Capital & Risk Management
Pillar 3 Disclosures

31st December 2016

Company Registration no. 06736473

Contents

Introduction 3
Activities and Scope 3
Regulatory framework for disclosures 4
Basis and frequency of disclosures 4
The Responsibility of the Board and Board Sub Committees 4
The Board 4
Number of other directorships 5
Board Sub-Committees 6
Risk management objectives and policies 7
Risk management framework 7
First line of defence - organisation 7
Second line of defence – management 8
Third line of defence - assurance 8
Capital resources 9
Own funds 9
Capital Management and Internal Capital Adequacy Assessment Process 9
Minimum Capital Requirement – Pillar 1 10
Additional Capital Requirement – Pillar 2 15
Pillar 2 - Additional Risk Capital 15
Credit Risk 15
Liquidity Risk 16
Leverage ratio 16
REMUNERATION POLICY 17

INTRODUCTION

Bank of Ceylon (UK) Limited ("BOCUK" or the "Bank") is a wholly owned subsidiary of Bank of Ceylon ("BOC"), a state-owned bank incorporated in Sri Lanka.

The international capital framework for financial institutions is structured around three "Pillars": Pillar 1, sets minimum capital requirements, Pillar 2, the arrangements for supervisory review, and Pillar 3, market discipline. In December 2010, the Basel Committee released "Basel III", which set higher levels for capital requirements and introduced a new global liquidity framework. In the European Union implementation of Basel III is by way of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms more commonly known as "CRD IV".

Pillar 3 aims to encourage market discipline by developing a set of disclosure requirements that allow market participants to assess certain specified information on the scope of application of Basel III framework, particularly the risk exposures and risk assessment processes, and hence the capital adequacy of the institution.

These Pillar 3 disclosures are summary descriptions of the risk management processes of the Bank of Ceylon (UK) Limited and have been prepared in accordance with the adoption of the CRD IV regulations by the United Kingdom regulators, the PRA and FCA.

The Pillar 3 Disclosures were subjected to internal review procedures broadly consistent with those undertaken for unaudited information published in the annual Financial Statements. The disclosures have been reviewed by the Bank's Audit and Risk Committee and approved by the Bank's Board of Directors. The Pillar 3 Disclosures have not been audited by the Bank's external auditors except where the information contained in the disclosures is equivalent to that included in the Bank's annual Financial Statements.

Pillar 3 disclosures in this document cover credit risks, market risks, and operational risks. There is additional information regarding risks in the Financial Statements and this disclosure document should be read in conjunction with the Bank's Financial Statements for the financial year ended 31 December 2016. Unless otherwise stated, all figures are as at 31 December 2016.

The Bank has adopted the standardised approach to credit risk and the basic indicator approach to operational risk. The Bank does not operate a trading book and the CRD IV own funds requirements for market risks have been adopted.

Activities and Scope

BOCUK undertakes deposit-taking business and also provides retail and corporate clients with a suite of banking services as well as offering a range of trade finance facilities, unregulated buy to let mortgages and correspondent banking; it does not operate a trading book. BOCUK does not have any subsidiaries or associates.

Regulatory framework for disclosures

On 1 April 2013 three new regulatory bodies were established in the UK: the Financial Policy Committee ("FPC"), the Prudential Regulatory Authority ("PRA") and the Financial Conduct Authority ("FCA").

The FPC does not directly supervise firms, being responsible for macro-prudential regulation and considering systemic risk affecting economic and financial stability. The FPC does, however, have power to direct the PRA or FCA, and it may make recommendations to the Treasury, to the PRA, FCA or 'other persons'. The PRA and FCA inherited the micro-prudential supervisory functions of the Financial Services Authority ('FSA'), and hold formal powers to issue directions to firms such as the Bank.

In December 2013, the PRA issued final rules implementing CRD IV, these rules coming into force in the UK in January 2014. In summary, these deploy available national discretion in order to accelerate significantly the transition timetable to full 'end-point' CRD IV compliance.

The Bank's approach to managing risk is designed to ensure that current regulatory requirements are fully met and the Bank is well placed to meet those expected in the future.

Basis and frequency of disclosures

In accordance with PRA requirements BOCUK will publish Pillar 3 disclosures at least annually. The disclosures are available on the Bank's website: www.bankofceylon.co.uk.

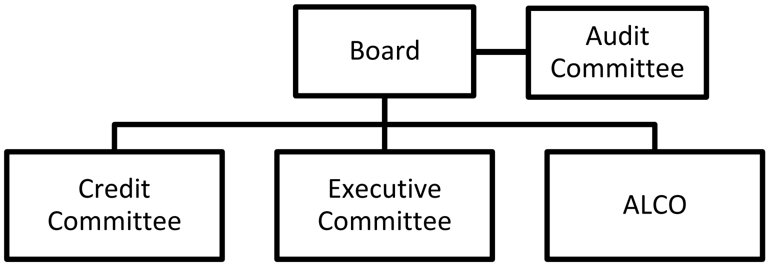
THE RESPONSIBILITY OF THE BOARD AND BOARD SUB COMMITTEES

The Board

Decision making responsibility at BOCUK rests ultimately with the Board of Directors. The Board is responsible for strategic direction and overall control of the Bank and for its compliance with all laws and regulations. The Board monitors and reviews overall performance and ensures that all the activities are in line with the Bank's overall objectives, risk-return philosophy and regulatory rules.

The Board meets on at least a quarterly basis and receives reports from the Bank's senior management highlighting any changes to the Bank's risk profile.

The Board has delegated certain powers and responsibilities to sub-committees.



When delegating responsibilities a number of principles are met and documented through formal committee terms of reference or role descriptions but may also be incorporated in control frameworks or procedures.

The Board considers that the risk management systems in place are adequate and aligned to the profile and strategy of the Bank.

The Board is structured as follows:-

- Chief Executive Officer
- Chief Operating Officer
- Two independent non-executive directors
- Two non-independent non-executive directors (nominated by the 100% shareholder, Bank of Ceylon, Sri Lanka)

All appointments are made on merit in line with a policy covering directors' appointment, induction, appraisal and professional development.

As at 31st December 2016 the Board consisted of the following membership:-

Name	**Designation**	**Number of other directorships**
Ronald C Perera PC	Non-Executive Chairman	2
Anthony John Pulle	Chief Executive Officer	0
M. P. Ruwan Kumara	Chief Operating Officer	0
W. D. R. Swanney	Independent Non-Executive Director	2
R. England	Independent Non-Executive Director	1
D. M Gunasekera	Non-Executive Director	9

Board Sub-Committees

Audit and Risk Committee

The Audit and Risk Committee (ARC) comprises two Independent Non-Executive Directors and is responsible for overseeing the Bank's adherence to the policies set by the Board. The ARC has the authority to investigate any activity within its terms of reference and all employees are directed to cooperate as requested by members of the ARC. The ARC is authorised by the Bank's Board to obtain outside legal or other independent professional advice as necessary to assist the ARC to fulfil its remit.

Its more detailed responsibilities include the examination and approval of the manner in which executive management ensures and monitors the adequacy and effectiveness of the process for the identification, assessment, mitigation, monitoring and management of all risks including liquidity, market, credit, operational, legal and strategic risks, the review of the internal audit scope and annual programme, the review of the external audit scope and the analysis of audit reports and proposals to amend operating procedures.

Asset and Liability Committee

The Asset and Liability Committee (ALCO) recommends and oversees the strategies, controls and system support for the effective management of the assets and liabilities of BOCUK. It reviews the Bank's liquidity and funding profiles, ability to borrow and lend in the inter-bank market and defines the strategies for the deposit base. The ALCO sets limits for liquidity, funding, interest rate, foreign exchange and market risk within the Bank's overall risk appetite and reviews capital allocations to reflect business strategy and risk appetite. It recommends the Bank's liquidity policy statement, its Individual Liquidity Adequacy Assessment Process (ILAAP) and its trading book policy statements to the Board.

Credit Committee

The Credit Committee is responsible for the effective management of all credit related risks at the Bank. It reviews all advances granted by the Bank and approves specific loans within the authority delegated to it by the Board. The Credit Committee reviews credit events and assesses their impact on the credit portfolio and where relevant, develops action plans to address those events. It is responsible for ensuring the maintenance of strong internal credit risk controls, the management of credit concentration risk and the approval of new credit products and processes.

Executive Committee

The Executive Committee deals with the day-to-day running of the business and any related issues as they arise and has been delegated authority by the Board to take whatever steps are necessary to conduct the business of the Bank within the confines of the Board approved strategy, risk appetite, policies, operating plans and budgets.

The Executive Committee monitors and assesses both the performance of all divisions of the Bank to ensure alignment with the Board's approved strategy and the likely impact of the external environment including competitor activity and performance, market trends and regulatory developments, on the achievement of that strategy. It monitors compliance issues including anti-money laundering activities and metrics demonstrating that the Bank is achieving its desired outcomes for "Treating Customer Fairly" and at least annually the Executive Committee recommends the Bank's Internal Capital Adequacy Assessment Process (ICAAP) and the Bank's Pillar 3 disclosures to the Board

RISK MANAGEMENT OBJECTIVES AND POLICIES

The major risks BOCUK faces comprise credit risk, market risk and operational risk, but BOCUK recognises that the range of risks is broader and ever changing and ensures that appropriate processes are in place for risks to be properly identified, assessed, treated, monitored and communicated.

The oversight of risk is exercised by the Board as a whole, supported by the Head of Risk (who also reports to the ARC). In particular, the Head of Risk is responsible for assessing the impact on BOCUK's risk appetite of any changes in circumstances (internal or external).

BOCUK's risk appetite statement sets out the level of risk that it is willing to take in pursuit of its business objectives. This document has been built-up following extensive discussions among the executive management and provides an articulation of tolerance for risk in both quantitative measures and qualitative terms. The risk appetite statement is formally reviewed on an annual basis by the Board as part of the rolling review of BOCUK's medium term strategy and is used in mapping key risks, assessing their materiality and ultimately underpinning BOCUK's overall risk management framework.

The Board also agrees the Bank's ICAAP and its ILAAP which provide a framework to have in place sufficient capital, liquidity and funding to support the business activities and risk exposures. The Bank's management formulates a business plan within the agreed risk tolerances. This plan is agreed by the Board.

The Board of the Bank adopts a prudent approach when deciding upon its appetite for risk in order to take a long-term view of value creation.

The high level approach taken by BOCUK to measure monitor and control risk is set out below.

RISK MANAGEMENT FRAMEWORK

BOCUK has chosen to adopt the three lines of defence model as its risk framework. Primary responsibility for the identification, control, monitoring and mitigation of risk lies with the operational areas (first line of defence). Oversight and governance is provided through risk, financial control and compliance functions and dedicated internal risk committees (second line of defence). Finally, assurance is provided by Internal Audit and overseen by the ARC (third line of defence). A summary of the framework is provided in the sections below.

First line of defence - organisation

Front office and client facing staff of BOCUK are primarily responsible for identifying and managing the risks that occur in the course of their daily roles in their business areas. Front office staff are required to contribute to developing policies, guidance and procedures that are necessary to manage risks and communicate these effectively to team members and other parties.

Second line of defence – management

The second line of defence is made up by the risk oversight functions and committees.

Treasury Back Office - the back office team will, as part of their role, identify potential risks resulting from the front office activities, alert front office to these risks and take action to mitigate them.

Head of Finance and Treasury – The Head of Finance and Treasury will monitor BOCUK's liquidity position and market risk position and will produce reports for senior management on the Bank's liquidity, funding and market risk management.

Head of Risk – the Head of Risk is responsible for developing, implementing and embedding the risk management procedures used by the Bank to identify, assess, monitor, control and mitigate the risks in BOCUK. The Head of Risk is also required to provide risk advice to senior management and the Board as required.

Head of Compliance – the Head of Compliance is required to develop, implement and encourage high compliance standards, policies and procedures, and ensure that these are adhered to through effective monitoring. The Head of Compliance is also required to provide compliance advice to senior management and the Board as required.

ALCO – the Bank's ALCO is responsible for monitoring and overseeing capital management, liquidity management (for both assets and liabilities) and the market risks faced by BOCUK. The ALCO is charged with approving and recommending the policy statements developed in these areas, establishing strategies for effective asset and liability management, setting capital, liquidity and market risk limits and monitoring exposures.

Credit Committee – the Bank's Credit Committee has responsibility for overseeing management of any credit risk assumed by any part of BOCUK's business. The Committee agrees and recommends the credit and concentration risk policies to the Board for approval and also approves customer and counterparty credit limits and facilities within the amounts delegated to it by the Board. The Credit Committee also monitors credit risk reports and arrears. The Committee has responsibility to review credit events, assess their impact and provide recommendations for further action.

Third line of defence - assurance

The Board looks to the Internal Audit function to provide independent assurance in respect of the operations of BOCUK. The ARC is also in place as a reporting line for Internal Audit, reviewing the function and its findings on a periodic basis.

Internal Audit is an independent, objective assurance activity that brings a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance. This involves ensuring that controls are in place and in accordance with the Bank's policies and procedures and that the Bank's records and reports are accurate and reliable.

In addition the external auditors provide comfort to the shareholder, the regulators and other third parties in respect of the statutory accounts.

CAPITAL RESOURCES

Own funds

BOCUK is funded by £15,000,000 share capital subscribed by the parent company. As at 31 December 2016 the composition of regulatory capital was as follows

Capital Resources	**31 December 2016**
Common Equity Tier 1 Capital	**Actual (£000)**
Share capital	15,000
Fair value reserve	1
Revaluation Reserve	435
Cumulative revenue losses	(2,105)
	13,331
Less: Intangible assets	(165)
Common Equity Tier 1 capital	**13,166**

CAPITAL MANAGEMENT AND INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS

BOCUK has documented a forward-looking business plan and financial projections as part of the rolling three year planning approved by the Board. BOCUK uses these projections, together with historic results, in the development and periodic review of the Internal Capital Adequacy Assessment Process (ICAAP) document to consider the level of capital it requires and to identify the sources of additional capital if necessary. This internal assessment makes use of the regulatory capital calculator and an internal evaluation of all other material risks that do not require the provision of regulatory capital. The ICAAP is performed annually or more frequently should the need arise. The outcome of the ICAAP covers all material risks identified by the Bank to determine the capital requirement over a three-year horizon, and includes stressed scenarios.

BOCUK has calculated the capital that it believes is necessary to hold in respect of the risks it faces. This comprises:

- Capital held in respect of Pillar 1 risks;
- Capital held in respect of Pillar 2 risks;
- Capital in respect of its Capital Planning Buffer (*see below); and

- If required, additional capital held in respect of potential crystallised risks highlighted by stress tests.

These are recalculated at each review of the ICAAP. Where capital is deemed as not being an appropriate mitigant for a particular risk, alternative management actions are developed.

The ICAAP is presented to the Executive Committee and then to the Board (with whom ultimate responsibility lies) for challenge and approval. The PRA periodically undertakes a supervisory review of the Bank's overall financial adequacy and sets Individual Capital Guidance (ICG) for the Bank.

Regulatory and internal capital adequacy is monitored and reported to the Board and Executive Committee. An assessment of the impact on internal and regulatory capital adequacy is made before launching any new products or undertaking new activities.

As part of the ICAAP process the Board has identified a number of other risks faced by the Bank which do not attract capital under the Pillar 1 rules. The Bank has allocated additional capital requirement for these additional Pillar 2 risks. The total capital requirement of the Bank is the sum of the Pillar 1 and the Pillar 2 capital requirements. In the view of the Bank the excess of capital resources over and above its Pillar 1 and Pillar 2 capital requirements was sufficient to meet its capital needs.

* With effect from 1st January 2016 a new Pillar 2 capital framework was introduced in line with the PRA's published Policy Statement "Assessing capital adequacy under Pillar 2". This has resulted in a new ICG set by the PRA in which the Capital Planning Buffer has been replaced with the PRA Buffer. In addition the Bank is required to maintain additional CRD IV capital buffers.

MINIMUM CAPITAL REQUIREMENT – PILLAR 1

The Bank's overall minimum capital resource requirement under Pillar 1 is calculated by adding the credit risk charge (standardised approach) to that required for market risk and the operational risk element (basic indicator approach).

Own funds Requirement	**31 December 2016**
	Actual (£000)
Credit Risk	3,159
Market Risk	5
Operational Risk	226
Total Pillar 1 Requirement	**3,390**

Credit Risk

Credit risk is the risk arising from an event that causes an asset (including off-balance sheet transactions) to lose value or become worthless resulting from an obligor's failure to meet the terms of a contract with BOCUK or its failure to perform as agreed. BOCUK is exposed to credit risk through some of its banking activities, in particular, through its trade finance activities, money market activities and lending businesses. BOCUK uses the

Standardised Approach to calculate its credit risk regulatory capital component. The risk weights applicable to each business vary according to the credit rating of each investment.

BOCUK has a detailed Credit Policy and Procedures Manual providing strict control of credit policy and an operating model with information on how the credit risk management processes are embedded in the business and are overseen within the Bank.

Counterparty risk relates to a firm's trading book and is the risk that the counterparty to the transaction could default before settlement. BOCUK does not have a trading book but may incur some counterparty risk to the extent that it enters into spot or forward exchange transactions with firms, but this will be limited.

At 31 December 2016 the Bank's minimum capital requirement for credit risk under the standardised approach (being 8% of the risk weighted exposure amounts for each of the applicable credit risk exposure classes) comprised:

Own Funds Requirement at 8%	**31 December 2016 Actual (£000)**
Central Governments and Central Banks	0
Institutions	819
Finance corporations & Corporates	1,853
Mortgages	136
Retail	103
Others	248
Total Pillar 1 Capital Requirement	**3,159**

Net values of on-balance sheet and off-balance sheet credit risk exposure (based on the definitions for regulatory capital purposes, before credit risk mitigation) and the average for the period to 31 December 2016 are summarised as follows:

Net credit risk exposure	**31-Dec-16 Actual (£000)**	**Average over the period (£000)**
Central Governments and Central Banks	93,056	98,878
Institutions	18,340	10,832
Finance corporations and Corporates	21,267	20,345
Mortgages	4,870	4,203
Retail	1,287	1,096
Others	191	306
Gross credit risk	**139,011**	**135,660**

Past due loans are loans on which payments are overdue including those with partial payments being made or loans and advances net of any impairment provision where the Bank has assessed that the loan is impaired.

All corporate exposures were classified as SME exposures.

The residual maturity of the exposures at 31 December 2016 on a contractual basis was as follows:

Gross credit risk residual maturity	**0-3 Months Actual (£000)**	**3-12 Months Actual (£000)**	**Over 12 months Actual (£000)**
Central Governments and Central Banks	93,050	-	
Financial Institutions	17,567	-	-
Financial and corporates	7,116	1,456	6,000
Retail	914	254	-
Secured by mortgages on immovable property	150	727	8,800
Past due loans	-	-	-
Gross credit risk	**118,797**	**2,437**	**14,800**

The geographic distribution of the exposures at 31 December 2016 was as follows:

Geographic credit risk exposure	**31 December 2016 United Kingdom Actual (£000)**	**31 December 2016 Other European Actual (£000)**	**31 December 2016 Other Actual (£000)**
Central Governments and Central Banks	93,050	-	-
Institutions	1,145	156	17,039
Financial corporations and Corporates	5,388	-	15,879
Mortgages	4,870	-	-
Retail advances	1,287	-	-
Others	3,141	-	-
Gross credit risk	**108,887**	**156**	**32,918**

As at 31 December 2016 the Bank did not have any country exposures that would give rise to a requirement to maintain a Countercyclical Capital Buffer.

The financial institution and sovereign exposure values associated with each credit quality step, for credit exposures in accordance with the CRD IV credit quality assessment scale under the standardised approach, were as follows:

Exposure type	Credit Quality Step	External Credit Rating	Risk weight	Actual (£000)
Central governments and central banks	1	Aa1	0%	93,050
	5	B1	100%	1,633
Institutions	1	Aa2	20%	1,186
	2	A1 to A3	20% to 50%	9,014
	3	Baa1	100%	8,163
	5	B2	150%	1,848
	Unrated	Unrated	100%	23,743

All assets are unencumbered.

For risk weighting purposes external credit ratings provided by Moody's have been used.

Impairment provisions

BOCUK has in place processes to ensure constant review of its risk assets portfolio so that non-performing accounts can be quickly identified and reclassified appropriately. The identification of problem and non-performing loans is initially the responsibility of the Credit Manager. Final classification of accounts into non-performing and problem exposures is initiated by the Head of Risk and ratified at the appropriate Credit Committee meetings. The status of impaired and past due loans are reported to the Credit Committee and Board together with recommended courses of action.

The Bank considers the following factors, amongst others, in determining the amount of impairment losses to apply against individual non-performing accounts.

- The amount of the financing and the Bank's other commitments to the customer or counterparty.
- All available information regarding the assets, liabilities, income and expenditure of the customer or counterparty.
- Value of any security for the financing (net of realisation costs) and how/when it could be realised.
- Legal enforceability of any security.

At the 31 December 2016 one credit exposures had been classified as non-performing and a full impairment provision was in place.

Market Risk

Market risk is the risk that arises from fluctuations in values of, or income from, assets, interest, exchange rates or market prices of commodities. BOCUK is exposed to changes in foreign exchange rates and incurs foreign exchange risk as a natural result of mismatched positions in the currencies in which it transacts business. BOCUK has set a prudent internal net open overnight FX limit. The foreign exchange position at 31 December 2016 comprised:

Position in Sterling Equivalent	**GBP £000**	**EUR £000**	**LKR £000**	**USD £000**
Total assets	109,433	2,264	0	27,776
Total liabilities and equity	(109,562)	(2,257)	(16)	(27,638)
Gross exposure	(129)	7	(16)	138
Foreign exchange contracts	-	-	-	-
Net exposure	**(129)**	**7**	**(16)**	**138**

At 31 December 2016 a 5% strengthening of Sterling against the US Dollar would have decreased profits by £6,000 and a 5% weakening of Sterling would have had an equal but opposite effect.

BOCUK is also exposed to interest rate risk in its banking book as a result of mismatches in the timing of interest rate resets of assets and liabilities.

Position in Sterling Equivalent	**0-3 Months £000**	**3-12 Months £000**	**Over 1 Year £ 000**	**Non Interest Bearing £000**
Total assets	117,557	2,437	14,718	4,761
Total liabilities and equity	(107,239)	(388)	(18,087)	(13,759)
Net interest gap	10,318	2,049	(3,369)	(8,998)
Cumulative interest gap	**10,318**	**12,367**	**8,998**	**-**

At 31 December 2016 a parallel shift increase of 1% in interest rates would bring additional income of £91,000 in a full year. A 0.25% reduction in rates would have a negative impact of £22,765 on income.

The Bank holds available for sale debt securities comprising UK Government gilts held for liquidity purposes as highly liquid assets. These were valued at £1,001,000 at 31 December 2016. A 5% movement in the value of these investments would impact reserves by £50,000.

Operational Risk

Operational risk is the risk of direct or indirect loss resulting from inadequate or failed internal processes, people and systems, or from external events arising from day-to-day operating activities. Operational risk is the second largest component of the BOCUK's Pillar 1 requirement.

The operational risk requirement under Pillar 1 is calculated using the Basic Indicator Approach. This uses a proxy of 15% of the average of 3 year net interest income and net non-interest income to calculate a capital charge for operational risk.

ADDITIONAL CAPITAL REQUIREMENT – PILLAR 2

Certain risks that BOCUK encounters are either not considered under Pillar 1, or are considered under Pillar 1 but BOCUK believes that the Pillar 1 model does not capture those risks adequately. These are the additional Pillar 2 risks to which BOCUK is exposed.

Where it is considered appropriate to hold additional capital in respect of a risk, this is set out net of the mitigation resulting from controls and management actions. BOCUK's Pillar 2 add-on amount is the sum of the additional capital held in respect of each of these. Even where risks are considered material, this may not result in BOCUK holding additional capital against them as it may be appropriate to mitigate each risk using another mechanism, for example a robust control or management action.

In addition, as part of the ICAAP risk assessment process, BOCUK undertakes stress testing and scenario analysis based on available trading data at business unit level, the projections and assumptions made by management, and considers whether additional capital would be required over and above the Pillar 1 and Pillar 2 amounts identified in this section if a significant event occurred .

The following are considered or each of the key Pillar 2 risks identified:

- Risk characteristics and how the risk might affect BOCUK;
- Likelihood of crystallisation of risk (net of controls);
- Whether the capital held under Pillar 1 in respect of that risk is sufficient;
- How the risk will be mitigated at BOCUK:

The specific Pillar 2 risks considered in addition to Pillar 1 risks are detailed below.

Pillar 2 - Additional Risk Capital

Credit Risk

Although credit risk is primarily considered under Pillar 1, BOCUK has considered the credit risks that it takes and whether the level of capital held under Pillar 1 is sufficient.

Credit risk is the largest component of BOCUK's Pillar 1 capital requirement. BOCUK believes that the risk weights applied under the Pillar 1 calculations are conservative and reflect the risk of the exposures effectively. In addition, the Board considers the internal control arrangements of BOCUK are adequate given that the transactions that BOCUK will undertake are well understood and non-complex.

Concentration Risk

Concentration risk relates primarily to credit risk, and is the risk of an unexpected accumulation of credit related losses as a result of a lack of diversification of a credit portfolio. Pillar 1 risk weights are based on a highly diversified portfolio and BOCUK's regional focus on the Sri Lankan corporate and retail community means risk is likely to be relatively concentrated. An external shock that affects one exposure has a greater than usual chance of affecting other credits, and difficulties experienced with one exposure may affect directly or indirectly, another of the bank's exposures; and a failure of one credit may lead to a failure of another.

Operational Risk

Although operational risk is primarily considered under Pillar 1, BOCUK has considered the level of operational risks that it takes and therefore whether the level of capital held under Pillar 1 is sufficient. Where BOCUK identifies specific operational risks against which it believes it is necessary to hold capital, it considers the greater of this and the Pillar 1 amount, rather than their sum. The major risks faced by BOCUK are considered to comprise:

- Systems and controls
- Operational errors and external fraud
- Key man / staff
- Regulatory / legislative change

Interest Rate Risk

Interest rate risk arises from the possibility that changes in interest rates will affect future profitability or the fair value of financial instruments. Interest rate risk at BOCUK is largely limited to the impact on interest free funds but may increase as the range of products expands. Positions are monitored and managed by Treasury Department under the oversight of ALCO.

Liquidity Risk

Liquidity risk is the risk that the Bank, although solvent, either does not have available sufficient financial resources to enable it to meet its obligations as they fall due, or can secure such resources only at excessive cost. BOCUK has produced an ILAAP. Whilst BOCUK considers management of liquidity risk as a priority for the Bank it has a relatively low level of liquidity risk due to the collapsible nature of its balance sheet.

Other Risks

BOCUK reviews all risks to which the Bank is exposed, including but not restricted to pro cyclicality business risk, reputational and group risk, regulatory risk, legal risk, conduct risk, technological risk, and money laundering risk.

LEVERAGE RATIO

The leverage ratio is defined as the ratio of Tier 1 capital to total exposure. This metric is a non-risk based measure used to manage the risk of excessive leverage. The leverage ratio is subject to an observation period by the European Banking Authority (EBA) from the 1 January 2013 until 1 January 2017. Following this a binding requirement will be finalised for implementation on 1 January 2018.

The leverage ratio is monitored on an ongoing basis to ensure that the expected minimum regulatory requirement is satisfied and that the Bank has sufficient levels of capital for current and projected activities.

The table below sets out the leverage ratio as at 31 December 2016 under the CRD IV definition:-

	£ 000s
Total Tier 1 Capital (**A**)	**13,166**
Total Balance sheet assets [1]	139,473
Total off-balance sheet assets and derivates [2]	4,174
Total assets and contingents (**B**)	**143,647**
Leverage ratio A ÷ B	**9.2%**

[1] (a) After deduction of intangible assets (£165,000); and, (b) includes sterling placed on an immediately available reserves account with the Bank of England the balance of which exceeds the sterling deposits of £85,105,000 accepted by the Bank as at 31st December 2016.
[2] Determined in accordance with CRD IV.

REMUNERATION POLICY

Decision making process for remuneration policy

Overall responsibility for BOCUK's remuneration strategy lies with the Board. The Executive Committee is responsible for the implementation of the remuneration policy and will recommend to the Board any changes to the policy taking into account the Bank's strategic objectives and risk appetite.

Objectives

BOCUK currently operates one award scheme that is linked with the performance of the Bank and which is designed to link reward with the long-term success of the Bank.

2016 Remuneration

BOCUK employed on average 27 staff including directors during 2016. In view of its size and the nature of its business there are no distinctions by business area when applying the Bank's remuneration policy.

Eight employees of the Bank have been identified as senior management. The criteria for identification are that the staff member is either a director of BOCUK or undertakes a function of significant influence.

No variable remuneration awards were paid to any employee of BOCUK based on the financial year 2016 results as they did not meet the level required to merit such payments.

No individuals received remuneration of the equivalent of EUR 1 million or more during the year.

	Number of staff	**Aggregate Fixed remuneration 2016 £ 000s**	**Aggregate Variable remuneration 2016 £ 000s**
Directors and senior management	8	513	-
Other members of staff	19	637	-