Year's Profit/Loss and Gains reflected in OCI	-	-
Ordinary Shares issued by Consolidated Banking and Financial Subsidiaries of the Bank and held by Third Parties	-	4,964,824
<b>Total Adjustments to CET1 Capital</b>	3,661,921	2,702,307
Goodwill (net)	-	122,942
Intangible Assets (net)	962,851	1,062,851
Others (specify)	-	-
Defined benefit pension fund assets	-	-
Investments in the capital of banking and financial institutions where the bank does not own more than 10 per cent of the issued ordinary share capital of the entity	199,842	164,137
Significant investments in the capital of financial institutions where the bank owns more than 10 per cent of the issued ordinary share capital of the entity	2,499,228	1,352,377
<b>Additional Tier 1 (AT1) Capital after Adjustments</b>	-	-
<b>Additional Tier 1 (AT1) Capital</b>	-	-
Qualifying Additional Tier 1 Capital Instruments	-	-
Instruments issued by Consolidated Banking and Financial Subsidiaries of the Bank and held by Third Parties	-	-
<b>Total Adjustments to AT1 Capital</b>	-	-
Investment in Own Shares	-	-
Others (specify)	-	-
<b>Tier 2 Capital after Adjustments</b>	29,253,576	29,068,436
<b>Tier 2 Capital</b>	29,253,576	29,068,436
Qualifying Tier 2 Capital Instruments	20,180,403	19,995,263
Revaluation Gains	2,090,479	2,090,479
General Provisions	6,982,695	6,982,695
Instruments issued by Consolidated Banking and Financial Subsidiaries of the Bank and held by Third Parties	-	-
<b>Total Adjustments to Tier 2</b>	-	-
Investment in Own Shares	-	-
Others (specify)	-	-
Investments in the capital of financial institutions and where the bank does not own more than 10 per cent of the issued capital carrying voting rights of the issuing entity	-	-
<b>CET1 Capital</b>	115,072,496	126,475,924
<b>Total Tier 1 Capital</b>	115,072,496	126,475,924
Total Capital	144,326,073	155,544,360
Total Risk Weighted Assets (RWA)	789,539,424	858,259,611
RWAs for Credit Risk	725,747,553	778,470,491
RWAs for Market Risk	606,406	686,302
RWAs for Operational Risk	63,185,465	79,102,817
<b>CET1 Capital Ratio (including Capital Conservation Buffer, Countercyclical Capital Buffer &amp; Surcharge on D-SIBs) (%)</b>	14.57%	14.74%
of which: Capital Conservation Buffer (%)	2.50%	2.50%
of which: Countercyclical Buffer (%)	N/A	N/A
of which: Capital Surcharge on D-SIBs (%)	1.00%	1.00%
<b>Total Tier 1 Capital Ratio (%)</b>	14.57%	14.74%
<b>Total Capital Ratio (including Capital Conservation Buffer, Countercyclical Capital Buffer &amp; Surcharge on D-SIBs) (%)</b>	18.28%	18.12%
of which: Capital Conservation Buffer (%)	2.50%	2.50%
of which: Countercyclical Buffer (%)	N/A	N/A
of which: Capital Surcharge on D-SIBs (%)	1.00%	1.00%

Note 1: CBSL has allowed the Bank to deduct Day 1 impact of IFRS 9 impairment charge from retained earnings over 4 years from December 2018. Bank has charged Rs 2.1 Bn as at 31st December 2019 and remaining balance is Rs 2.1 Bn approx.

### Template 3

#### Computation of Leverage Ratio

Item	Amount (LKR '000)	
	Bank 2019 (LKR'000)	Group 2019 (LKR'000)
Tier 1 Capital	115,072,496	126,475,924
Total Exposures	1,413,843,587	1,486,302,051
On-Balance Sheet Items		
(excluding Derivatives and Securities Financing Transactions, but including Collateral)	1,119,962,503	1,190,348,485
Derivative Exposures	159,747,611	159,747,611
Securities Financing Transaction Exposures	18,379,746	20,452,228
Other Off-Balance Sheet Exposures	115,753,727	115,753,727
Basel III Leverage Ratio (%) (Tier 1/Total Exposure)	8.14%	8.51%

### Template 4

#### Basel III Computation of Liquidity Coverage Ratio All Currency

Item	Amount (LKR'000)			
	2019		2018	
	Total Un-weighted Value	Total Weighted Value	Total Un-weighted Value	Total Weighted Value
Total Stock of High-Quality Liquid Assets (HQLA)	149,011,660	140,423,389	96,361,469	90,942,189
Total Adjusted Level 1A Assets	98,783,496	98,783,496	68,437,312	68,437,312
Level 1 Assets	96,592,203	96,592,203	67,655,237	67,655,237
Total Adjusted Level 2A Assets	50,347,022	42,794,969	25,525,245	21,696,459
Level 2A Assets	50,347,022	42,794,969	25,525,245	21,696,459
Total Adjusted Level 2B Assets	2,072,435	1,036,218	3,180,987	1,590,493
Level 2B Assets	2,072,435	1,036,218	3,180,987	1,590,493
Total Cash Outflows	917,360,563	140,525,652	908,732,314	162,080,877
Deposits	647,381,008	64,738,101	556,729,752	55,672,975
Unsecured Wholesale Funding	116,784,932	43,416,765	196,929,536	75,437,532
Secured Funding Transactions	16,709,886	-	16,164,607	-
Undrawn Portion of Committed (Irrevocable) Facilities and Other Contingent Funding Obligations	118,856,108	14,742,156	123,422,711	15,484,662
Additional Requirements	17,628,629	17,628,629	15,485,708	15,485,708
<b>Total Cash Inflows</b>	<b>167,399,558</b>	<b>84,594,792</b>	<b>141,188,930</b>	<b>74,512,931</b>
Maturing Secured Lending Transactions Backed by Collateral	-	-	-	-
Committed Facilities	3,000,000	-	3,000,000	-
Other Inflows by Counterparty which are Maturing within 30 Days	147,957,913	76,853,957	121,107,448	65,262,112
Operational Deposits	1,143,172	-	1,861,454	-
Other Cash Inflows	15,298,472	7,740,835	15,220,029	9,250,819
Liquidity Coverage Ratio (%) (Stock of High Quality Liquid Assets/Total Net Cash Outflows over the Next 30 Calendar Days) * 100		251.07%		103.85%

## MARKET DISCIPLINE

### - DISCLOSURE REQUIREMENTS UNDER PILLAR III

#### Template 5

#### Main Features of Regulatory Capital Instruments

Description of the Capital Instrument	Stated Capital	Debentures - 2007	Debentures - 2006 Type E	Debentures - 2006 Type F	Debentures - 2011	Debentures - 2016	Debentures - 2016	Debentures - 2019	Debentures - 2019	Foreign Borrowing
Issuer	HNB PLC	HNB PLC	HNB PLC	HNB PLC	HNB PLC	HNB PLC	HNB PLC	HNB PLC	HNB PLC	German Development Financial Institution
Unique Identifier (e.g., ISIN or Bloomberg Identifier for Private Placement)										
Governing Law(s) of the Instrument	Sri Lanka	Sri Lanka	Sri Lanka	Sri Lanka	Sri Lanka	Sri Lanka	Sri Lanka	Sri Lanka	Sri Lanka	German
Original Date of Issuance	N/A	August 1, 2007	April 1, 2006	April 1, 2006	September 5, 2011	March 28, 2016	November 1, 2016	September 23, 2019	September 23, 2019	June 12, 2012
Par Value of Instrument	N/A	LKR 100/-	LKR 100/-	LKR 100/-	LKR 100/-	LKR 100/-	LKR 100/-	LKR 100/-	LKR 100/-	N/A
Perpetual or Dated	Perpetual	Dated	Dated	Dated	Dated	Dated	Dated	Dated	Dated	Dated
Original Maturity Date, if Applicable										
Amount Recognised in Regulatory Capital (in LKR '000 as at the Reporting Date)	33,820,906	420,000	387,074	866,579	800,000	2,800,000	800,000	3,200,000	1,922,570	8,077,430
Accounting Classification (Equity/Liability)	Equity	Liability	Liability	Liability	Liability	Liability	Liability	Liability	Liability	Liability
Issuer Call subject to Prior Supervisory Approval	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Optional Call Date, Contingent Call Dates and Redemption Amount (LKR '000)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Subsequent Call Dates, if Applicable	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
<b>Coupons/Dividends</b>	Dividends	Coupons	Coupons	Coupons	Coupons	Coupons	Coupons	Coupons	Coupons	Coupons
Fixed or Floating Dividend/Coupon	N/A	Fixed	Fixed	Fixed	Fixed	Fixed	Fixed	Fixed	Fixed	Floating
Coupon Rate and any Related Index	N/A	16.75%	11.00%	11.25%	11.50%	11.25%	11.75%	13.00%	12.30%	12.80%
										6 Month LIBOR + 4.25% p.a.
Non-Cumulative or Cumulative										
<b>Convertible or Non-Convertible</b>	N/A	Non-Convertible	Non-Convertible	Non-Convertible	Non-Convertible	Non-Convertible	Non-Convertible	Non-Convertible	Convertible	Non-Convertible
If Convertible, Conversion Trigger (s)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
If Convertible, Fully or Partially	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
If Convertible, Mandatory or Optional	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
If Convertible, Conversion Rate	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

## Template 6

### Capital Planning Overview

- The Bank's balance sheet is projected based on the strategy of the Bank, macro-economic outlook and the expectation of business growth
- Based on the projected balance sheet, future capital requirement would be assessed and the requirement for additional capital apart from the capital generated internally would be determined.
- Options for raising capital such as rights issues, debenture issues and divestment of capital inefficient investments would be evaluated
- The most appropriate option would be recommended to the Board of Directors for approval and Board decision would be implemented in raising the required capital.
- As at end of 2019, the tier I capital (14.57%) and the total capital requirements (18.28%) remain well above the statutory requirements, hence based on the projected growth for the Bank, there is no requirement to raise additional capital either in the form of tier I capital or tier II capital in the year 2020.
- However, in the event of an unforeseen event, the Bank could resort to raising capital through the options listed above.

## Template 7

### Credit Risk under Standardised Approach – Credit Risk Exposures and Credit Risk Mitigation (CRM) Effects

Item	Amount (LKR'000) as at December 31, 2019					
	Exposures before Credit Conversion Factor (CCF) and CRM		Exposures post CCF and CRM		RWA and RWA Density (%)	
	On-Balance Sheet Amount	Off-Balance Sheet Amount	On-Balance Sheet Amount	Off-Balance Sheet Amount	RWA	RWA Density
Claims on Central Government and CBSL	336,654,586	-	297,656,461	-	34,417,999	0.12
Claims on Foreign Sovereigns and their Central Banks	-	-	-	-	-	-
Claims on Public Sector Entities	-	-	-	-	-	-
Claims on Official Entities and Multilateral Development Banks	-	-	-	-	-	-
Claims on Banks Exposures	11,662,594	-	11,662,594	-	5,525,907	0.47
Claims on Financial Institutions	22,913,270	2,667,112	22,913,270	2,667,112	15,346,394	0.60
Claims on Corporates	294,368,011	336,651,353	286,496,505	97,447,602	360,968,696	0.94
Retail Claims	338,694,574	69,747,364	297,270,199	17,895,601	220,261,020	0.70
Claims Secured by Residential Property	42,023,947	-	42,023,947	-	28,619,161	0.68
Claims Secured by Commercial Real Estate	-	-	-	-	-	-
Non-Performing Assets (NPAs)(i)	19,730,081	-	19,730,081	-	21,839,515	1.11
Higher-risk Categories	1,175,717	-	1,175,717	-	2,939,293	2.50
Cash Items and Other Assets	62,511,236	-	62,511,236	-	35,829,568	0.57
Total	1,129,734,016	409,065,829	1,041,440,011	118,010,315	725,747,553	

## MARKET DISCIPLINE

### - DISCLOSURE REQUIREMENTS UNDER PILLAR III

#### Template 8

##### Credit Risk under Standardised Approach: Exposures by Asset Classes and Risk Weights

Description	Amount (LKR'000) as at December 31, 2019 (Post CCF & CRM)									Total Credit Exposures Amount
	Risk Weight	0%	20%	50%	60%	75%	100%	150%	>150%	
Asset Classes										
Claims on Central Government and Central Bank of Sri Lanka		125,566,467	172,089,994	-	-	-	-	-	-	297,656,461
Claims on Foreign Sovereigns and their Central Banks		-	-	-	-	-	-	-	-	-
Claims on Public Sector Entities		-	-	-	-	-	-	-	-	-
Claims on Official Entities and Multilateral Development Banks		-	-	-	-	-	-	-	-	-
Claims on Banks Exposures		-	5,021,948	4,238,255	-	-	2,402,390	-	-	11,662,594
Claims on Financial Institutions		-	501,627	19,665,373	-	-	5,413,382	-	-	25,580,382
Claims on Corporates		-	16,842,099	19,064,029	-	-	347,977,418	60,562	-	383,944,108
Retail Claims		-	-	-	97,483,024	142,176,486	55,138,841	-	-	294,798,351
Claims Secured by Gold		20,302,136	65,313	-	-	-	-	-	-	20,367,449
Claims Secured by Residential Property		-	-	26,835,696	-	-	15,188,251	-	-	42,023,947
Claims Secured by Commercial Real Estate		-	-	-	-	-	-	-	-	-
Non-Performing Assets (NPAs)		-	-	120,380	-	-	15,270,456	4,339,246	-	19,730,081
Higher-risk Categories		-	-	-	-	-	-	-	1,175,717	1,175,717
Cash Items and Other Assets		26,681,669	-	-	-	-	35,829,568	-	-	62,511,236
<b>Total</b>										<b>1,159,450,326</b>

#### Template 9

##### Market Risk under Standardised Measurement Method

Item	Amount (LKR'000) as at December 31, 2019
<b>(a) RWA for Interest Rate Risk</b>	<b>14,106</b>
General Interest Rate Risk	1,904
(i) Net Long or Short Position	1,904
(ii) Horizontal Disallowance	
(iii) Vertical Disallowance	
(iv) Options	
Specific Interest Rate Risk	
<b>(b) RWA for Equity</b>	<b>102,513</b>
(i) General Equity Risk	7,244
(ii) Specific Equity Risk	6,596
<b>(c) RWA for Foreign Exchange &amp; Gold</b>	<b>489,787</b>
Capital Charge for Market Risk [(a) + (b) + (c)] * CAR	606,406



## Template 10

### Operational Risk under Basic Indicator Approach

Business Lines	Capital Charge Factor	Fixed Factor	Gross Income (LKR'000) as at December 31, 2019		
			1st Year	2nd Year	3rd Year
The Basic Indicator Approach	15%		49,769,056	60,830,747	60,000,953
Capital Charges for Operational Risk (LKR'000)					8,530,038
Risk Weighted Amount for Operational Risk (LKR'000)					63,185,465

## Template 11

### Mapping of Financial Statement Categories with Regulatory Risk Categories – Bank Only

Item	Amount (LKR '000) as at December 31 ,2019				
	a	b	c	d	e
	Carrying Values as Reported in Published Financial Statements	Carrying Values under Scope of Regulatory Reporting	Subject to Credit Risk Framework	Subject to Market Risk Framework	Not subject to Capital Requirements or Subject to Deduction from Capital
<b>Assets</b>	1,125,008,562	1,130,943,331	1,036,028,318	1,013,375	94,267,038
Cash and Cash Equivalents	29,089,189	29,093,985	29,093,985	-	-
Balances with Central Banks	22,795,332	22,795,332	22,795,332	-	-
Placements with Banks	7,602,543	7,651,612	7,651,612	-	-
Reverse repurchase agreements	-	-	-	-	-
Derivative Financial Instruments	527,193	-	-	-	-
Financial assets measured at amortised cost - debt and other instruments	149,720,835	150,903,781	150,903,781	-	-
Financial assets recognised through profit or loss - measured at fair value	1,013,375	1,013,375	-	1,013,375	-
Financial assets measured at amortised cost - loans and advances to customers	741,769,073	754,250,658	665,956,652	-	88,294,005
Financial assets measured at fair value through other comprehensive income	127,694,982	124,554,839	121,343,943	-	3,210,896
Investments in Subsidiaries	3,017,285	3,017,285	1,973,000	-	1,044,285
Investments in Joint Ventures	755,000	755,000	-	-	755,000
Property, Plant and Equipment	21,076,762	21,076,762	21,076,762	-	-
Investment Properties	480,444	480,444	480,444	-	-
Goodwill and Intangible Assets	1,076,641	1,076,641	-	-	962,851
Deferred Tax Assets	-	-	-	-	-
Other Assets	18,389,908	14,273,617	14,752,806	-	-
<b>Liabilities</b>	997,504,410	1,003,465,380	-	-	-
Due to Banks	86,396,304	86,033,494	-	-	-
Derivative Financial Instruments	573,365	-	-	-	-
Securities sold under repurchase agreements	17,569,394	17,522,798	-	-	-

## MARKET DISCIPLINE

### - DISCLOSURE REQUIREMENTS UNDER PILLAR III

Item	Amount (LKR '000) as at December 31 ,2019				
	a	b	c	d	e
	Carrying Values as Reported in Published Financial Statements	Carrying Values under Scope of Regulatory Reporting	Subject to Credit Risk Framework	Subject to Market Risk Framework	Not subject to Capital Requirements or Subject to Deduction from Capital
Financial Liabilities Designated at Fair Value Through Profit or Loss	-	-	-	-	-
Financial liabilities measured at amortised cost - due to depositors	810,035,114	790,934,645	-	-	-
Dividends payable	1,449,472	1,449,472	-	-	-
Financial liabilities measured at amortised cost - other borrowings	22,604,039	22,463,996	-	-	-
Debt Securities Issued	1,797,645	1,743,437	-	-	-
Current Tax Liabilities	5,348,985	7,081,996	-	-	-
Deferred Tax Liabilities	1,381,754	7,131,960	-	-	-
Other Provisions	3,599,739	3,777,829	-	-	-
Other Liabilities	14,053,378	33,773,790	-	-	-
Due to Subsidiaries	-	-	-	-	-
Subordinated Term Debts	32,695,221	31,551,963	-	-	-
<b>Off-Balance Sheet Liabilities</b>	<b>673,230,813</b>	<b>673,230,813</b>	-	-	-
Guarantees	120,954,668	120,954,668	120,954,668	-	-
Performance Bonds	-	-	-	-	-
Letters of Credit	25,006,460	25,006,460	25,006,460	-	-
Other Contingent Items	148,149,628	148,149,628	148,149,628	-	-
Undrawn Loan Commitments	379,120,057	379,120,057	379,120,057	-	-
Other Commitments	-	-	-	-	-
<b>Shareholders' Equity</b>					
Equity Capital (Stated Capital)/Assigned Capital	33,820,906	33,484,953	-	-	-
of which Amount Eligible for CET1	-	-	-	-	-
of which Amount Eligible for AT1	-	-	-	-	-
Retained Earnings	17,977,905	21,042,005	-	-	-
Accumulated Other Comprehensive Income	-	-	-	-	-
Other Reserves	75,705,341	72,950,994	-	-	-
<b>Total Shareholders' Equity</b>	<b>127,504,152</b>	<b>127,477,952</b>	-	-	-

## Template 12

### Explanation of Significant Differences between Accounting and Regulatory Exposure Amounts

(a) **Derivative financial instruments**

Derivatives are financial instruments which derive values in response to changes in interest rates, financial instrument prices, commodity prices, foreign exchange rates, credit risk and indices.

The fair value of these derivative financial instruments are determined using forward pricing models. The positive fair value changes of these financial instruments as at the balance sheet date are reported as assets while the negative fair value changes are reported as liabilities. The details of derivative financial instruments have been disclosed in Note 28 to the financial statements.

(b) **Loans and advances to customers**

The loans and advances to customers considered in regulatory reporting differs with the published financial statements since CBSL time based provisions were netted off when arriving at loans and advances for regulatory reporting purposes, while impairment allowances based on expected losses have been netted off in loans and advances for publication purposes. The impairment allowance is based on the credit losses expected to arise by considering the change in the risk of default occurring over the remaining life of the financial instrument provision has been described in detail in Note 30(b) to the financial statements.

(c) **Financial assets measured at amortised cost - Debt and other instruments**

Debt and other instruments considered in regulatory reporting differs with the published financial statements since impairment allowances based on expected losses were netted off for publication purposes. The details of financial assets measured at amortised cost – debt have been disclosed in Note 31 to the financial statements.

(d) **Financial assets measured at fair value through other comprehensive income**

Financial assets under this category have been measured at fair value in published financial statements while these investments have been measured at cost for regulatory reporting purposes. The details of financial assets measured at fair value through OCI have been disclosed in Note 32 to the financial statements.

## Template 13 : Bank Risk Management Approach

The Risk & Capital Review Report from pages 41 to 80 in CG&RR sets out the Bank's approach to risk management including governance structures, policies, processes, limits and the current risk profile of the Bank.

## Template 14 : Risk Management Related to Key Risk Exposures

Risk	Compliance
• Section I -Credit Risk	• Refer Note 4 to the Financial Statements on pages 161 to 176 in IR
• Section II Market Risk	• Refer Note 4 to the Financial Statements on pages 179 to 180 in IR
• Section II (a) IRR	• Refer Pages 90 to 91 in CG&RR
• Section II (b) Equity Position Risk	• Refer Page 91 in CG&RR
• Section II (c) Foreign Exchange	• Refer Page 92 in CG&RR
• Section III Liquidity Risk	
• Section III (a)	• Refer Page 93 in CG&RR
• Section III (b)	• Refer Pages 94 to 95 in CG&RR
• Section III (c) & (d)	• Refer Pages 71 to 72 in CG&RR
	• Refer Note 4 to the Financial Statements on pages 176 to 178 in IR
• Section IV Operational Risk	• Major Financial Losses incurred by Bank on page 60 in CG&RR
	• Details of activities that have been outsourced together with parties and basis for payment for such services on page 61 in CG&RR.
	• Details of due diligence tests of third party service providers on page 61 in CG&RR.
• Section V Interest Rate Risk in Banking Book (IRRBB)	• Refer page 96 in CG&RR

## MARKET DISCIPLINE

### – DISCLOSURE REQUIREMENTS UNDER PILLAR III

#### Template 14 - Section II Market Risk -(a) Interest Rate Risk

##### Interest Rate Sensitivity Gap Analysis as at 31-Dec-2019-LKR

(Values are in Millions LKR)

			1M	3M	6M	1Y	3Y	5Y	>5Y
Account Type	Product	Product Name Level18							
Rate Sensitive Assets	Inflows	Balances due from Head Office, Affiliates and Own Branches	0.00	0.00	0.00	0.00	0.00	0.00	3,772.29
		Bills of Exchange	623.53	23.20	0.00	0.00	0.00	0.00	0.00
		Cash on hand	26,681.67	0.00	0.00	96.16	0.00	0.00	0.00
		Deposits with CBSL	1,139.77	1,139.77	1,139.77	2,279.53	5,698.83	5,698.83	5,698.83
		Investments (Net of provisions)	4,089.41	14,632.07	21,940.40	20,538.35	25,567.95	11,211.07	3,617.56
		Loans and Advances	294,714.02	32,132.28	23,394.32	42,679.02	79,050.56	42,107.69	29,070.81
		NPLs	0.00	0.00	0.00	1,035.15	0.00	0.00	3,105.44
		Net Inter-Branch Transactions	0.00	0.00	0.00	0.00	0.00	0.00	-0.53
		Other Assets	141.77	1,734.31	116.62	0.00	170.70	1,347.52	10,858.55
		Overdraft	66,410.06	8,263.75	6,098.08	7,688.47	4,863.93	4,789.30	4,682.35
		Accrued Interest	2,412.05	1,004.77	885.93	556.61	105.87	13.24	0.00
		Balances due from Other Banks	4,750.00	0.00	0.00	1,000.00	0.00	0.00	0.00
		Fixed Assets L1	0.00	0.00	0.00	0.00	0.00	0.00	22,630.23
			400,962.28	58,930.15	53,575.12	75,873.29	115,457.85	65,167.65	83,435.53
Rate Sensitive Liabilities	Outflows	Balances due to Other Banks	1,600.00	0.00	0.00	0.00	0.00	0.00	351.15
		Bills Payable	1,195.24	0.00	0.00	0.00	0.00	0.00	0.00
		Demand Deposits	8,680.14	8,680.14	6,510.11	8,680.14	2.30	2.30	10,851.71
		Interest Payable	1,206.13	4,951.76	4,546.85	2,165.13	1,708.87	1,742.36	0.00
		Other Liabilities	137.80	158.77	187.37	9,405.85	15,277.43	544.10	9,613.56
		Savings Deposits	12,979.98	27,185.15	8,911.32	11,869.87	44,557.47	44,556.58	44,556.58
		Time Deposits	54,684.63	113,697.10	96,026.89	130,212.44	8,375.12	7,324.14	0.00
		Bonds Issued	0.00	0.00	0.00	0.00	16,151.63	4,532.59	8,077.43
		Borrowings	594.86	213.59	276.60	788.30	2,423.85	1,236.28	255.56
		Capital & Reserves	0.00	0.00	0.00	0.00	0.00	0.00	33,484.95
		Repo	16,709.89	724.97	77.06	10.89	0.00	0.00	0.00
		Reserves	0.00	0.00	0.00	0.00	0.00	0.00	97,379.64
			97,788.66	155,611.48	116,536.19	163,132.63	88,496.68	59,938.35	204,570.58
Net Gap			303,173.62	(96,681.32)	(62,961.06)	(87,259.35)	26,961.17	5,229.30	(121,135.04)
Cumulative Gap			303,173.62	206,492.29	143,531.23	56,271.89	83,233.06	88,462.36	(32,672.69)
Rate Sensitive Assets total		(Excl- Cash on hand, Deposits with CBSL)	373,140.84	57,790.39	52,435.36	73,497.60	109,759.02	59,468.82	77,736.70
Rate Sensitive Liabilities total		(Excl- Demand Deposits, Capital)	89,108.52	146,931.34	110,026.08	154,452.49	88,494.38	59,936.05	160,233.91
Net Gap			284,032.33	(89,140.95)	(57,590.72)	(80,954.89)	21,264.64	(467.23)	(82,497.21)
Cumulative Gap			284,032.33	194,891.38	137,300.65	56,345.76	77,610.40	77,143.16	(5,354.05)

#### Notes

- 1) The above figures have been prepared as per SLAS including interest cash flows and may differ from SLFRS figures given in the Statement of Financial Position
- 2) Prepared as per requirement given in the Banking Act Direction No 7 of 2011 on "Integrated Risk Management Framework".

## Interest Rate Sensitivity Gap Analysis as at 31-Dec-2019-USD

(Values are in Thousands USD)

			1M	3M	6M	1Y	3Y	5Y	>5Y
Account Type	Product	Product Name Level18							
Rate Sensitive Assets	Inflows	Bills of Exchange	3,200.11	4,854.94	1,539.29	0.00	0.00	0.00	0.00
		Cash on hand	5,000.90	0.00	0.00	0.00	0.00	0.00	0.00
		Investments (Net of provisions)	0.00	65,000.00	280,000.00	0.00	288,840.00	182,022.50	126,761.00
		Loans and Advances	283,646.90	105,408.18	23,122.95	4,174.87	4,613.90	2,660.15	(21,692.66)
		NPLs	0.00	0.00	0.00	5.12	0.00	0.00	15.36
		Other Assets	0.00	1,881.09	0.00	0.00	0.00	0.00	0.00
		Overdraft	6,477.70	536.20	110.73	377.72	255.49	255.47	255.56
		Accrued Interest	1,596.26	1,384.61	2,014.67	34.38	0.00	0.00	0.00
		Balances due from Other Banks	9,810.47	0.00	0.00	0.00	0.00	0.00	2,312.19
				309,732.34	179,065.02	306,787.64	4,592.08	293,709.39	184,938.11
Rate Sensitive Liabilities	Outflows	Balances due to Other Banks	12,000.00	219,539.04	86,111.11	96,718.36	130,000.00	0.00	0.00
		Demand Deposits	7,558.47	7,558.48	5,668.83	7,558.36	282.17	282.16	9,636.15
		Interest Payable	1,077.62	3,216.41	2,378.45	1,464.05	2,606.33	1,215.36	0.00
		Other Liabilities	226.05	353.65	306.55	61,192.49	847.34	847.32	12,103.71
		Savings Deposits	11,929.94	11,930.83	8,943.65	11,912.95	44,719.16	44,718.26	44,718.26
		Time Deposits	47,988.43	121,128.97	117,440.19	119,273.71	16,731.42	24,986.90	0.00
		80,780.50	363,727.38	220,848.78	298,119.92	195,186.41	72,050.01	66,458.13	
Net Gap		228,951.84	(184,662.36)	85,938.86	(293,527.83)	98,522.98	112,888.11	41,193.33	
Cumulative Gap		228,951.84	44,289.48	130,228.34	(163,299.49)	(64,776.51)	48,111.60	89,304.93	
Rate Sensitive Assets total (Excl - Cash on Hand)			304,731.44	179,065.02	306,787.64	4,592.08	293,709.39	184,938.11	107,651.46
Rate Sensitive Liabilities total (Excl- Demand Deposit)			73,222.03	356,168.90	215,179.95	290,561.55	194,904.24	71,767.85	56,821.97
Net Gap			231,509.41	(177,103.88)	91,607.69	(285,969.47)	98,805.15	113,170.27	50,829.49
Cumulative Gap			231,509.41	54,405.52	146,013.22	(139,956.25)	(41,151.10)	72,019.16	122,848.65

### Notes

- 1) The above figures have been prepared as per SLAS including interest cash flows and may differ from SLFRS figures given in the Statement of Financial Position
- 2) Prepared as per requirement given in the Banking Act Direction No 7 of 2011 on "Integrated Risk Management Framework".

## Template 14 - Section II Market Risk -(b) Equity Position Risk

(Rs. 000)

Equity	Carrying Value	Fair Value	Realized Gains/Losses	Unrealized Gains/Losses	Capital Adequacy Calculation
Investment Portfolio	3,633,426	5,524,674	-	1,891,248	Capital Charge - 13,840
Trading Portfolio	176,642	105,310	237	(71,332)	RWA - 102,513

## MARKET DISCIPLINE

### – DISCLOSURE REQUIREMENTS UNDER PILLAR III

#### Template 14 - Section II Market Risk -(c) Foreign Exchange Risk

#### Report on Liquidity Gap Summary as at 31st Dec 2019 (Consolidated Foreign Currency)

(Values are in Millions LKR)

		1M	3M	6M	1Y	3Y	5Y	>5Y
Particulars	Product							
Total Inflows	Bills of Exchange	3,252.40	4,952.91	1,539.29	0.00	0.00	0.00	0.00
	Cash on hand	6,690.79	0.00	0.00	0.00	0.00	0.00	0.00
	Investments (Net of provisions)	2,453.19	68,886.51	292,602.33	9,197.62	324,086.10	208,848.94	143,228.47
	Loans and Advances	42,502.83	92,996.55	47,047.67	38,825.37	151,898.10	78,144.46	11,043.76
	NPLs	0.00	0.00	0.00	5.14	0.00	0.00	15.43
	Other Assets	2,023.05	(380.15)	0.00	0.00	0.00	0.00	840.66
	Other	0.00	0.00	4,838.19	9,677.82	0.00	0.00	0.00
	Overdraft	656.52	689.68	716.26	1,408.09	2,216.27	2,016.42	1,821.23
	Accrued Interest	1,614.09	1,385.23	2,074.28	13.56	0.00	0.00	0.00
	Balances due from Other Banks	9,811.24	0.00	0.00	0.00	0.00	0.00	1,829.19
	Forward Contracts	108,812.99	73,899.24	71,572.75	87,512.00	0.00	0.00	0.00
		177,817.10	242,429.95	420,390.77	146,639.60	478,200.47	289,009.81	158,778.74
Total Outflows	Balances due to Other Banks	17,781.03	89,828.99	54,347.81	163,836.86	251,032.06	2,399.83	8,342.06
	Demand Deposits	7,995.95	7,995.95	5,996.94	7,995.84	287.87	287.87	10,186.81
	Interest Payable	1,215.08	3,435.98	2,640.83	1,623.20	2,613.56	1,215.36	0.00
	Letters of Credit/Guarantees/ Acceptances	0.00	4,838.19	4,838.19	4,839.64	0.00	0.00	0.00
	Other Liabilities	232.58	259.20	327.77	61,323.89	871.82	871.80	349.30
	Savings Deposits	15,073.92	15,354.50	11,918.06	16,350.49	60,431.03	58,323.64	56,258.04
	Time Deposits	64,842.83	139,747.55	142,514.89	151,226.75	22,010.58	30,675.53	0.00
	Forward Contracts Payable	173,423.90	147,878.54	44,011.54	6,843.45	0.00	0.00	0.00
		280,565.29	409,338.90	266,596.03	414,040.11	337,246.93	93,774.04	75,136.21
Net Liquidity Gap		(102,748.19)	(166,908.95)	153,794.73	(267,400.51)	140,953.54	195,235.77	83,642.53
Net Gap as % of Total Outflows		(36.62)	(40.78)	57.69	(64.58)	41.80	208.20	111.32
Cumulative Gap		(102,748.19)	(269,657.14)	(115,862.40)	(383,262.91)	(242,309.37)	(47,073.60)	36,568.94

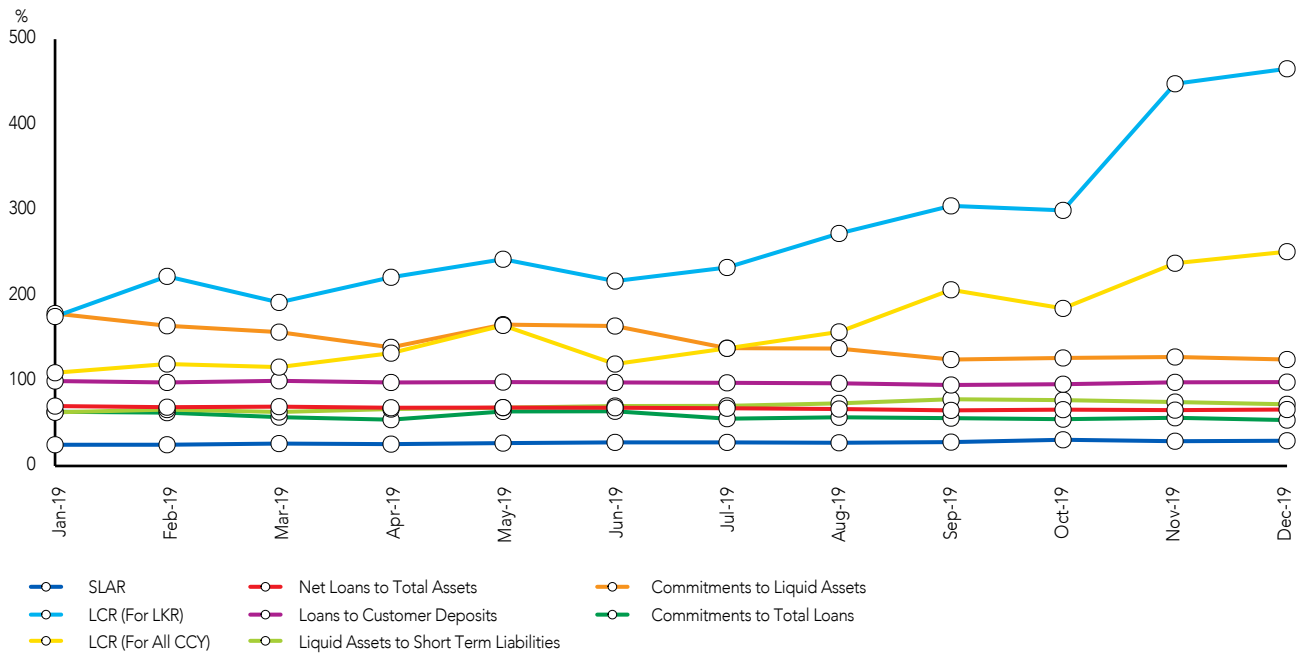
#### Notes

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### Template 14 - Section III (A) Liquidity Risk - Key Liquidity Ratios

#### Key Liquidity Ratios

Ratio	Jan-19	Feb-19	Mar-19	Apr-19	May-19	Jun-19	Jul-19	Aug-19	Sep-19	Oct-19	Nov-19	Dec-19
SLAR	24.84%	24.87%	26.24%	25.59%	26.79%	27.63%	27.62%	27.18%	27.96%	30.69%	29.01%	29.55%
LCR (For LKR)	175.09%	222.15%	191.62%	221.07%	242.21%	216.62%	232.55%	272.41%	304.72%	299.46%	447.79%	465.37%
LCR (For All CCY)	109.22%	119.45%	115.82%	132.18%	164.69%	119.44%	137.80%	157.09%	206.42%	184.60%	237.52%	251.07%
Net Loans to Total Assets	70.18%	68.87%	69.49%	68.21%	68.41%	68.20%	67.62%	66.72%	65.14%	65.98%	65.43%	66.12%
Loans to Customer Deposits	99.49%	97.85%	99.75%	97.83%	98.28%	97.85%	97.42%	96.86%	94.87%	95.80%	98.00%	98.27%
Liquid Assets to Short Term Liabilities	62.83%	66.06%	63.25%	66.66%	68.31%	70.21%	70.42%	73.38%	78.17%	77.14%	74.89%	72.25%
Commitments to Liquid Assets	178.59%	164.26%	156.82%	138.98%	165.62%	163.96%	138.03%	137.55%	124.68%	126.55%	127.68%	124.73%
Commitments to Total Loans	63.55%	62.45%	57.20%	54.24%	63.87%	64.07%	55.40%	57.04%	56.03%	54.82%	56.45%	53.76%



## MARKET DISCIPLINE

### - DISCLOSURE REQUIREMENTS UNDER PILLAR III

#### Template 14 - Section III (b) Liquidity Risk - Currency Wise

#### Report on Liquidity Gap Summary as at 31st Dec 2019 (LKR/ Behavioral)

(Amount in Million LKR)

		1M	3M	6M	1Y	3Y	5Y	>5Y
Particulars	Product							
Total Inflows	Balances due from Head Office, Affiliates and Own Branches	0.00	0.00	0.00	0.00	0.00	0.00	3,772.29
	Bills of Exchange	623.53	23.20	0.00	0.00	0.00	0.00	0.00
	Cash on hand	26,681.67	0.00	0.00	96.16	0.00	0.00	0.00
	Deposits with CBSL	1,139.77	1,139.77	1,139.77	2,279.53	5,698.83	5,698.83	5,698.83
	Investments (Net of provisions)	4,324.20	15,832.39	22,916.49	22,872.99	30,879.24	13,275.37	3,758.97
	NPLs	80,247.19	84,707.95	64,790.43	90,590.70	194,657.37	94,872.09	77,881.13
	Net Inter-Branch Transactions	0.00	0.00	0.00	1,035.15	0.00	0.00	3,105.44
	Loans and Advances	0.00	0.00	0.00	0.00	0.00	0.00	(0.53)
	Other Assets	141.77	1,734.31	116.62	0.00	170.70	1,347.52	10,858.55
	Other	0.00	0.00	584.03	1,168.24	0.00	0.00	0.00
	Overdraft	7,984.35	9,873.04	10,729.87	20,864.08	37,339.79	30,969.37	24,737.10
	Accrued Interest	2,412.05	1,004.77	885.93	1,996.66	105.87	13.24	0.00
	Balances due from Other Banks	4,852.93	0.00	0.00	1,100.55	0.00	0.00	0.00
	Fixed Assets L1	0.00	0.00	0.00	0.00	0.00	0.00	22,630.23
	Forward Contracts	5,492.10	6,479.11	5,615.78	0.00	0.00	0.00	0.00
	Reverse Repo	0.00	0.00	0.00	0.00	0.00	0.00	0.00
		133,899.57	120,794.55	106,778.92	142,004.05	268,851.82	146,176.42	152,442.01
Total Outflows	Balances due to Other Banks	1,600.33	0.00	0.00	0.00	0.00	0.00	351.15
	Bills Payable	1,195.24	0.00	0.00	0.00	0.00	0.00	0.00
	Demand Deposits	8,680.14	8,680.14	6,510.11	8,680.14	2.30	2.30	10,851.71
	Interest Payable	1,206.13	4,951.76	4,546.85	3,605.18	1,708.87	1,742.36	0.00
	Letters of Credit/Guarantees/Acceptances	0.00	584.03	584.03	584.21	0.00	0.00	0.00
	Other Liabilities	137.80	158.77	187.37	9,405.85	15,277.43	544.10	9,613.56
	Savings Deposits	13,681.94	14,258.33	11,531.79	16,341.52	59,391.98	55,045.92	50,784.80
	Time Deposits	58,214.97	120,801.20	104,648.24	141,381.59	11,596.85	11,730.75	0.00
	Bonds Issued	0.00	787.50	354.25	2,158.14	18,955.79	7,658.70	14,280.90
	Borrowings	679.41	253.47	319.62	930.32	2,806.01	1,488.61	432.09
	Capital	0.00	0.00	0.00	0.00	0.00	0.00	33,484.95
	Forward Contracts Payable	10,293.79	7,760.04	13,288.42	14,971.40	0.00	0.00	0.00
	Repo	16,730.87	762.22	83.37	11.76	0.00	0.00	0.00
	Reserves	0.00	0.00	0.00	0.00	0.00	0.00	97,379.64
		112,420.62	158,997.47	142,054.06	198,070.12	109,739.21	78,212.74	217,178.80
Net Liquidity Gap		21,478.95	(38,202.92)	(35,275.14)	(56,066.06)	159,112.61	67,963.68	(64,736.79)
Net Gap as % of Total Outflows		19.11	(24.03)	(24.83)	(28.31)	144.99	86.90	(29.81)
Cumulative Gap		21,478.95	(16,723.97)	(51,999.11)	(108,065.17)	51,047.44	119,011.12	54,274.33
Adjustments for Behavioural Maturities	Time Deposits	48,332.57	99,889.26	73,191.95	86,719.88	(148,292.28)	(74,892.03)	(84,949.35)
	Unutilised O/D	(11,039.28)	(11,039.28)	(11,039.28)	(22,078.56)			
	Undisbursed Loans	(2,276.30)	(2,276.30)	(2,276.30)	(4,552.60)	(3,793.84)		
	Pawning Rollovers	(346.51)	(811.99)	(1,549.51)	(6,174.61)	8,882.62		
Total Adjustments		34,670.48	85,761.69	58,326.86	53,914.11	(143,203.50)	(74,892.03)	(84,949.35)
Adjusted Net Liquidity Gap		56,149.43	47,558.77	23,051.72	(2,151.95)	15,909.11	(6,928.35)	(149,686.13)
Adjusted Net Gap as % of Total Outflows		72.22	64.94	27.53	(1.49)	6.29	(4.53)	(49.54)
Adjusted Cumulative Gap		56,149.43	103,708.20	126,759.92	124,607.97	140,517.08	133,588.73	(16,097.40)

#### Notes

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- 2) Prepared as per requirement given in the Banking Act Direction No 7 of 2011 on "Integrated Risk Management Framework".



## Report on Liquidity Gap Summary as at 31st Dec 2019 (USD/ Behavioral)

(Values are in Thousands USD)

		1M	3M	6M	1Y	3Y	5Y	>5Y
Particulars	Product							
Total Inflows	Bills of Exchange	3,200.11	4,859.75	1,539.29	0.00	0.00	0.00	0.00
	Cash on hand	5,000.90	0.00	0.00	0.00	0.00	0.00	0.00
	Investments (Net of provisions)	2,453.19	68,886.51	292,602.33	9,197.62	324,086.10	208,848.94	142,875.19
	Loans and Advances	41,400.90	90,202.13	45,078.66	37,913.97	149,288.73	76,237.92	10,080.80
	NPLs	0.00	0.00	0.00	5.12	0.00	0.00	15.36
	Other Assets	0.00	1,881.09	0.00	0.00	0.00	0.00	0.00
	Other	0.00	0.00	3,530.26	7,061.59	0.00	0.00	0.00
	Overdraft	656.51	689.68	716.26	1,408.08	2,216.26	2,016.41	1,821.22
	Accrued Interest	1,596.26	1,384.61	2,014.67	34.38	0.00	0.00	0.00
	Balances due from Other Banks	9,811.24	0.00	0.00	0.00	0.00	0.00	2,312.19
	Forward Contracts	43,094.21	30,788.04	65,000.00	80,500.00	0.00	0.00	0.00
		107,213.33	198,691.81	410,481.47	136,120.76	475,591.09	287,103.27	157,104.77
Total Outflows	Balances due to Other Banks	12,088.25	89,828.99	54,347.81	156,649.08	251,032.06	2,399.83	10,278.36
	Demand Deposits	7,558.47	7,558.48	5,668.83	7,558.36	282.17	282.16	9,636.15
	Interest Payable	1,077.62	3,216.41	2,378.45	1,464.05	2,606.33	1,215.36	0.00
	Letters of Credit/Guarantees/ Acceptances	0.00	3,530.26	3,530.26	3,531.32	0.00	0.00	0.00
	Other Liabilities	226.05	354.67	311.44	61,215.02	847.34	847.32	12,103.71
	Savings Deposits	12,237.90	12,491.23	9,732.23	13,392.95	49,420.44	47,516.98	45,651.17
	Time Deposits	49,165.52	125,308.71	121,590.97	125,088.99	21,596.83	30,675.53	0.00
	Forward Contracts Payable	163,523.63	145,470.31	44,011.54	6,843.45	0.00	0.00	0.00
		245,877.43	387,759.07	241,571.53	375,743.23	325,785.16	82,937.19	77,669.39
Net Liquidity Gap		(138,664)	(189,067)	168,910	(239,622)	149,806	204,166	79,435
Net Gap as % of Total Outflows		(56.40)	(48.76)	69.92	(126.33)	45.98	246.17	102.27
Cumulative Gap		(138,664)	(327,731)	(158,821)	(648,510)	(248,638)	(44,472)	34,963
Adjustments for Behavioural Maturities	Time Deposits	38,730.93	103,228.31	88,377.05	67,373.05	(147,226.13)	(60,787.31)	(89,695.90)
	Unutilised O/D	(4,467.42)	(4,467.42)	(4,467.42)	(8,934.85)			
	Undisbursed Loans	(16,475.96)	(16,475.96)	(16,475.96)	(32,951.93)	(27,459.94)		
Total Adjustments		17,787.55	82,284.92	67,433.66	25,486.27	(174,686.07)	(60,787.31)	(89,695.90)
Adjusted Net Liquidity Gap		(120,876.56)	(106,782.33)	236,343.60	(214,136.19)	(24,880.14)	143,378.77	(10,260.53)
Adjusted Net Gap as % of Total Outflows		(53.00)	(34.96)	135.72	(61.14)	(4.97)	99.76	(6.13)
Adjusted Cumulative Gap		(120,876.56)	(227,658.90)	8,684.70	(205,451.49)	(230,331.63)	(86,952.86)	(97,213.39)

### Notes

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## MARKET DISCIPLINE

### - DISCLOSURE REQUIREMENTS UNDER PILLAR III

#### Template 14 - Section (V) Interest Rate Risk in the Banking Book (IRBB)

##### Present Market Value of RSA/RSL on Movement of Market Interest Rates - LKR

(Values are in Millions LKR)

	1M	3M	6M	1Y	3Y	5Y	>5Y
Rate Sensitive Assets total	373,140.84	57,790.39	52,435.36	73,497.60	109,759.02	59,468.82	77,736.70
Rate Sensitive Liabilities total	89,108.52	146,931.34	110,026.08	154,452.49	88,494.38	59,936.05	160,233.91
Net Gap	284,032.33	(89,140.95)	(57,590.72)	(80,954.89)	21,264.64	(467.23)	(82,497.21)
Cumulative Gap	284,032.33	194,891.38	137,300.65	56,345.76	77,610.40	77,143.16	(5,354.05)
Duration weight	0.08	0.25	0.50	1.00	3.00	5.00	7.00
Market Rates	9.06%	9.16%	9.71%	10.30%	10.97%	11.37%	10.30%
Present Value at market rates	284,011	89,121	57,563	80,872	21,220	465	81,905
Present Value at market rates + 50 basis pt	283,893	89,010	57,420	80,470	21,010	456	79,097
Change in Market value for 50 basis point interest movement	(118)	(111)	(143)	(402)	(210)	(9)	(2,807)

##### Present Market Value of RSA/RSL on Movement of Market Interest Rates - USD

(Values are in Thousands USD)

	1M	3M	6M	1Y	3Y	5Y	>5Y
Rate Sensitive Assets total	304,731.44	179,065.02	306,787.64	4,592.08	293,709.39	184,938.11	107,651.46
Rate Sensitive Liabilities total	73,222.03	356,168.90	215,179.95	290,561.55	194,904.24	71,767.85	56,821.97
Net Gap	231,509.41	(177,103.88)	91,607.69	(285,969.47)	98,805.15	113,170.27	50,829.49
Cumulative Gap	231,509.41	54,405.52	146,013.22	(139,956.25)	(41,151.10)	72,019.16	122,848.65
Duration weight	0.08	0.25	0.5	1	3	5	7
Market Rates	2.07675	2.34238	2.52988	2.82138	2.939	2.97	2.987
Present Value at market rates	231,113	176,082	90,470	278,123	90,582	100,703	41,366
Present Value at market rates + 10 basis pt	231,094	176,039	90,426	277,852	90,318	100,312	41,085
Change in Market value for 10 basis point interest movement	(19)	(43)	(44)	(270)	(263)	(390)	(280)

#### Notes

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- 2) Prepared as per requirement given in the Banking Act Direction No 7 of 2011 on "Integrated Risk Management Framework"

## End 2019 D-SIB Assessment Exercise

### General Information

Name of the Bank - HNB PLC

Size Indicator	Rs. (Mn) Group
<b>Section 1 - Total Exposures</b>	
(1) Counterparty exposure of derivatives contracts	1,487,502

### Interconnectedness Indicators

<b>Section 2 - Intra-Financial System Assets</b>	
a. Funds deposited with or lent to other financial institutions (including unused portion of committed lines extended)	61,480
(i) Funds deposited	18,007
(ii) Lending	43,473
b. Holdings of securities issued by other financial institutions	17,782
c. Net positive current exposure of securities financing transactions (SFTs) with other financial institutions	2,359
d. Over-the-counter (OTC) derivatives with other financial institutions that have a net positive mark to market value	519
Intra-financial system assets	82,140
<b>Section 3 - Intra-Financial System Liabilities</b>	
a. Funds deposited by or borrowed from other financial institutions (including unused portion of committed lines obtained)	98,231
(i) Funds deposited	9,338
(ii) Borrowings	88,893
b. Net negative current exposure of securities financing transactions with other financial institutions	-
c. Over-the-counter derivatives with other financial institutions that have a net negative mark to market value	568
Intra-financial system liabilities	98,799
<b>Section 4 - Securities Outstanding</b>	
Securities outstanding	36,321

### Substitutability/Financial Institution Infrastructure Indicators

<b>Section 5 - Payments made in the reporting year (excluding intragroup payments)</b>	
Payments activity	2,226,430
<b>Section 6 - Assets Under Custody</b>	
Assets under custody	182,593
<b>Section 7 - Underwritten Transaction</b>	
Underwritten transaction	-
<b>Section 8 - Trading Volume</b>	
Trading Volume	0.54

### Complexity indicators

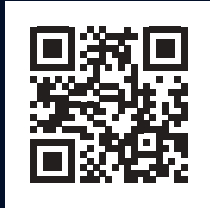
<b>Section 9 - Notional Amount of Over-the-Counter (OTC) Derivatives</b>	
OTC derivatives	112,202
<b>Section 10 - Level 2 Assets</b>	
Level 2 assets	52,419
<b>Section 11 - Trading and available for sale (AFS) securities</b>	
Trading & AFS securities	135,108
<b>Section 12 - Cross-Jurisdictional Liabilities</b>	
Foreign liabilities (excluding derivatives and intragroup liabilities) Cross-jurisdictional liabilities	61,553
<b>Section 13 - Cross-Jurisdictional Claims</b>	
Foreign claims (excluding derivatives and intragroup claims) Cross-jurisdictional claims	21,421



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