Sonali Bank (UK) Ltd

Pillar 3 Disclosures

(as at December 31st 2019)

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Document Owner:	Chief Risk Officer
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Contents

Abbreviations

EBA	European Banking Authority	**KYC**	Know Your Customer
CRR	EU Capital Requirements Regulations	**IFRS**	International Financial Reporting Standard
PRA	Prudential Regulation Authority	**ECL**	Expected Credit Losses
CRO	Chief Risk Officer	**EAD**	Exposure at default
IRRBB	Interest rate risk in the banking book	**PD**	Probability of default
ICAAP	Internal Capital Adequacy Assessment Process	**CCF**	Credit conversion factor
ILAAP	Internal Liquidity Adequacy Assessment Process	**LGD**	Loss given default
CEO	Chief Executive Officer	**CRM**	Credit risk mitigation
ALCO	Asset and Liability Committee	**SME**	Small/medium-sized entity
ARCC	Board Audit, Risk and Compliance Committee	**ECAI**	External Credit Assessment Institution
LCR	Liquidity coverage ratio	**ECA**	Export Credit Agency
NSFR	Net stable funding ratio	**RemCo**	Board Remuneration Committee
MLRO	Money Laundering Reporting Officer	**FCA**	Financial Conduct Authority
ToR	Terms of Reference	**B/S**	Balance Sheet
KPI	Key Performance Indicator		

1 Background, Scope and Purpose

1.1 Background

This Pillar 3 Statement is designed to comply with:

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

…in both cases as applicable and relevant to Sonali Bank (UK) Limited (SBUK and the Bank), at December 31st 2019 (the data date).

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

1.2 Statement of adequacy

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

This Pillar 3 Statement will be made available and remain on the Bank's website until superseded by its successor document.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

1.3 Document ownership and control

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

2 Risk management objectives and policies

2.1 Risk Management Objective and Policies

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

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

In 2017 the Bank received additional funds from its shareholders, in proportion to their respective shareholdings, of £17.1m (51%) from the Government of Bangladesh and £16.4m (49%) from Sonali Bank Limited, a Bangladesh banking corporation wholly-owned by the Government of Bangladesh. These funds have increased the Banks' share capital from £28m to £61.5m. At 31 December 2019 the Bank had a surplus capital of £29m over its regulatory capital requirement[1]. A portion of this capital will support graduated future growth in credit exposures, in line with the Bank's existing conservative credit policies and while maintaining a surplus above regulatory requirements.

While capital and liquidity reserves may be effective in mitigating the adverse effects of some risk categories, the Bank's risk management infrastructure, meaning its policies, processes and

[1] Figures to the nearest £100,000

assurance mechanisms, is the preferred and primary methodology deployed by the Bank in order to control and mitigate risk.

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

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

- interest rate risk in the banking book (IRRBB), in which respect the Bank effectively runs a matched book, allocating loans on a transaction-by-transaction basis and funding from either a fixed or notice 180/365-day account. The hypothetical sensitivity of the Bank's reported profit to a 2% increase or decrease in the respective interest rates to which the Bank is exposed would be £101,311.

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

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

2.2 Material risk categories

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

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

2.3 Group Risk

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

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

2.4 Credit Risk and Credit Concentration Risk

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

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

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

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

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

2.5 Business Risk

Also, sometimes called 'strategic risk', this is the risk that revenues are materially lower, and/or costs materially higher, than forecast in our Business Plan, which projects modest but

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

consistently-growing profits. The Bank calculates a capital planning reserve based on both significantly lower revenues and coinciding significantly higher costs.

However, Business Risk and Group Risk (as defined at 2.3 above) are mutually exclusive, in the sense that were an orderly wind-down to take place as under the Group Risk scenario, Business Risk would by definition no longer exist; equally, if the business continues as a going concern, albeit under stress as in this Business Risk scenario, wind-down costs would not additionally apply. Therefore, the capital held against Group Risk is offset against the (much larger) Business Risk Pillar 2 capital reserve.

2.6 Operational Risk

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

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

With regards to Conduct operational risk, the Bank's mandatory minimum Pillar 1 capital reserve is much higher than is required by the Bank's recorded operational risk loss history. The Pillar 1 operational risk capital requirement was £765k at the effective date of this Statement.

2.7 Downgrade Risk

As majority of the banks' exposure is with Bangladeshi Banks, SBUK recognises the existence of Downgrade Risk. Therefore, capital is also held against Downgrade Risk. The current Credit Rating for Bangladesh is Ba3 (Moody's).

2.8 Liquidity Risk

SBUK monitors and manages liquidity risk on a daily basis taking into account its liquidity risk appetite statement, which incorporates minimum compliance tolerances for the Bank's liquidity coverage ratio (LCR), net stable funding ratio (NSFR) and its survival under severe liquidity stress scenarios, specific to the Bank's business model and operations but also coinciding with adverse market events. The Bank's activities and operations are such that through its Treasury it is able to accurately predict, and satisfy beforehand, all intraday requirements – this is in any event an operational necessity, as SBUK has no intraday credit facilities.

The Bank monitors future cash flow mismatch risk using regulatory returns populated on a daily basis.

3 Governance

3.1 SBUK ARCC and risk management function

The Bank has a ARCC comprising at least 2 non-Executive Directors (NEDs) as voting members, including the Chair, and with a standing invitation to the CEO, CRO and the Head of Compliance and Money Laundering Reporting Officer (HoC & MLRO).

The ARCC must be convened at least 4 times in 2020.

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

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

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

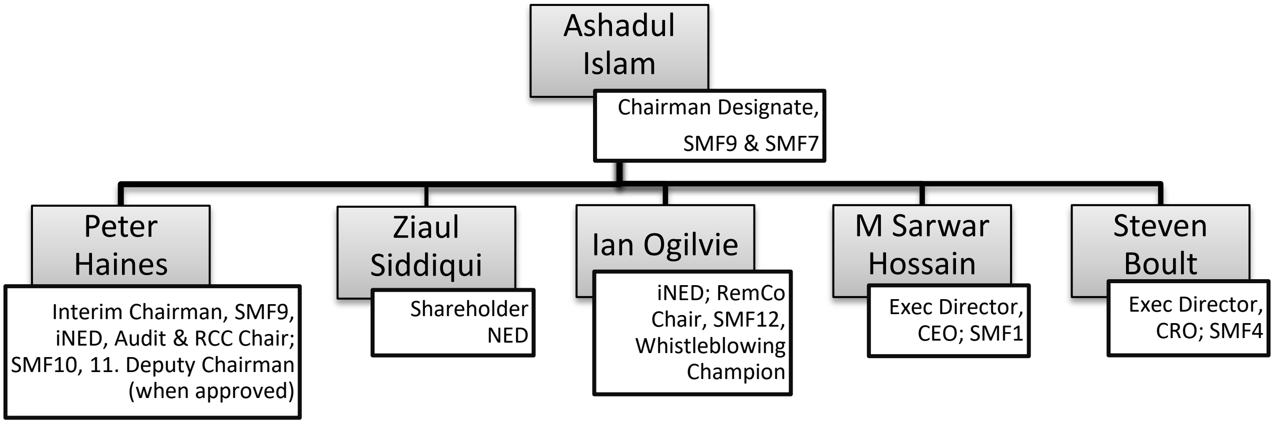
The Board is satisfied with the Bank's ability to continue as a going concern and that it has the financial resources to continue in business for the foreseeable future. This includes surplus capital at December 31st 2019, over regulatory thresholds, of £29m, a liquidity coverage ratio of 186% against a requirement of 100%, and positive profit and cash flow projections.

3.2 Declaration

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

3.3 Directorships

The SBUK Board as at February 3rd 2020 is represented below:



An External Conflict of Interests Register is maintained by Compliance and records other directorships of Board members. At February 3rd 2020 the six Directors held in total ten other board positions, none of which was deemed to conflict with membership of the SBUK Board.

The Bank's Senior Management Regime (SMR) Data Checklist SBUK incorporate:

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

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

3.4 Diversity

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

(a) age

(b) disability

(c) gender reassignment

(d) race

(e) religion or belief

(f) gender

(g) sexual orientation

(h) marriage or civil partnership status

(i) pregnancy and maternity or

(j) caring responsibility.

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

4 Financial Position

As at 31st December 2019 the Bank's Common Equity Tier 1 capital comprises ordinary share capital of £61.5m retained earnings of £1.1m and Accumulated Reserves of £-35k. Totalling to £62.6m. No other capital resources are held.

The following table shows gross and risk-weighted assets (after credit risk mitigation) per Capital Requirements Regulations Exposure Class, with a pillar 1 capital requirement of 8% of the Risk Weight Assets:

Total Exposures	Gross (£)	Risk weighted (£)	Pillar 1 Requirement (£)
Institutions	39.5m	9.4m	0.8m
Corporates	74.8m	74.8m	6.1m
Money Market Funds - CIU's	17.7m	0	0
Retail	12,110	0	
Central Governments or central banks	9.7m	0	0
Other Assets	11.2m	0	0
Off -B/S	1m		
Total	**144.3m**	**85.1m**	**6.8m**

There is no exposure to counterparty credit risk.

5 Countercyclical Capital Buffer (CCyB)

At December 31st 2019 the CCyB rate for the UK was1% and 2% for Sweden. https://www.bis.org/bcbs/ccyb/ The Bank had no material exposure to those other jurisdictions where the CCyB had been implemented. (Lithuania, Denmark, the USA, the Czech Republic, Slovakia and Iceland). On 11 March 2020 the CCyB was reduced to 0% for both UK and Sweden.

6 Capital Conservation Buffer (CCB)

The CCB is a general buffer that builds up the bank's available capital resources and therefore resilience, during non-stressed periods. On 31st December 2019 the bank was required to hold a CCB of 2.5% of RWAs. https://www.esrb.europa.eu/national_policy/capital/html/index.en.html

7 Credit Risk Adjustments

The Bank's definition of impairment is consistent with that in International Financial Reporting Standard 9 (IFRS 9).

SBUK has adopted and deems itself compliant in all applicable respects with, IFRS 9. The Bank carried no credit loss provisions under the previous accounting standard. Under IFRS 9 the Bank has approved a policy approach and built a model in order to calculate Expected Credit Losses (ECL). The ECL provision as at 31st December 2019 is £88k. This is 0.06% of gross (i.e. on- and off-balance sheet) credit risk exposures, and 0.3% of the Bank's surplus capital held at December 31st 2019.

Classifying financial assets for the measurement of ECL

ECL are a probability-weighted estimate of credit losses. To estimate the ECL, all financial assets are classified as follows:

Stage 1 - Performing

- Financial instruments will be categorised as performing and Stage 1 if there has been no significant increase in credit risk since recognition or if they are assessed to have inherent low credit risk.

Stage 2 - Significant Increase in Credit Risk

- A financial instrument will be categorised as Stage 2 if it is determined that a significant increase in credit risk since initial recognition has occurred.

Stage 3 - Impaired

SBUK will deem a financial instrument to be impaired when one or more events that have a detrimental impact on the estimated future cash flows from the financial instrument are observed. The Bank had no stage 2 or 3 assets as at the data date.

Measurement of ECL

The key inputs into the measurement of ECL are the term structure of the following variables:

- probability of default (PD);
- loss given default (LGD); and
- exposure at default (EAD).

ECL for exposures in Stage 1 is calculated by multiplying the 12-month PD by LGD and EAD. Lifetime ECL is calculated by multiplying the lifetime PD by LGD and EAD.

Probability of Default (PD)

One-year PD parameters are estimated for all counterparty and sovereign/country. The ECL tool provides ECL calculations for three major segments, and thus three different rating processes and the use of different PD models and/or model concepts were identified for Banks, Sovereigns and off balance sheet positions.

Loss Given Default (LGD)

LGD is the magnitude of the likely loss if there is a default and considers recoveries from collateral and from unsecured recovery. As SBUK has not experienced defaults in the past the internal LGD models cannot be based on historic events. Instead the LGDs have been adopted by keeping with the regulatory benchmarks (as defined by the Basel Committee).

Exposure at Default (EAD)

EAD represents the expected exposure in the event of a default. The Bank derives the EAD from the current exposure of the counterparty and potential changes to the current amount allowed under the contract and arising from amortisation. The EAD of a financial asset is its gross carrying amount at the time of default.

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

8 Credit Risk

As at 31st December 2019 the gross credit risk exposures totalled £145m (including off-balance sheet items of £1m), however as a result of (i) cash collateralisation and (ii) significant short-term exposures to Institutions of Credit Quality Steps 1, 2 or 3, the Bank’s credit risk weighted assets were £87m, of which 89% were to Corporates and the remainder to Institutions.

£73m (51%) of exposures were domiciled in Bangladesh and £33.5m (23%) in the UK and other EU countries, with the remainder divided principally between North America, Canada, Sweden, Japan and China.

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

All credit risk exposures were of under 1 year’s duration with the exception of one fully cash-collateralised long-term corporate loan that was paid down before year end. The only cash collateralised loan held was with Biman which was fully returned by the end of Q3 2019, SBUK does not currently hold any exposure with Biman.

9 Use of External Credit Assessment Institutions (ECAIs)

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

10 Exposure to market risk

The Bank’s market risk exposure at the effective date of this Statement was £47,142 generating a Pillar 1 capital requirement of c. £3,771.

11 Remuneration

In accordance with the Capital Requirements Regulation remuneration disclosure requirements, as further elaborated in the FCA's General guidance on Proportionality: The Remuneration Code (SYSC 19A) & Pillar 3 disclosures on Remuneration (Article 450 of the CRR), the Firm falls within proportionality level 3 and is required to provide the following disclosures regarding its remuneration policy and practices for those categories of staff whose professional activities have a material impact on its risk profile.

The Bank's Remuneration Policy is generated and maintained by the CEO, for challenge and review by the Remuneration Committee of the Board (RemCo) which is held at least twice a year, before recommendation to the Board itself.

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

As per CRR Article 450(b) the SBUK remuneration scheme includes both fixed and variable components. These are appropriately balanced so that the fixed or guaranteed component represents a sufficiently high proportion of the total remuneration to avoid employees being overly dependent on the variable components. This allows SBUK to operate a fully flexible bonus policy, including the option to pay no variable component.

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

RemCo approval is required for all and any termination payments.

The key management personnel are considered to be the Directors. The highest paid Director received remuneration of £155,000 and a contribution of £15,000 to that Director's money purchase pension scheme.

The requirements under PILLAR 3 Disclosures regarding independence of the Risk & Compliance remuneration, as set out in the Basel papers, is also captured by virtue of the independent assessment of the remuneration of these functions by RemCo. It is noted that RemCo, is among others comprised of Independent Non-Executive Directors, including the Chairman (SMF12), therefore the risk and compliance employees are remunerated independently of the businesses they oversee. Hence, the Bank, given its size and remuneration structure, does not need a standalone Remuneration Policy Statement (RPS).

12 Leverage

At the relevant date the Bank's leverage ratio, whether or not using a fully phased-in definition of Tier 1 capital, was 42.6%, based on a total exposure value of £145m. This is partly accounted for by the capital inflow referenced at 3.1 above, nevertheless given the Bank's cautious risk appetite and modest planned growth, the Bank does not consider the risk of excessive leverage to be a material threat.

13 Document Control Sheet

Document Draft History				
Date	Version	Status	Document Author	Action/Comment
16/3/18	V1.0	DRAFT	KnowCo (External Consultant)	Draft received 5/3/18. Reviewed by CRO, SHoF & CEO 16/3/18
30/7/18	V1.0	DRAFT	KnowCo (External Consultant)	Draft received 30/7/18. Reviewed by CRO & SHoF 30/7/18
09/07/19	V1.1	DRAFT	SB	Annual update
10/06/20	V2.0	DRAFT	SB	Annual update

Document Review History				
Date	Version	Status	Document Reviewer	Action/Comment
27/3/18	V1.0	DRAFT	ExCo	Reviewed, further amendments needed
31/7/18	V1.0	DRAFT	ExCo	Reviewed and Approved
July 2019	V1.1	DRAFT	ExCo	Reviewed and Approved
June 2020	V2.0	DRAFT	ExCo	Reviewed and Approved
July 2020	V2.0	DRAFT	ARCC	Reviewed on 08/07/20 and amendments were requested – to be submitted to the Board for approval

Document Approval History				
Date	Version	Status	Document Approver	Action/Comment
31/7/18	v1.0	FINAL	SBUK Board Risk Committee	Approved
July 2019	V1.1	FINAL	SBUK Board Risk Committee	Approved
July 2019	V1.1	FINAL	Board	Approved – 27/07/20
July 2020	V2.0	FINAL	Board	Approved – 14/07/20

Next Review Date		
Date	Document Approver(s)	Action/Comment
June 2021	Board ARCC	