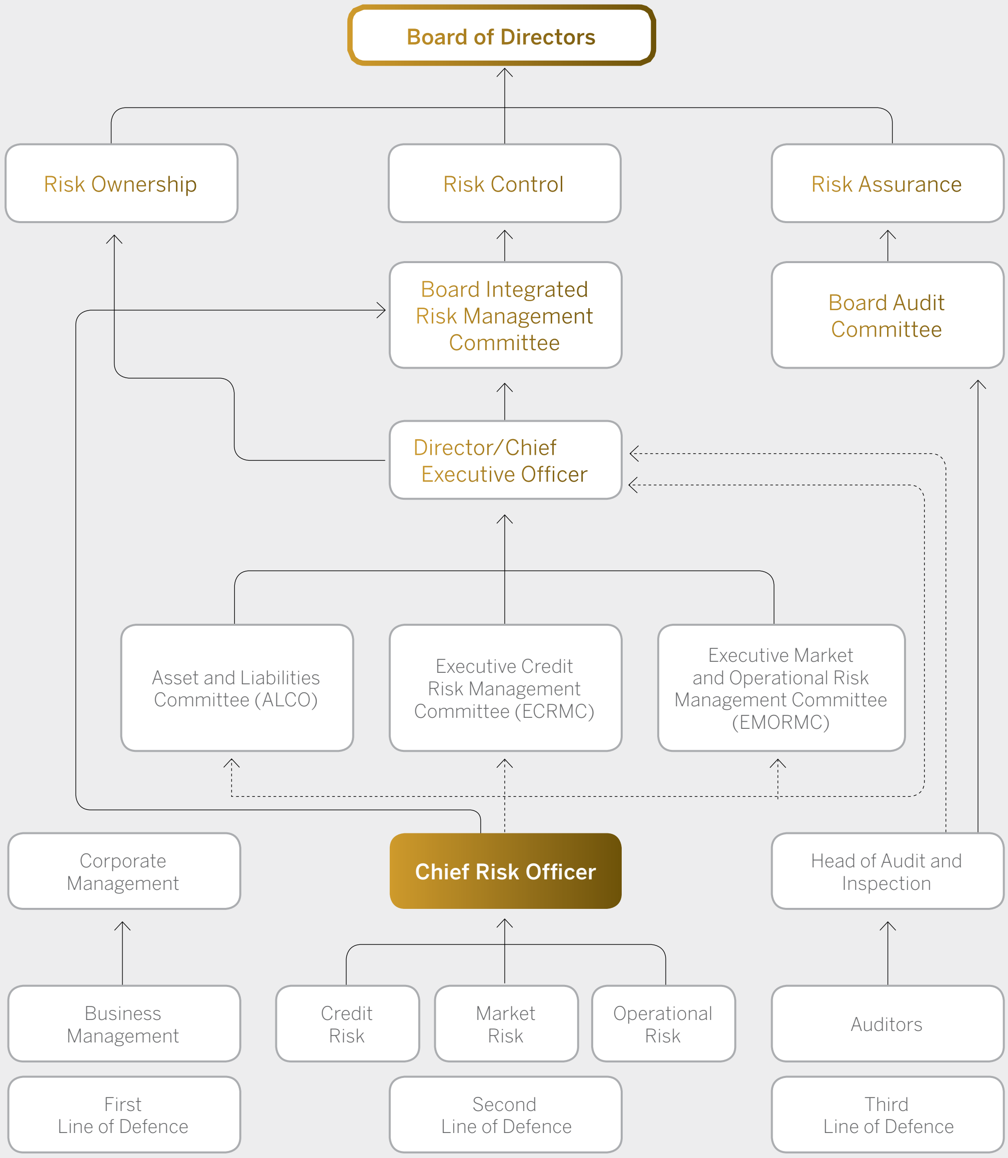
PILLAR - III DISCLOSURES

(Included in the 2017 Annual Report)

The preceding report on how the Bank manages its overall risk includes the following Pillar-III disclosure requirements as mandated by the Central Bank of Sri Lanka

Integrated Risk Management and Governance Structure

Risk management in Seylan Bank comprises Three Lines of Defence. The Director/Chief Executive Officer has delegated responsibility for managing all risks to business managers within stipulated risk limits (1st Line of Defence). Risk management across the entire Organisation has been assigned to an independent Chief Risk Officer (2nd Line of Defence). The internal and external audit provides the risk assurance (3rd Line of Defence). Seylan Bank's Board has established two Board committees supported by three executive management committees to oversee risk management as shown on the following chart:



At Seylan Bank, having understood that risk management is an essential component of growth, we have developed risk management policies and procedures that are applied across the Bank to assist the business units in their daily interaction with customers. The regulator recommended risk framework is in place to manage the risk on an integrated basis and monitor developments in real time to provide the right level of information to the attention and action of Integrated Risk Management Committees.

As per Pillar II, we prepare and submit the findings of Internal Capital Adequacy Assessment Process (ICAAP) in order to go beyond management of key risks, namely Credit, Market and Operational. We also use tools such as VaR, stress testing and other simulations within approved threshold limits to contain risks. The entire risk management function is carried out with defined roles and responsibilities and have the oversight of the Board of Directors. IT systems are constantly upgraded to facilitate the risk management process, whilst regular training and communication takes place to create a risk management culture across the Bank. We are ready to implement alternative standardised approach in computing capital on operational risk and certainly geared to adhere to new guidelines introduced by the regulator. We also have developed a dashboard to monitor and report comprehensive overall view of risk with given targets and thresholds to manage risk within the approved appetite and tolerance levels.

Risk appetite elements

Risk appetite framework

The definition of risk appetite is the first step in the Risk Appetite Framework (RAF) process. While the Risk Management Unit defines and proposes the Appetite and Tolerance Limits, the Board of Directors is responsible for approving the risk appetite and has the overall responsibility to ensure that the most significant risks are properly managed.

The Bank sets risk tolerance limits for its key risk indicators pertaining to credit risk, market risk and liquidity, and operational risk.

Seylan Bank's risk appetite incorporates, at minimum, the following dimensions:

Bank wide (target credit rating, capital adequacy, profitability and growth).

Credit risk (NPL ratio, increase/decrease in NPL, overdraft without limits, large exposures to core capital, specific provision cover to Gross NPL, watch list to performing advances, related party lending to core capital, geographical and industry concentration).

Market risk (Maturity Gaps – less than one year net gap percentage of liabilities, Government Securities to total assets, market value of equity investments to total assets, net open position, interest rate risk in the Banking book).

Liquidity risk (Statutory liquidity ratio for domestic and foreign currency, advances to deposits ratio in domestic and foreign currency, advances to deposit ratio – Banks, Swaps, external borrowings in domestic currency).

Operational risk (Pawning operational losses as percentage of pawning capital outstanding, non-rectified high risk audit finding over total high risk audit findings, cheque returns as a percentage of total cheques in clearing, number of skimming cards and non-EMV converted POS transactions etc.)

Compliance to CBSL guidelines, all banking regulatory requirements and Reputational risk.

Risk Appetite Statement
(comprising key credit, market, liquidity and operational indicators)

Risk type	Tolerance limit 2017 %	December 2017 %	December 2016 %	Low	Medium	High
Credit risk						
1. Gross NPA ratio (as per CBSL)	3.5	4.83	5.14		○	
2. Gross NPA ratio (Net of IIS as per CBSL)	2.5	4.42	4.47		○	
3. Overdue + NPA/total advances	10	14.88	12.67		○	
4. Specific provision/gross NPL	35	21.60	19.00		○	
5. Watch list/total performing advances	6.5	10.56	7.94		○	
6. Performing overdrafts without limits (Mn.)	750	764	843		○	
7. Large exposure/core capital	6 times	5.91	5.74	○		
8. Exposure on related parties/core capital	Max of 55	27.76	29.44	○		
9. Open credit exposure	17.50	26.27	25.35		○	
Market risk						
10. Maturity gap less than one year to total liabilities	Less than 25	3.55	-22.74	○		
11. Government Securities to total assets (Int. bearing)	Less than 30	21.79	20.59	○		
12. Market value of equity investments (quoted) to total assets (Int. bearing)	Less than 1	0.06	0.08	○		
13. Net open position short (-)/Long(+) (USD) (Mn.)	8 Mn.	-0.134	2.406	○		

Risk type	Tolerance limit 2017 %	December 2017 %	December 2016 %	Low	Medium	High
Liquidity risk						
14. Statutory liquidity ratio Domestic Banking Unit	> 21	23.57	22.68	○		
15. Statutory liquidity ratio Foreign Currency Banking Unit	> 21	37.08	26.24	○		
16. Advances to Deposits Ratio – Bank	< 97.50	93.28	88.52	○		
17. Advances to Deposits Ratio – LCY	< 97.50	94.34	90.43	○		
18. Advances to Deposits Ratio – FCY	< 97.50	84.76	70.90	○		
19. Advances to Deposits + Debentures	< 95.00	89.64	84.66	○		
20. Advances to Stable Funds	< 100.00	87.69	88.50	○		
21. SWAPs (USD)	Not exceed 175 Mn.	110.50	91.00	○		
22. External borrowing (LKR)	Not exceed 40 Bn.	24	17	○		
Operational risk						
23. Pawning operational losses as percentage of pawning average capital outstanding	0.25%	Nil	Nil	○		
24. Cheque returns as percentage of total cheques in clearing	3	4.29	3.40		○	
25. Non-rectified high risk findings (< 90 days) over total high risk audit findings (%)	Zero	3.13	1.55		○	
26. Number of skimming cards and Non-EMV converted POS Transactions (LKR)	Zero	Nil	0.46 Mn. 27 Txn	○		

Monitoring the risk profile

The Board Integrated Risk Management Committee and its appointed subcommittees use the Risk appetite statement to determine appropriate earnings volatility, risk/return targets and risk tolerance and concentration limits which it allocates to business activities or to specific risk types. Risk Management Unit and Board Integrated Risk Management Committee have the responsibility to continuously monitor the risk profile of Seylan Bank PLC, ensure that the latter is within the approved risk appetite tolerance limits and ascertain whether certain business lines need further monitoring or new guidance regarding risk-taking.

Each business unit defines its strategy and business plans with a view to optimising its overall risk/return trade offs within the Bank's risk appetite. Consistency is maintained between the top-down targets and limits set by the Board integrated Risk Management Committee and more granular limits are set in case of products, portfolio, individuals and traders.

Credit risk management

Credit risk is defined as the risk of a potential loss to the Bank, when counterparty fails to perform on an obligation, in accordance with the agreed terms or its ability to perform such obligation is impaired resulting in a loss to the Bank. In essence, the proper management of credit risk underpins a Bank's financial stability, growth prospects and profitability and as such Seylan Bank has developed a well-structured credit risk management process in order to maintain the quality of the credit portfolio of the Bank at the optimal level.

Accordingly, credit risk is managed through a comprehensive framework which includes well-defined policies and procedures that include clearly structured approval hierarchies and different committees to oversee various aspects of credit risk management processes in the Bank. In addition, the Bank manages its credit exposures through diversification strategies across products, geographies, clients and customer segments. The Bank's main objectives in credit risk management are as follows:

- Maintain a credit risk management framework to ensure quality, consistency and transparency in credit risk approvals at all times
- Identify, assess and measure credit risk clearly and accurately across the Bank and within each separate business, from the level of individual facilities up to the total portfolio
- Control and plan credit risk-taking in line with external stakeholder expectations and avoid undesirable concentrations
- Monitor credit risk and adherence to agreed controls on a continuous basis to ensure that risk-reward objectives are met

The Credit Standards and Policy Manual outlines the fundamental standards and disciplines that the Bank has implemented to actively manage credit risk across our lending book. The Credit Procedure Manual on the other hand, outlines the proper processes to be adopted in evaluating proposals and granting of credit facilities to clients. These standards, policies and procedures lay down key roles and responsibilities of those required to originate, identify, analyse, rate, review, price, report, diversify, control/mitigate and manage credit risks and are applicable to all lending activities undertaken by our Bank. These two Manuals are reviewed regularly and updated throughout the year on a regular basis to ensure consistency with the Bank's business strategy. The Lending Guidelines outlines the Bank's strategic risk/reward objectives in the light of evolving market conditions by clearly setting out the preferred industries and lending types to be targeted for lending growth during each calendar year. The Lending Guidelines are also reviewed biannually to better align the Bank's lending strategies with the emerging trends in the market.

In order to better manage the overall credit, liquidity and interest rate risk, the Bank mainly focuses on self-liquidating facilities with short to medium-term maturities in growing its loan book. In addition to setting up exposure limits for clients individually, the Bank manages counterparty credit exposures, using the "one obligor principle", so that all facilities to a group of borrowers wholly or substantially owned or controlled by common or related parties are aggregated and evaluated together under the coordination of a designated Lead Relationship Manager.

When a number of counterparties are engaged in similar activities and have similar economic characteristics, their ability to meet contractual obligations can be similarly affected by changes in the economic and other conditions, leading to a credit concentration risk. In view of this, the monitoring of credit concentration is an integral part of the credit risk monitoring process at Seylan Bank. Accordingly, the Bank constantly reviews its credit concentration on a number of areas such as; geography, product type, industrial sectors and maturity. Close monitoring of key ratios/internal thresholds on a continuous basis and stress testing of the credit portfolios form another strategy to measure and monitor the credit concentration risk in Bank's loan portfolio.

Additionally, the Bank's credit risk management strategy includes; identifying the emerging risks, which can impact the business activities of the clients well in advance, ensuring that the credit facility or the relationship returns the expected profitability, close monitoring of the usage of working capital facilities to prevent diversion of funds into unintended areas and ensuring timely repayment of the facilities.

Assessment of credit risk

In order to grow the Bank's loan book on high quality loans and advances, there is a clear segregation of duties between transaction originators in business areas and approving authorities under the risk function. All credit exposure limits are approved within a well-defined credit approval authority framework. Credit risk evaluation and approval is undertaken by experienced credit risk professionals operating within a clearly defined delegated authority framework, with only the most senior credit officers entrusted with the higher levels of delegated authority. All high value credit propositions above a certain threshold level are approved by the Board Credit Committee or the Board of Directors as relevant.

The Bank has delegated credit approval authority to individual lending officers, based upon a consistent set of standards such as experience, judgement and ability. These authority levels are subjected to review on an annual basis. If an individual lending officer's authority is insufficient to establish, materially change or restructure the required credit limits, the proposals are escalated to an officer or committee having the required higher delegated authority. In addition, the individual credit exposure limits on the clients are subjected to a critical review annually and require the approval at the appropriate authority level. Managers recommending, reviewing or approving facilities are held accountable for the outcome.

Functions of credit risk management

Credit Risk Management Structure comprises two main functional components, namely Credit Risk Management Unit (CRMU) and the Credit Risk Review Unit (CRRU). While the Credit Risk Management Unit evaluates proposals at the pre-sanction stage, the Credit Risk Review function assesses the proposals at post-sanction stage.

All high value lending proposals and reviews are subjected to an independent critical examination by the CRMU to ascertain whether the risks have been fully identified and evaluated, they are in line with the Bank's Lending Guidelines and risk acceptance criteria, risks have been adequately mitigated, the facilities are well-structured and whether proposed credit exposures are at prudent levels. CRMU then recommends that the approving authority either approves the proposal (with additional risk mitigants/conditions wherever necessary) or declines it. In addition to this exercise it is mandatory that all the high value credit propositions need to be approved by the CRO on an independent basis. Further, the Bank is currently in the process of assigning credit risk managers at Area Offices with a view of broad-basing the risk oversight on medium sized credit propositions and simultaneously enhancing the delegated authority level of the Area Managers leading to better efficiencies within the credit approval hierarchy.

CRMU functions independently but is in regular interaction with the business units so that emerging risks and the lessons learnt through our lending and recoveries experiences are used to continuously improve the Bank's policies and practices.

CRMU also monitors credit concentrations against approved prudential exposure limits and the achievements of business and lending portfolio managers in improving credit quality, as measured by their success in minimising overdue/non-performing advances portfolios and submits regular reports to the Executive Credit Risk Management Committee (ECRMC) recommending corrective action wherever required. The Bank has further strengthened the portfolio monitoring at the CRMU by deploying additional staff who are capable of analysing data.

Credit Risk Review Unit (CRRU) independently reviews the already approved high level facilities within three months of drawdown/renewal focusing on the approval, disbursement, relationship management and credit portfolio management processes. Further, CRRU identifies instances of non-compliance with credit standards, policies, procedures and Lending Guidelines, if any. Also, CRRU independently ascertains whether there had been any emerging risks that have not been addressed at the time of evaluating the credit proposals or whether there are any facilities where any appropriate remedial actions have not been initiated. Based on this critical assessment, CRRU makes recommendations which are aimed at reducing the risk of default and minimising losses in the event of default. The lessons learnt from these reviews and recommended actions are referred to Risk Committees and circulated to all lending officers on a regular basis leading to qualitative improvements across the Bank's lending portfolio. In addition, CRRU also involves in conducting training programmes at regional locations and at the Training Centre to educate the branch managers and the credit staff about the proper usage of the Lending Guidelines and evaluation of credit proposals in order to improve Bank's credit quality.

Credit Administration Unit

Seylan Bank's loan portfolio is administrated through a Centralised Credit Administration Division, which ensures efficient and effective post-sanction customer support including disbursement, settlements, processing of security documents. Setting up of the Unit has effectively reduced the transaction costs and improved the efficiency in processing and managing a quality credit portfolio for the Bank. Further, the Unit is also involved in conducting training for branch and department staff in the procedures relating to Credit Administration.

Credit rating and measurement

Risk measurement plays a central role, along with judgement and experience, in forming risk-taking and portfolio management decisions. It is a primary area for sustained investment and Senior Management's attention.

As part of the Bank's credit risk management strategy, a "Credit Rating System" was initially introduced in April 2007, with the broader objective of improving the credit quality of the Bank through pre-qualifying borrowers for credit facilities and risk-based pricing of such credit facilities through an objective risk analysis. As a further step towards developing this credit rating system to be in line with the vastly changed macro-economic conditions and as well as to meet the regulatory requirements vis-à-vis the CBSL/Basel guidelines, the Bank upgraded the Credit Rating System during the year 2014. Further, one of the main prerequisites of moving to the IRB approach for the computation of capital requirement for credit risk is the need for vibrant Internal Rating Models to risk grade the clients and the availability of through the cycle probability of default (PD) values for a minimum period of five years. The Bank therefore is currently in the process of conducting a gap study to assess the Bank's readiness to move to the IRB approach with the assistance a of a reputed consultancy firm with the collaboration of their Indian counterparts. Additionally this consultancy firm has been entrusted to validate the existing credit rating models and to assist the Bank in introducing a Risk-Based Pricing Mechanism in granting loans.

Credit evaluation and approval process

The Bank commenced designing a Loan Origination System (LOS) in mid-December 2015 to streamline the credit evaluation/approval process across all business channels. After a tedious well-structured development process, the live implementation of this System was done and the Bank managed to successfully roll out this System across all the branches and lending units during the year 2017. Further upgrades to the System will be done in the year 2018 and the Bank expects that this System will provide the foundation for an efficient credit appraisal process by reducing the time taken to evaluate/approve facilities thus improving the quality of the credit portfolio.

Credit hubs

The Bank has already commenced setting up SME Hubs on a Regional basis with the objective of improving the quality of credit evaluation and improving the efficiency/reducing turnaround time

(TAT) for SME credit approvals. The Bank expects that this measure would enable the branches to focus more on canvassing new SME clients and to serve the existing SME clients in a much better way. Three of the fourteen SME credit hubs have already been setup in 2017. We expect the remaining hubs to be established by third quarter of 2018.

Credit risk mitigation

In mitigating credit risk, the Bank primarily relies on a rigorous assessment of credit applicants, the strength of their business model, sustainable financial conditions and our ability to meet their financial requirements. Further, the lending proposals are normally required to show more than one independent credible source of repayment. The primary source is established through a conservative evaluation of whether the borrower's realistic projected cash flows will be sufficient to repay their debts. The Bank normally requires this to be supported by at least one alternative way of settling the debt in the event of unforeseen adverse circumstances but firmly believes that the availability of collateral does not in itself make an unacceptable lending proposition acceptable.

In instances where the Bank accommodates highly reputable and financially strong corporate borrowers, whose performance is regularly and rigorously reassessed on the basis of reliable financial information, we exceptionally grant facilities on an unsecured basis solely based on their cash flows.

The Bank uses various techniques and controls to limit and mitigate credit risk exposures and reduce potential credit losses. These include documenting credit transactions with adequate terms, conditions and covenants in a comprehensive and legally enforceable basis and obtaining of guarantees, financial or other collaterals to provide a secondary recourse to minimise credit losses. Such guarantees serve to mitigate the inherent risk due to credit default and minimise any related losses by either substituting the borrower default risk or improving recoveries.

The Bank ensures that the collateral accepted for risk mitigation purposes is of high quality and supported by legally effective and enforceable documentation. When determining security, the Bank will be guided by:

- Whether the ownership and the title to the security is acceptable without any defects or other encumbrances with stable minimum value and required margin of security in favour of the Bank, to support the borrowing through the period of repayment.
- Whether the security can be realised without any difficulties to recover our dues fully in an eventuality.

The Bank nets off collateralised cash deposits against the on balance sheet non-performing advances in the instances where the relevant documentation which is legally binding all parties and enforceable on all jurisdictions are available.

In the standardised approach, collateral recognition is limited to eligible financial collateral such as gold only but this approach provides a preferred (lower) risk weight for "SME exposures secured by immovable property" and "claims secured by residential property". Though the Bank has relied on the individual and corporate guarantees in granting credit facilities, the Bank has not relied upon any credit derivative instruments to transfer the credit risk assumed on the clients.

Collateral impairment haircuts are applied to security valuations, based on conservative and predetermined Loan/Collateral ratios in compliance with the Banking Act Direction No. 03 of 2008, "Classification of Loans and Receivables, Income Recognition and Provisioning".

Non-performing advances by collateral type

Collateral type (Secured by)	2017 LKR '000	2016 LKR '000
Cash/shares	228,164	432,591
Immovable property	8,227,789	5,912,148
Movable assets	806,485	567,887
Other securities	1,726,850	3,278,965
Pawned articles	71,212	57,086
Clean	2,422,400	1,327,847
Grand total*	**13,482,900**	**11,576,524**

** Excluding interest receivables.*

Monitoring, reporting and disclosure of credit risk

Corporate, business and area management are primarily responsible for monitoring the performance of their lending to ensure that the Bank's credit portfolio profitability and lending quality objectives are achieved. Credit risk management uses a comprehensive range of quantitative tools and Bank-wide credit limits to monitor lending, contingent commitments and other off-balance sheet exposures, profitability, quality trends and concentrations and identifies whether the Bank is growing undue exposure concentrations and whether credit risks are adequately remunerated. The Risk Management Unit makes recommendations for suitable amendments if required, after reviewing the existing credit policy framework.

CRO reports these concentrations regularly together with his recommendations for corrective actions to the Executive Credit Risk Management Committee (ECRMC) and escalates the significantly important matters to the attention of Board Integrated Risk Management Committee (BIRMC). This rigorous process enables the Board of Directors to oversee the Bank's credit risk exposures, ensuring that the Bank quickly identifies emerging risks and risks that are not aligned with the Board approved credit risk appetite and initiates timely corrective measures.

Below: We present the qualitative and quantitative disclosures of credit risk of the Bank.

Qualitative disclosures

Definition of past due and impaired

A non-performing loan is any loan that is 90 days or more past due or is otherwise individually impaired (which represents those loans against which individual impairment provisions have been raised) and excludes:

- Loans renegotiated before 90 days past due and on which no default in interest payments or loss of principal is expected.
- Loans renegotiated at or after 90 days past due, but on which there has been no default in interest or principal payments for more than 180 days since renegotiation and against which no loss of principal is expected.

"Impaired Loans" comprise loans where an individually identified impairment allowance has been raised and loans which are collateralised or where indebtedness has already been written down to the expected realisable value. This category includes all loans that have been transferred to legal/recovery departments. The impaired loan category may include loans, which, while impaired, are still performing.

The "accruing past due 90 days or more" category comprises loans that are 90 days or more past due with respect to principal or interest. An impairment allowance will be raised against these loans, if the expected cash flows discounted at the effective interest rate are less than the carrying value.

The "impaired and restructured loans" category comprises loans not included above where, for economic or legal reasons related to the debtor's financial difficulties, a concession has been granted to the debtor that would not otherwise be considered. Where the concession results in the expected cash flows discounted at the effective interest rate being less than the loan's carrying value, an impairment allowance will be raised.

Approach on individually significant and collective loan loss provisioning

The Bank's loan loss provisions are established to recognise impairment losses incurred either on specific loan assets or within a portfolio of loans and receivables.

Impairment allowances may be assessed and created either for individually significant accounts or, on a collective basis, for groups of individually significant accounts for which no evidence of impairment has been individually identified or for high volume groups of homogeneous loans that are not considered individually significant. Individually impaired loans are those loans against which individual impairment provisions have been raised.

Estimating the amount and timing of future recoveries involves significant judgement and considers the level of arrears as well as the assessment of matters such as future economic conditions and the value of collateral, for which there may not be a readily accessible market.

Loan losses that have been incurred but have not been separately identified at the Statement of Financial Position date are determined on a portfolio basis, which takes into account past loss experience as a result of uncertainties arising from the economic environment and defaults based on portfolio trends. Under SLFRS/LKAS, impairment allowances are recognised where there is objective evidence of impairment as a result of one or more loss events that have occurred after initial recognition and where these events have had an impact on the estimated future cash flows of the financial asset or portfolio of financial assets. Impairment of loans and receivables is measured as the difference between the carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. If the carrying amount is less than the discounted cash flows, then no further allowance is necessary. Impairment allowances are measured individually for assets that are individually significant, and collectively where a portfolio comprises homogeneous assets and where appropriate statistical techniques are available.

Credit risk concentrations with limits

Credit concentration risk may arise where a number of counterparties are engaged in similar activities and have similar characteristics, which could result in inability to meet contractual obligations being similarly affected by changes in economic or environment conditions.

Concentration risk is mitigated to a large extent by stipulating prudent credit risk limits on various parameters. CBSL also has specified certain guidelines on maximum exposures in respect of single/ related party borrower limits and large exposures.

Related party lending

Related parties include the Major Shareholders, Subsidiaries, Directors and Key Management Personnel of the Bank. The Bank has set an internal limit on the overall exposure to the related parties and ensured that credit decisions are made on a rational basis, as per the relevant legislation, approved policies and procedures and is based on market terms, with no preferential treatment.

Over exposure to geographical areas, economic sectors and lending products

Exposure to a single sector of the economy or lending product or to a narrow geographical region is another dimension of risk concentration. Borrowers may be vulnerable in the event of an economic or market downturn affecting their economic sector, which in turn can affect their ability to service the loans and to mitigate this risk the Bank sets individual concentration limits for exposure to various sectors. The Bank closely monitors the quantum and quality of lending by geography (area) but is of the opinion that weaknesses in any local economy, will not pose a significant risk in the foreseeable future.

Quantitative disclosures

Credit exposure by product types as at 31 December 2017

The core banking products such as term loans and overdrafts account for more than 70% of total advances. The specialised products are closely monitored to mitigate inherent risks.

	Total as at 31 December 2017 LKR '000	Total as at 31 December 2016 LKR '000
Credit cards	4,886,489	3,803,627
Housing	13,500,139	12,515,412
Leasing	16,222,825	14,685,690
Term loans	144,459,003	113,518,062
Margin trading	2,588,413	2,658,052
Overdrafts	62,788,151	60,076,383
Pawning	10,046,055	9,609,406
Staff term loans	6,108,917	5,521,128
Trade finance	25,869,381	19,685,422
Grand total	**286,469,373**	**242,073,182**

The Sector-wise comparison: December 2017 and December 2016

Sector	Total as at 31 December 2017 LKR '000	Total as at 31 December 2016 LKR '000
Agriculture and fishing	29,270,288	21,203,942
Manufacturing	34,776,273	26,046,082
Tourism	16,728,197	11,130,650
Transport*	26,185,451	25,795,747
Construction	32,481,598	24,716,395
Traders	53,633,312	50,288,818
New economy	1,850,642	1,753,684
Financial and business services	32,776,967	32,532,072
Infrastructure	2,630,970	2,149,585
Other services	7,925,446	8,271,100
Credit cards	4,886,489	3,803,627
Pawning**	10,046,055	9,609,406
Other	33,277,685	24,772,074
Grand total	**286,469,373**	**242,073,182**

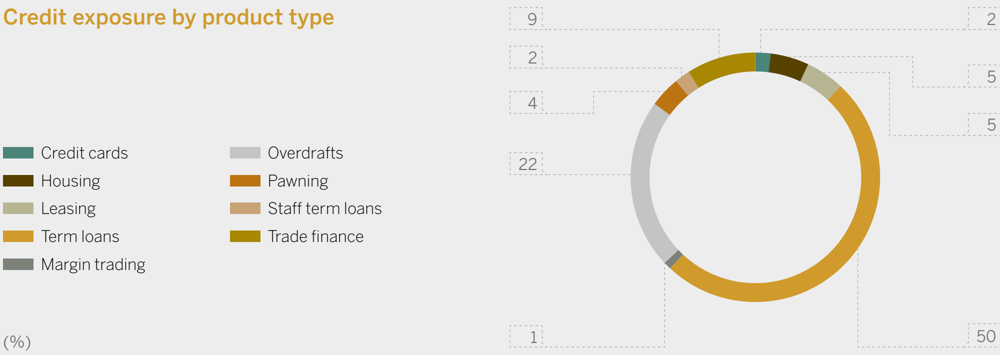
**Transport includes leasing.*

*** Pawning includes agriculture sector lending.*

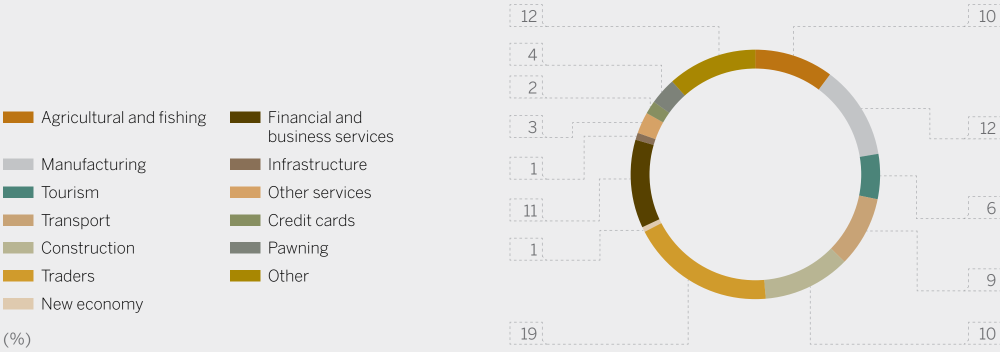
Age analysis of non-performing loans by product distribution (excluding interest receivables) – 31 December 2017 based on CBSL directions

Loan category	3-6 months NPA special mention LKR '000	6-12 months NPA substandard LKR '000	12-18 months NPA doubtful LKR '000	18 months and above NPA loss LKR '000	NPA Grand total LKR '000
Credit cards	84,985	70,910	65,953	120,566	342,414
Housing	228,114	89,242	77,742	397,190	792,288
Leasing	354,977	70,033	168,940	177,967	771,917
Margin trading	–	–	–	1,373	1,373
Overdrafts	672,216	449,391	162,286	1,277,792	2,561,685
Pawning	26,647	–	–	44,565	71,212
Staff term loans	6,979	6,931	–	18,353	32,263
Term loans	2,331,366	1,200,397	416,504	4,499,516	8,447,783
Trade finance	155,499	29,567	107,186	169,713	461,965
Grand total	**3,860,783**	**1,916,471**	**998,611**	**6,707,035**	**13,482,900**

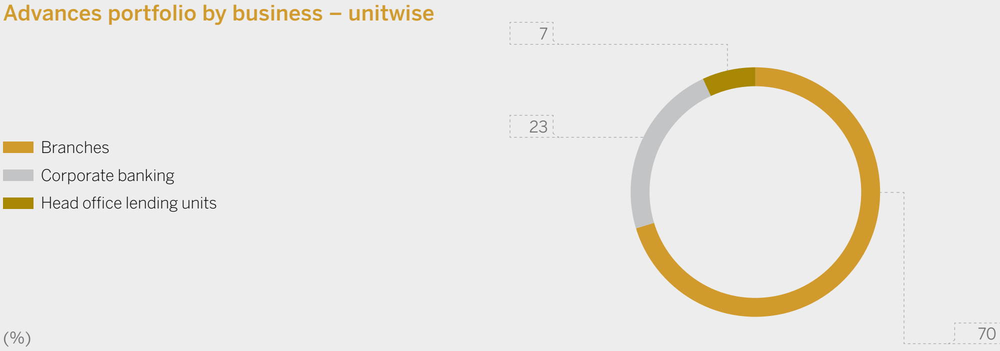
Credit exposure by product type



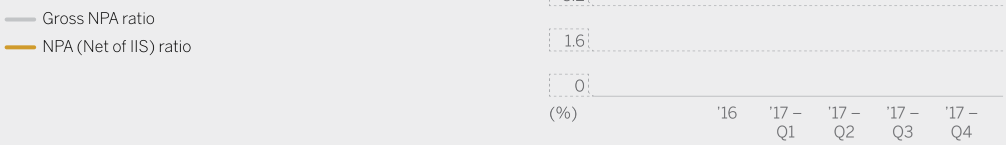
Analysis of the advances portfolio – sectorwise



Advances portfolio by business – unitwise



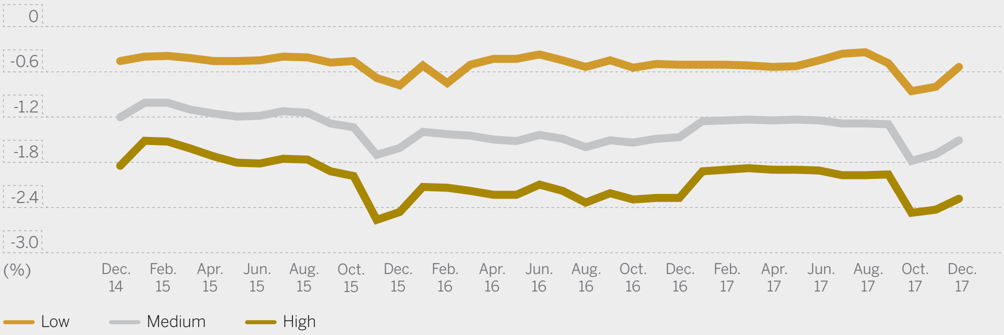
Reduction in gross NPA and NPA (Net of IIS) during the year



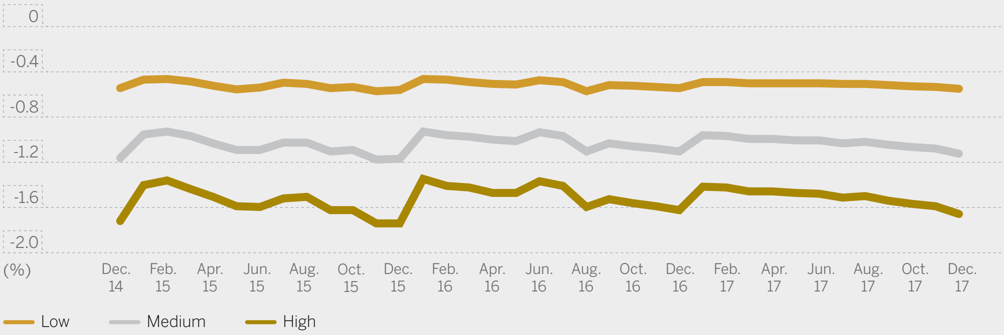
Net infection ratio of the advances portfolio during the year

Stress tests on credit risk as at 31 December 2017

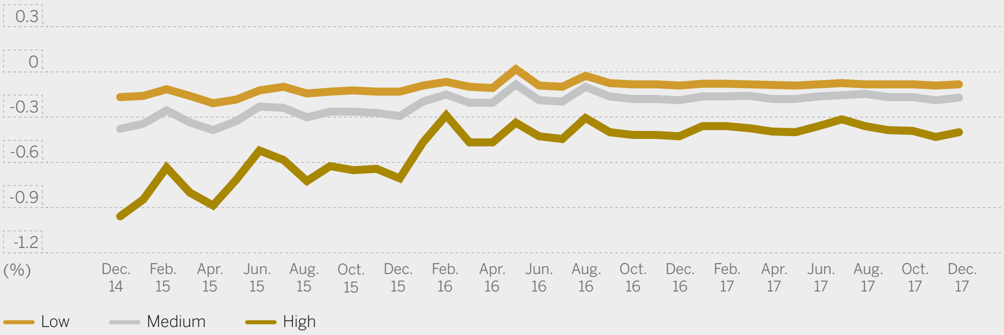
Stress test on the credit concentration risk – default by large borrowers – Net Impact on CAR



Asset classification downgrading stress test – Net impact on CAR



Stress test on fall in collateral value – net impact on CAR



Additional quantitative disclosures made in other sections of this Annual Report:

- Credit quality of financial assets and allowances for impairment held by the Bank against those assets (on page 230 of the 2017 Financial Statements)
- Details of the collateral types (on page 231 of the 2017 Financial Statements)
- Analysis of rupee gross loans and receivables by product (Note 24.1.1 of the 2017 Financial Statements)
- Analysis of foreign currency gross loans and receivables by product (Note 24.1.1 of the 2017 Financial Statements)
- Analysis of gross loans and receivables by currency (Note 24.1.2 of the 2017 Financial Statements)
- Analysis of gross loans and receivables by industry-wise (Note 24.1.3 of the 2017 Financial Statements)
- An analysis of concentrations of credit risk of loans and receivables by geographic locations (Note 24.1.4 of the 2017 Financial Statements)
- Movement in impairment allowance on loans and receivables (Note 24.3 of the 2017 Financial Statements)

Credit risk exposures and RWA calculated under the standardised approach as at 31 December 2017

Credit risk exposures and Credit Risk Mitigation (CRM) effects

	Amount as at 31 December 2017						
	Exposures before Credit Conversion Factor (CCF) and CRM		Exposures post CCF and CRM			RWA and RWA Density (%)	
Description	On-balance Sheet amount LKR '000	Off-balance Sheet amount LKR '000	On-balance Sheet amount LKR '000	Off-balance Sheet amount LKR '000	Total LKR '000	RWA LKR '000	RWA Density (ii) %
Claims on Central Government and CBSL	99,044,422		99,044,422		99,044,422	2,093,224	2.11
Claims on foreign sovereigns and their Central Banks	–	–	–	–	–	–	0.00
Claims on public sector entities	–	–	–	–	–	–	0.00
Claims on official entities and multilateral development banks	–	–	–	–	–	–	0.00
Claims on Bank's exposures	2,530,376	54,981	2,530,376	54,981	2,585,357	1,559,252	60.31
Claims on financial institutions	16,518,517	22,593	16,509,567	22,593	16,532,160	14,850,982	89.83
Claims on corporates	94,909,232	102,092,016	90,529,964	14,770,086	105,300,049	104,411,493	99.16
Retail claims	146,935,619	33,567,964	118,647,857	6,035,947	124,683,804	87,768,128	70.39
Claims secured by residential property	15,634,841	–	15,590,960	–	15,590,960	8,176,915	52.45
Claims secured by commercial real estate	–	–	–	–	–	–	–
Non-performing assets (NPAs) (i)	10,216,069	–	10,216,069	–	10,216,069	14,853,779	145.40
Higher-risk categories	–	–	–	–	–	–	–
Cash items and other assets	24,032,962	–	24,032,962	–	24,032,962	16,251,941	67.62
Total	**409,822,038**	**135,737,554**	**377,102,177**	**20,883,607**	**397,985,783**	**249,965,714**	**62.81**

(i) NPAs – As per Banking Act Directions on classification of loans and advances, income recognition and provisioning.
(ii) RWA Density – Total RWA/Exposures post CCF and CRM.

Credit risk under standardised approach: Exposures by asset classes and risk weights

	Amount as at 31 December 2017 (Post CCF and CRM) (LKR '000)								
Risk-weight	0%	20%	50%	60%	75%	100%	150%	>150%	Total credit exposures amount
Asset classes									
Claims on Central Government and CBSL	88,578,301	10,466,121	–	–	–	–	–	–	99,044,422
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	–	995,475	459,450	–	–	1,130,432	–	–	2,585,357
Claims on financial institutions	–	–	3,362,355	–	–	13,169,805	–	–	16,532,160
Claims on corporates	–	351,975	1,305,376	–	–	103,551,274	91,425	–	105,300,049
Retail claims	–	–	–	15,493,549	89,911,320	9,946,910	–	–	115,351,779
Claims secured by gold	3,953,187	5,359,050	–	–	–	19,788	–	–	9,332,025
Claims secured by residential property	–	–	14,828,091	–	–	762,869	–	–	15,590,960
Claims secured by commercial real estate	–	–	–	–	–	–	–	–	–
Non-performing assets (NPAS) (i)	–	–	62,647	–	–	815,355	9,338,067	–	10,216,069
Higher-risk categories	–	–	–	–	–	–	–	–	–
Cash items and other assets	7,613,487	209,417	–	–	–	16,210,058	–	–	24,032,962
Total	**100,144,975**	**17,382,038**	**20,017,919**	**15,493,549**	**89,911,320**	**145,606,491**	**9,429,492**	**–**	**397,985,783**

Market risk management

Market risk management is considered and established to promote oversight of all market risks the Bank is exposed to, where a framework is put in place to systematically identify, assess, monitor and management report the risk arising due to the volatility of market factors.

The Bank's capacity to take risks is set out in our Risk Appetite Framework. Within this framework, we monitor a range of risk metrics to make sure our risk profile is in line with our appetite for risk. Timely reporting of such risks helps the Senior Management to promote effective decision-making. The risk managers identify these types of risks through active portfolio analysis and engagement with the business areas.

The Bank's most important risks and control measures are regularly reported and discussed by the Executive risk committees and the Board Risk Committee. Both financial and non-financial risk reports are reviewed in detail, with regard to liquidity, interest rate risk and market risk. We conduct bank-wide and portfolio-specific stress tests to assess resilience in specific market conditions. Underlying assumptions and metrics are regularly reviewed to ensure they stay relevant in a constantly changing environment.

Risk policies, procedures and standards

The Bank has a framework of risk management policies, procedures and standards in place to create consistency throughout the organisation, and to define requirements that are binding to all related business units.

There are also separate policies, procedures and standards unique and relevant to market risk management such as the Market Risk Policy, Liquidity Policy, Stress Testing Policy, the limit frame work, the regulatory guidelines and other policies which contribute to the market risk management framework.

The governance framework of the risk taking business units are aligned with the Bank's risk framework and meets regulatory and internal requirements. The Market Risk Management is responsible to ensure policies, procedures and standards are implemented and adhered accordingly. Policies, procedures and standards are regularly reviewed and updated via the relevant Executive risk committees to reflect changes in markets, products and practices.

Managing and measuring market risk

To ensure dynamism in risk monitoring and management, the Bank has put in place a treasury system which facilitates enhanced and real time risk monitoring. This has boosted the robustness of Treasury Middle Office to monitor the risk real time and escalate any exceptions to the Management.

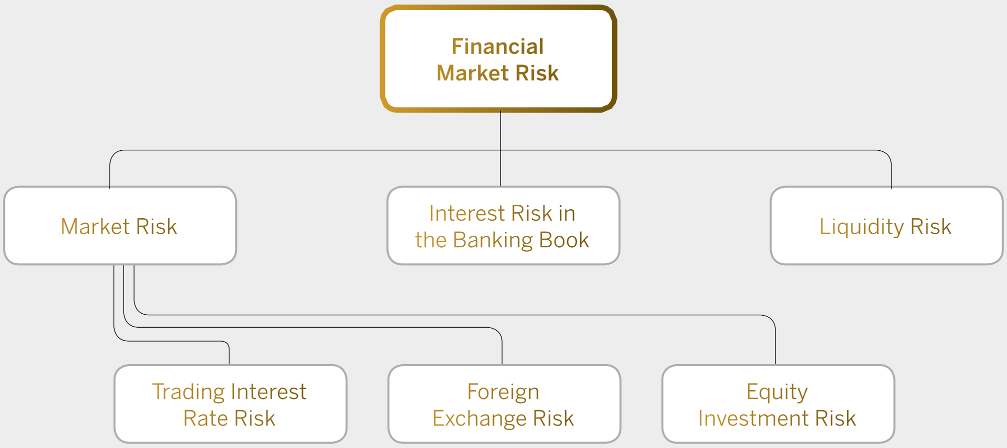
A set of limits ensures the risk-taking units do not exceed the aggregate risk and concentration parameters set by the Board. Limits are set for business units and individuals.

Independent mark to market valuations, reconciliation of positions and tracking stop losses for trading positions on a timely basis are done more frequently and reported timely to expedite relevant decision-making.

Key financial market risk categories

The key financial risks the Bank is exposed to can be divided into market risk (including trading interest rate, equity, and foreign exchange risks), funding liquidity risk and interest rate risk in the banking book.

The table below presents the key financial risk categories which are associated with Seylan Bank's business activities linked to market risk:



Market risk Capital charge calculated under the standardised approach as at 31 December 2017

Item	RWA amount as at 31 December 2017 (LKR '000)
(a) Capital charge for interest rate risk	
General interest rate risk	83,838
(i) Net long or short position	83,838
(ii) Horizontal disallowance	–
(iii) Vertical disallowance	–
(iv) Options	–
Specific interest rate risk	–
(b) Capital charge for equity	27,649
(i) General equity risk	16,726
(ii) Specific equity risk	10,923
(c) Capital charge for foreign exchange and Gold	4,053
Total Capital charge for market risk [(a)+(b)+(c)]	115,540
Total risk weighted assets on market risk	1,027,022

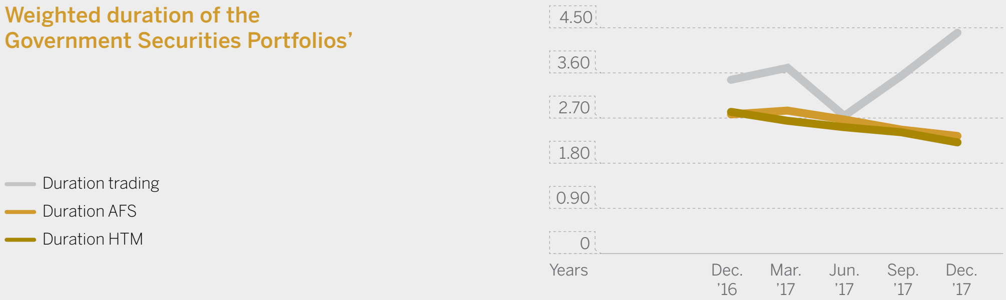
Trading interest rate risk

Our primary mechanism to manage trading interest rate risk is the application of our Risk Appetite framework of which the limit framework is a key component. The Management and Board supported by market risk management, sets portfolio limits for market risk in the trading book. These limits are allocated to our Treasury Division and individual business units based on established and agreed business plans. We have also businesses aligned with market risk management to establish business limits, by allocating the limits down to individual portfolios and cumulative exposures.

Interest rate risk on the trading book is marked to market on a daily basis and reported to the Management weekly or more frequently during volatile market movements.

The following graph represent the weighted average duration of the Government Security portfolios from 31 December 2016 and 31 December 2017:

Weighted duration of the Government Securities Portfolios'



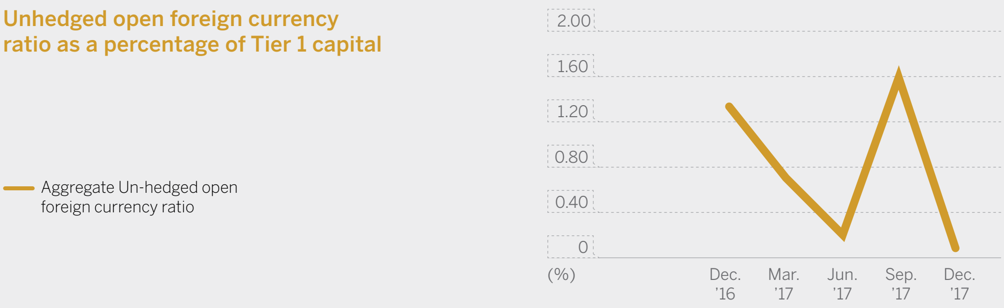
Foreign exchange risk

Foreign exchange risk is the current or potential risk to earnings and capital that arises from adverse movements in foreign exchange rates.

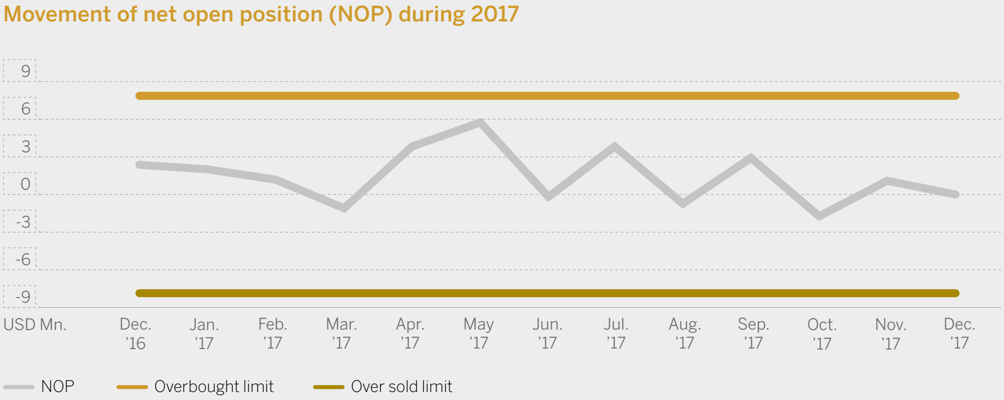
The foreign exchange risk is monitored daily and discussed at the Asset and Liability Committee on a monthly basis. Limits are agreed and approved by the Board of Directors. The risks in holding foreign currency exposures are reduced by applying individual currency limits and the overall exposure is managed within the Net Open Position (NOP) limit defined by the regulator. Individual and cumulative Intraday limits, Daylight limits and Overnight limits are defined for the treasury dealers to operate within these boundaries to mitigate the risk emanated through these exposures.

The basket of currencies held in the portfolio is translated in US Dollar terms for overall limit monitoring purposes and to interpret the general currency exposures. However when revaluing the currency exposures the individual currency value is taken into consideration for cash and forward exposures. A portion of foreign assets is held under foreign exchange swap agreements. These do not expose the Bank to exchange rate risk because, at the time the forward foreign exchange contract is entered to, an exchange rate for the reversal on a future date is agreed.

The following graph presents the NOP as a percentage of the Tier 1 Capital from 31 December 2016 to 31 December 2017:



NOP movement during the year is depicted in the following graph:



Currency wise maturity gap reports of the main currency exposures (USD, GBP and EUR)

Bucket	Currency	Assets '000	Liabilities '000	Mismatch '000	Cumulative Gap USD '000	As a percentage of total liabilities	(-/+) Mismatch limits %
RL: < 1 month	USD	68,910	94,044	-25,134	-25,134	-6.34	20
RL: 1-3 months		117,456	70,173	47,282	22,148	5.59	20
RL: 3-6 months		79,563	52,642	26,921	49,069	12.39	20
RL: 6-12 months		15,996	70,403	-54,407	-5,337	-1.35	30
RL: 1-3 years		68,733	7,741	60,992	55,655	14.05	20
RL: 3-5 years		38,312	85,450	-47,138	8,517	2.15	20
RL: 5-10 years		2,860	0	2,860	11,377	2.87	10
RL: >10 years		4,093	15,732	-11,639	-262	-0.07	10
Exposure		395,923	396,184	-262			

Bucket	Currency	Assets '000	Liabilities '000	Mismatch '000	Cumulative Gap GBP '000	As a percentage of total liabilities	Negative Mismatch limits %
RL: < 1 month	GBP	9,376	1,897	7,478	7,478	52.10	20
RL: 1-3 months		4,148	2,896	1,251	8,730	60.82	20
RL: 3-6 months		45	1,680	-1,635	7,095	49.43	20
RL: 6-12 months		90	7,837	-7,747	-652	-4.54	30
RL: 1-3 years		359	0	359	-293	-2.04	10
RL: 3-5 years		167	0	167	-127	-0.88	10
RL: 5-10 years		123	0	123	-4	-0.02	10
RL: >10 years		47	43	4			
Exposure		14,353	14,353	0			

Bucket	Currency	Assets '000	Liabilities '000	Mismatch '000	Cumulative Gap EUR '000	As a percentage of total liabilities	Negative Mismatch limits %
RL: < 1 month	EUR	3,326	1,687	1,639	1,639	13.25	20
RL: 1-3 months		8,892	5,667	3,225	4,864	39.33	20
RL: 3-6 months		0	399	-399	4,465	36.10	20
RL: 6-12 months		0	4,439	-4,439	26	0.21	30
RL: 3-5 years		0	25	-25	1	0.01	10
RL: >10 years		154	151	3	4	0.04	10
Exposure		12,372	12,368	4			

Equity price risk

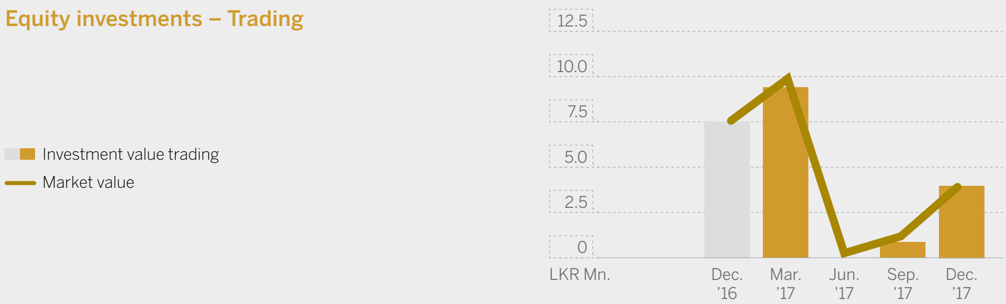
The Bank maintains a strategic portfolio with a not so large equity exposure in the AFS book, and a very small exposure in the trading book.

The management of the price risk of equity investments is the responsibility of the treasury department with oversight of the Treasury Investment Committee.

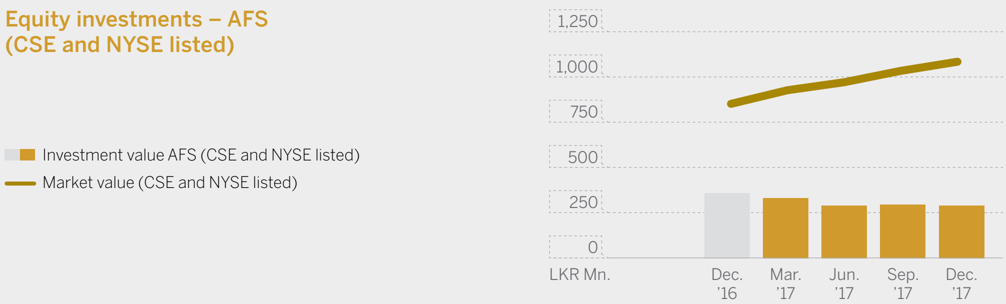
Market risk management unit acts independently in monitoring and reporting the equity investments risk, and is responsible for reporting the impact on earnings on a daily basis to the Treasury Investment Committee and the impact on earnings and regulatory capital on a monthly basis to ALCO and the Risk Committee and subsequently to the Board.

The Graphs represents the investments in the Trading and the AFS portfolios and the behaviour of market values of the equity investment portfolios:

Equity investments – Trading



Equity investments – AFS (CSE and NYSE listed)



Interest Rate Risk in the Banking Book (IRRBB)

Interest rate risk in the banking book arises principally from mismatches between the future yield of assets and their funding cost (deposit liabilities) as a result of interest rate changes. The aim through the management of IRRBB is to mitigate the effect of prospective interest rate movements that could reduce future net interest income, while balancing the cost of such hedging activities on the net revenue stream. Analysis of this risk is sometimes complicated for products where the contractual terms tend to differ from the actual duration, due to unpredictable customer behaviours. For these products, assumptions are used to allow more accurate analysis.

Managing IRRBB includes the impact of interest rate shocks on the change in Economic Value of Equity (ΔEVE) and Net Interest Income (NII) based on prescribed scenarios. The aim is to promote greater consistency, transparency and comparability in the measurement and management of IRRBB.

The following table presents a change in annual net interest income with the rate change by +/-100, 200 and 250 bps and balance sheet assumed to be stable.

The analysis is based on the following assumptions:

- For a rate increase: interest on savings accounts shall not increase except when rates increase by 250 bps where the savings component will be increased by 75 bps only.
- The interest sensitive assets and liabilities are bucketed on their reprising maturities or failing which on their contractual maturities.

Change in the net interest income per annum	31 December 2017 LKR '000	31 December 2016 LKR '000
100 bps	+/- 289,717	+/- 265,419
250 bps	+/- 743,314	+/- 680,274

Funding and liquidity risk

Funding and liquidity risk management has two dimensions:

- Liquidity risk management focuses on having a sufficient buffer to cope with a short-term situations.
- Funding risk management ensures long-term compliance with both internal and external goals.

Managing funding and liquidity risk focuses both on "business as usual" (based on the run-off profile to show the stickiness of deposits combined with the run-off of assets without new production) on a stressed situation.

For liquidity risk, the Bank focuses the time to survive under cash flow projections, while for funding risk we focus on having a stable funding profile.

Managing liquidity risk

The Bank seeks to manage liquidity risk across all classes of assets and liabilities to ensure that even under adverse conditions; we have access to funds at a reasonable cost. Ultimate responsibility for liquidity management lies with the Bank's Asset Liability Committee, with Treasury managing the liquidity and funding needs of the Bank on a daily basis.

Deposits represent the Banks principal source of funding. Our well-diversified retail deposit base represents a large portion of our funding concentration and a portion of hot-money has been raised from corporate and institutional clients. The Bank raises funds locally or internationally, mostly through the funding concentration, including repurchase agreements, borrowings and money market instruments.

At Seylan Bank essential ingredients in managing liquidity risk are in tapping available sources of liquidity, preserving necessary funding capacity, and continuous contingency planning. Liquidity targets are maintained to ensure that even under adverse conditions; funds are available to cover customer needs, maturing liabilities, and other funding requirements.

Liquidity risk mitigation techniques

Liquidity risk management

Liquidity risk is the risk that the banks would incur losses because it finds it difficult to secure the necessary funds or is forced to obtain funds at far higher interest rates than under normal conditions due to a mismatch between the maturities of assets and liabilities or an unexpected outflow of funds.

At Seylan Bank liquidity risk is managed in the following manner:

- Asset Liability Management (ALM) Policy of the Bank specifically deals with liquidity and interest rate risk management.
- As envisaged in the ALM policy, liquidity risk is managed through the traditional floor approach better known as the "Gap Analysis" based on the residual maturity/behavioural pattern of assets and liabilities as prescribed by CBSL and against prudential (tolerance) limits set for different residual maturity time buckets.
- Daily the Bank monitors liquidity risk through the stock approach by implementing ratios' and limits to monitor the Bank's liquidity requirements and to monitor the long term and short term funding concentration of the Bank for efficient asset/liability management.
- The Bank has also put in place a mechanism of short term dynamic liquidity and contingency plan for liquidity risk management.
- Contingency Funding Plan (CFP), approved by the Board sets the process to take care of a crisis situation in the event of liquidity crunch or a run on the Bank. A comprehensive set of early warning indicators has been designed to forewarn of impending liquidity stress.

Liquidity Coverage Ratio (LCR)

While the LCR complements the internal stress testing framework, maintaining a ratio in excess of minimum regulatory requirements, ensures that the Bank holds adequate liquidity resources to mitigate a short-term liquidity stress.

Our LCR of 122% as of 31 December 2017 has been calculated in accordance with the regulatory guidelines.

LCR components	31 December 2017 liquidity value LKR Mn.	31 December 2016 liquidity value LKR Mn.
High quality liquid assets	56,261	49,394
Gross outflows	68,382	59,651
Gross inflows	22,243	15,195
Net outflows	46,139	44,456
LCR ratio (%)	122	111

Basel III computation of liquidity coverage ratio

	Reporting period 31 December 2017			Previous reporting period 31 December 2016		
Item	Total un-weighted value LKR '000	Factor %	Total weighted value LKR '000	Total un-weighted value LKR '000	Factor %	Total weighted value LKR '000
Total stock of high-quality liquid assets (HQLA)	–	–	56,261,229	–	–	49,394,168
Total adjusted level 1A assets	56,553,893	–	56,553,893	48,632,173		48,980,791
Level 1A assets	56,157,004	100	56,157,004	48,922,886	100	49,271,504
Total adjusted level 2A assets	–	–	–	–	–	–
Level 2A assets	–	–	–	–	–	–
Total adjusted level 2B assets	–	–	104,225	–	–	122,664
Level 2B assets	208,450	50	104,225	245,327	50	122,664
Total cash outflows	–	–	68,381,552	–	–	59,650,950
Deposits	241,876,890	10	24,187,689	243,863,772	10	24,386,377
Unsecured wholesale funding	58,961,390	25-100	28,263,268	24,262,592	25-100	14,203,211
Secured funding transactions	–	–	–	–	–	–
Undrawn portion of committed (irrevocable) facilities and other contingent funding obligations	96,478,724	0-100	6,773,396	61,410,634	0-100	4,716,183
Additional requirements	9,157,199	100	9,157,199	16,345,179	100	16,345,179
Total cash inflows	–	–	22,242,860	–	–	15,194,686
Maturing secured lending transactions backed by collateral						
Committed facilities	3,719	0	–	7,490	0	–
Other inflows by counterparty which are maturing within 30 days	40,923,442	50	20,461,721	26,560,403	50	13,280,202
Operational deposits	1,159,518	0	–	842,058	0	–
Other cash inflows	3,562,278	50	1,781,139	3,828,968	50	1,914,484
Liquidity coverage ratio (%) (stock of high quality liquid assets/total net cash outflows over the next 30 calendar days)* 100	–	–	121.94	–	–	111.11

Stress testing

Stress testing is an integral component of our risk and capital management framework. It allows us to assess potential vulnerabilities to the business. It also helps to understand the sensitivities of the core assumptions in our strategic and capital plans; and improve decision-making through balancing risk and return.

In addition to internal stress test scenarios reflecting the outcomes of the annual risk assessments, the Bank also performs regular stress test exercises for management insight and timely decision-making.

The stress test are generally carried out applying static balance sheet assumptions either at a close of a month, quarter or the end of a financial year.

The result of the stress test reaffirms the resilience of our business models and the strength of the Bank's capital base. Our commitment to maintain a robust, Capital Adequacy Ratio (CAR) in excess of the prevailing requirements remains.

Stress tests carried out for the trading exposures and their impact on profit and capital is depicted below:

I. Trading interest rate risk

Trading interest rate risk on the Government Security treasury bond portfolio		31 December 2017	
Face value LKR '000	Market value LKR '000	Portfolio duration Years	Present CAR %
3,673,896	3,990,111	4.49	13.25

PV01 – Deviation in the price of a bond due to 01 basis point change in yield

Increase in rates by	Change in WA portfolio duration	Impact on Earnings '000	Impact on CAR %
100 bps	4.49	179,349	-0.01
200 bps		358,698	-0.02
300 bps		538,047	-0.03

II. Foreign exchange risk

Sensitivity of the foreign exchange exposure as at 31 December 2017

Net open position (prior to stress)	Net open position USD '000	Open position LKR '000	Capital charge on open position (RWA)	Current CAR %
	-134	-20,887	-2,089	13.25

Net open position after Stress Test

Scenario	Shock levels (appreciation)	Adjusted position LKR	Impact on P and L	Impact on required capital		Impact on CAR %
*Minor	5%	-19,843	1,044	-1,984	104	0.00
Moderate	10%	-18,798	2,089	-1,880	209	0.00
Major	15%	-17,754	3,133	-1,775	313	0.00

** Negative shocks represent an appreciation of LKR/USD*

III. Equity price risk

Sensitivity of the equity trading exposure as at 31 December 2017

Equity position (Prior to stress)	Invested value LKR '000	Equity carrying value LKR '000	Specific capital charge	General capital charge	Total capital required	Current CAR (%)
	4,043	3,719	186	372	558	13.25

Equity position after stress test

Scenario	Shock levels	Adjusted equity net position LKR '000	Impact on P and L LKR '000	Specific capital charge LKR '000	General capital charge LKR '000	Adjusted capital required LKR '000	Net impact on CAR %
Minor	-10%	3,347	-372	167	335	502	0.00
Moderate	-20%	2,975	-744	149	297	446	0.00
Major	-30%	2,603	-1,116	130	260	390	0.00

Sensitivity of the equity AFS Exposure as of 31 December 2017

Equity position (Prior to stress)	Invested value (CSE Listed) LKR '000	Equity carrying value (CSE Listed) LKR '000	Specific capital charge	General capital charge	Total capital required	Current CAR %
	208,798	163,546	10,737	16,355	27,091	13.25

Equity position after stress test

Scenario		Equity Net Position	Impact on OCI	Specific capital charge	General capital charge	Adjusted capital required	Net Impact on CAR
Minor	-10%	147,191	-16,355	9,663	14,719	24,382	-0.01%
Moderate	-20%	130,837	-32,709	8,589	13,084	21,673	-0.01%
Major	-30%	114,482	-49,064	7,516	11,448	18,964	-0.02%

Stressed LCR

LCR for an increase in interest rates by 1% and its impact on the Government Security Portfolio and the impact on LCR:

Description	31 December 2017		31 December 2016	
	Actual LCR LKR Mn.	Stressed LCR LKR Mn.	Actual LCR LKR Mn.	Stressed LCR LKR Mn.
Stock of high quality liquid assets	56,261	54,747	49,394	47,610
Total outflows	68,382	68,382	59,651	59,651
Total inflows	22,243	22,243	15,195	15,195
Net cash outflows	46,139	46,139	44,456	44,456
Liquidity coverage ratio (%)	122	119	111	107

Linkage between Accounting and regulatory exposure amounts

Exposure to market risk is separated into two portfolios:

- Trading portfolios comprise positions arising from market making. The instruments classified as under this portfolio is Disclosed in Note 23 to the 2017 Financial Statements
- Non-trading portfolios comprise positions that primarily arise from the interest rate management of our retail and commercial banking assets and liabilities, financial investments designated as available for sale (AFS) and held to maturity (HTM). The instruments classified as AFS and HTM are disclosed in Notes 25 and 26 to the 2017 Financial Statements

Other risks managed under market risk management

Counterparty credit risk

Counterparty credit risk is the risk arising from the possibility that the counterparty may default on amounts owned on a transaction. Financial transactions that derive their value from the performance of assets, interest or currency exchange rates get included in structuring the obligation where debt obligations and deposits, swaps, futures and forward contracts are considered for the combination.

Counterparty credit risk which is managed and monitored by Treasury Middle Office are mostly transactions entered by treasury and a combination of trade transactions entered with foreign and locale financial counterparts. The treasury related transactions include all foreign currency contracts, Money market transactions, and outright treasury transactions entered with local and foreign counterparts. A limit framework is put in place in managing the counterparty credit risk. Treasury Middle Office monitors on a real time basis the utilisation of each counterparty; against the stipulated limit and a daily reporting is carried out to appraise the Senior Management of any irregularities in the limits.

Country risk concentration

Country risk is the risk that arises due to adverse events occurring in a specific country. Country risk is the risk of loss for the Bank associated with lending, pre-settlement, money market and investment transactions as a result of country risk events. A country risk event can be described as economic, financial and political shocks and transfer or exchange restrictions, affecting all counterparties in a specific country. The occurrence of a country risk event may cause all counterparties in a country to be unable to ensure timely payments, despite their willingness to meet their contractual debt obligations. As such, country risk is an additional factor the Bank has taken into account in the credit approval process of individual counterparties, as the country risk event probability may impact the default probability of individual counterparties. Country risk ratings represent a key tool in our management of country risk. They are established by an independent country risk research function within our credit risk management function.

We manage our exposure to country risk through a framework of limits. The Bank specifically limits and monitors its exposures to countries with trade barriers and embargo's. Limits are reviewed at least annually, in conjunction with the review of country risk ratings. Country risk limits are approved by the Board and are monitored daily by Treasury Middle Office.

Operational risk management

Operational risk is the potential risk of loss or damage arising from inadequacy of internal processes, people and systems, controls or from external events such as natural disasters, social or political events that may impact the Bank. The Bank is exposed to operational risk as it is inherent in all banking products and processes.

This risk is intrinsic to the Bank in all its material products, activities, processes and systems, and is emerging as an important component of the enterprise-wide risk management system. Dealing with operational risks is a key element of the Integrated Risk Management Framework of the Bank.

Operational risk management framework and responsibilities

Under the Comprehensive Operational Risk Management Policy and the Framework, the roles and responsibilities for operational risk have been defined from Board level to business unit levels. Operational risk is monitored on a regular basis and the operational risk management policy framework is practiced in the daily activities of all employees.

The objective of the Operational Risk Management (ORM) division is to establish sound control practices to increase the effectiveness of the Bank's resources and minimise financial losses. It has developed comprehensive practices under the following policies and techniques to assist in identifying, measuring, monitoring and reporting operational risk:

- Operational risk management
- Corporate information security
- Business continuity management
- Incident and near miss management
- Fraud risk management
- Insurance governance
- Business process outsourcing
- Risk Control Self-Assessment (RCSA)
- Internal Loss Data Analysis (ILD)
- Key Operational Risk Indicators (KORI)

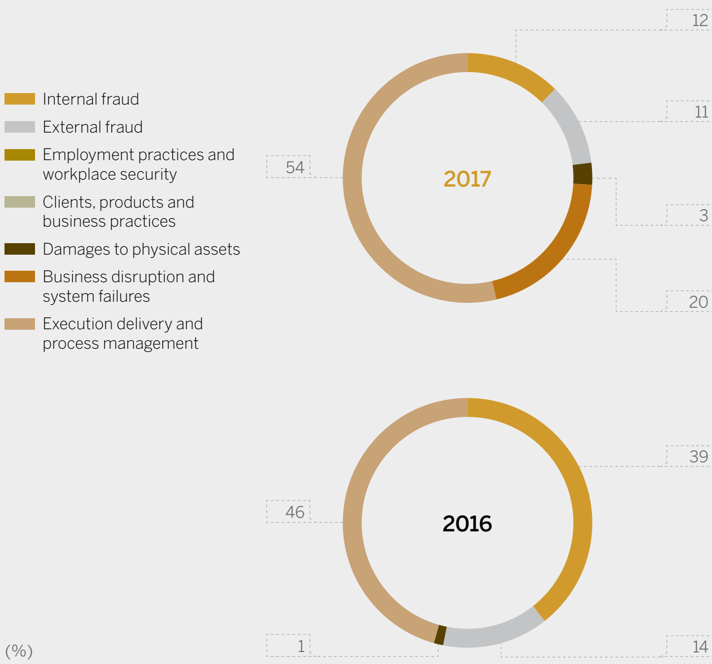
The operational risk management function is enabled through the day-to-day management within a predefined framework. The Head of operational risk function reports to the Chief Risk Officer (CRO) and an Executive Market and Operational Risk Management Committee (EMORMC) for reporting and oversight. The CRO accordingly represents the risk function at the Board Integrated Risk Management Committee (BIRMC) for reporting and accountability. The BIRMC ensures appropriate implementation of its instructions through the defined governance structure.

Operational risk management concepts and mitigants

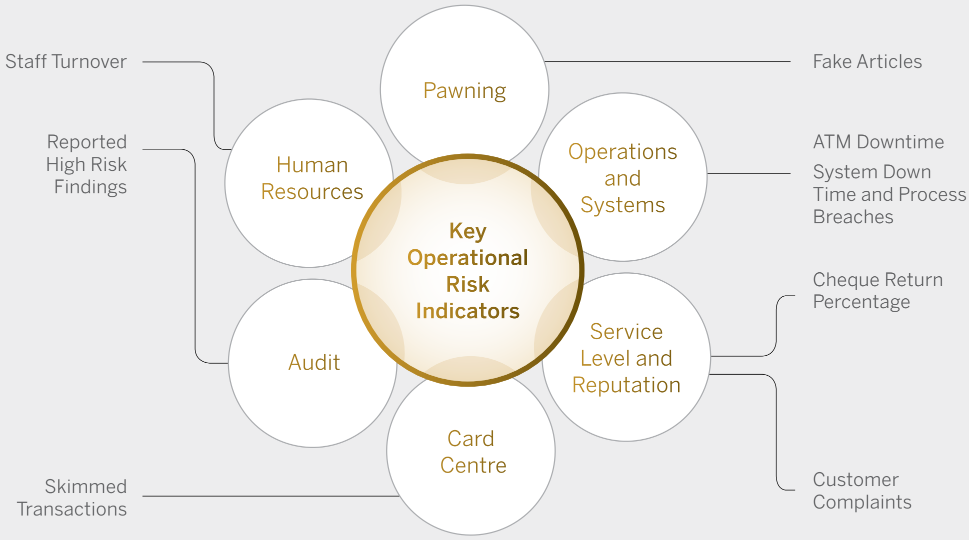
Based on Basel III and regulatory requirements, Industry best practices have been used to design the following risk management techniques to monitor and manage operational risk at the Bank.

Technique	Management/mitigation
Risk control Self-Assessment process (RCSA)	Centralised key business units/branches of the Bank carry out RCSA at least on an annual basis for their business processes to identify the inherent risks proactively. Findings from the RCSA exercise are used to mitigate the residual risks through implementation of proper action plans and control improvements.
Collecting and analysing Internal Loss Data (ILD), incident and near-miss data collection	ILDs are classified into seven loss types as per Basel guidelines and into four broad business lines such as Trading Sales, Payments Settlements, Retail Banking, Commercial Banking in which Bank operates its activities. Loss events exceeding LKR 500,000 have been reported as required by the Central Bank of Sri Lanka (CBSL) quarterly. Following graph exhibits the operational losses incurred for the last two years. The gross operational losses in 2017 increased to LKR 44.6 Mn. compared to LKR 29.7 Mn. in 2016. The major contributors to operational losses attributed to execution delivery process management and business disruption system failures. The control environment, insurance arrangements and disciplinary actions taken against the policy violators could be considered as mitigating actions on it, besides the RCSA exercise. Further the operational losses incurred in year 2017 are reported under mainly the retail banking business lines and the following charts exhibit the operational losses incurred for last two years with the drill down of the same.

Operational loss



Technique	Management/mitigation
Establishing and reviewing Key Operational Risk Indicators (KORI)	KORIs are reported to each designated meeting by way of a dashboard and monitored against the corresponding threshold levels. The appropriate action plans are directed to mitigate the risks based on those indicators.



Technique	Management/mitigation
Reviewing information risk, integrity and availability	Bank is in the position to identify and respond to suspect information flows and intruder attacks while observing the system readiness through the information risk management practices using the tools and techniques such as modern firewall technologies, intruder detection and prevention systems. The Bank has implemented Baseline Security Standards in compliance with regulatory requirement and has deployed softwares to continuously monitor cyber attacks. As per the Information Security Policy Framework all IT modifications/ implementations are reviewed for information security aspects to avoid operational losses.
Effectiveness of business continuity and disaster recovery plans (BCP)	Business continuity planning (BCP) ensures the capability and resilience to business disruption that may arise from internal or external events and should reduce any adverse impact on business operations, as well as profitability and reputation. Bank has a well-established Disaster Recovery Site and carried out several drills for critical systems including core banking systems in order to verify the readiness of business continuity related issues. The related executive committees and regulators are updated on outcomes of the BCP DR drills with the appropriate actions.
Outsourcing services	Outsourcing takes place when the Bank uses another party to perform non-core banking functions that would traditionally have been undertaken by the Bank itself. As a result, Bank will be benefited in focusing its core banking activities while having the non-core functions being taken care by outside experts. Bank has outsourced some business functions under its comprehensive policy after evaluating whether the services are suitable for outsourcing based on assessment of the risks involved and undertaking due diligence tests on the companies concerned such as credibility and ability of the owners, BCP arrangements, technical skilled manpower capability, financial strength etc.
Insurance arrangements	Bank has taken cover from the insurance providers as one of the risk mitigation strategies for high severity, low probability and the uncontrollable operational risk events such as natural disasters, fire as well as internal and external frauds, errors, omissions, hold up, employee fidelity etc. However, insurance has not been used for taking upon us risks that would otherwise not be undertaken thereby avoiding moral hazards. The insurance policy is reviewed annually for effectiveness of the same.

Technique	Management/mitigation
Reviewing new products/processes	Bank was able to provide risk assurance for the newly-implemented products through Product Management Policy. This procedure includes the proactive risk identification, assessment and introduced mitigation control for risks inherent to new products, processes, systems and their amended versions as well as to projects that have a material impact on Bank's operations.

Operational risk mitigation techniques

a. Bank has taken cover from the insurance providers as one of the risk mitigation strategies for high severity low probability and the uncontrollable operational risk events such as natural disasters, fire as well as internal and external frauds, errors, omissions, hold up, employee fidelity etc. However, insurance has not been used for taking upon us risks that would otherwise not be undertaken thereby avoiding moral hazards. The insurance policy is reviewed annually for effectiveness of the same.

b. Business continuity planning (BCP) ensures the capability and resilience to business disruption that may arise from internal or external events and should reduce any adverse impact on business operations, as well as profitability and reputation. Bank has a well-established Disaster Recovery Site and carried out several drills for critical systems including core banking systems in order to verify the readiness of business continuity related issues. The related executive committees and regulators are being updated on outcomes of the BCP and DR drills with the appropriate actions.

c. Bank uses a set of key control mechanisms to monitor and control its operational risk. These are monitored through Key Operational Risk Indicators (KORI) which are reported to each designated meeting by way of a dashboard and monitored against the corresponding threshold levels. The appropriate action plans are directed to mitigate the risks based on those indicators.

Operational risk under basic indicator is as follows:

		Gross income		
	LKR '000	2017 LKR '000	2016 LKR '000	2015 LKR '000
Gross Income		20,568,345	17,709,785	15,895,931
Capital Charge (15%)	2,708,703			
Risk-weighted amount for operational risk	24,077,361			

Details of outsourcing activities

Outsourcing involves transferring responsibility for carrying out Information Technology and Business Processing functions (previously carried on internally) to an outsourcer for an agreed charge. The outsourcer provides services to the Bank based on a mutually agreed service level, normally defined in a formal contract.

Many commercial benefits have been ascribed to outsourcing, the most common amongst these being:

- Reducing the costs
- Greater focus on core banking business by outsourcing non-core functions
- Access to world-class skills and resources
- Resource optimisation in limited duration projects

Despite the potential benefits information security incidents such as inappropriate access to or disclosure of sensitive information, loss of intellectual property protection or the inability of the outsourcer to live up to agreed service levels, would reduce the benefits and could jeopardise the security posture of the Organisation.

Definition and applicability

- An "Outsourcing arrangement" is an agreement between Seylan Bank PLC and a "Service Provider", whereby the service provider performs an activity, function or process connected with the operations of Seylan Bank PLC.
- Outsourcing arrangements shall be entered into only with "External Service Providers" who have specialised resources and skills to perform the related activities. (In compliance with CBSL Direction No. 2 of 2012).

- The CBSL directions for reporting purposes shall not apply to outsourced arrangements that are not directly related to the provision of financial services such as mail, courier services, catering of staff, housekeeping and janitorial services, security of premises, printing services (e.g. application forms, brochures etc.), recruitments on contract and temporary basis and communication services [as described under Section 2 (3) of CBSL Direction No. 2 of 2012].

Details of outsourced activities are given below –

Purpose	Name of the service provider
Recovery of overdue cards	Central Management Services (Pvt) Limited
Recovery of overdue cards (recovery call centre)	Central Management Services (Pvt) Limited
Recovery of overdue cards	Global Credit Management Services (Pvt) Limited
Recovery of overdue cards	KHC Recoveries Agency
Recovery of overdue cards	Colanka Management Services (pvt) Limited
Recovery of overdue cards	Rimacve Management Services (Pvt) Limited
Supply of man power (outsourced staff)	Central Management Services (Pvt) Limited
Canvassing new merchants/servicing existing merchants/installing POS terminals	Global Merchant Services (Pvt) Limited
Call centre operations	Scicom Lanka (Pvt) Limited
Providing hosted platform to function prepaid travel and rupee card	Yalamanchili International (Pvt) Limited
Acquiring of internet payment gateway transactions	Enstage (Pvt) Limited
EMV card embossing	Oberthur Technologies India Private Limited
M-Pay	CBA Solutions (Pvt) Limited
Printing of credit card statement	Digiscan Secure Print
Card centre data capturing	Bellvantage (Pvt) Limited
Cash transport	AB Securitas (Pvt) Limited
Cash transport	Certis Lanka Secure Logistics (Pvt) Limited
Printing of current A/C statements	Toppan Forms
Printing of FD renewals	Toppan Forms
Printing of cheque return notices	Toppan Forms
Printing of NRFC/RFC daily advices	Toppan Forms
Archiving	Trans National BPM Lanka
Check book printing	Toppan Forms
Check book printing	Lake House Printers and Publishers PLC
Corporate website	Efutures (Pvt) Limited
Rental of integrated data centre	Dialog Axiata (Pvt) Limited
Recovery of written-down and written-off	Rimacve Management Services (Pvt) Limited
Recovery of written-down and written-off	Global Credit Management Service Lanka (Pvt) Limited
Recovery of written-down and written-off	Interlanka Service Company
Recovery of written-down and written-off	Colanka Management Services (Pvt) Limited
Recovery of written-down and written-off	John Ford Credit Management (Pvt) Limited
Registrars to the Bank's debenture issue	S.S.P. Corporate Services (Pvt) Limited
Cash transport	Monaro Group Security Service (Pvt) Limited
Cash sorting	AB Securitas (Pvt) Limited
Cash sorting	Certis Lanka Secure Logistics (Pvt) Limited

Details of due diligence test of third party service providers

The Bank has developed a comprehensive policy in line with the Directions of the CBSL Direction No. 2 of 2012 and is fully implemented. This covers all aspects of due diligence controls such as comprehensive assessment, complaint handling, service quality monitoring, review of information security and business continuity plans of service providers.

Capital

The Bank complied with the Capital requirement under Basel III issued by Central Bank of Sri Lanka. As part of its capital management process, the Bank seeks to maintain a prudent balance between the composition of its capital and its investment.

Item	Amount (LKR'000) Reporting period 2017
Common Equity Tier 1 (CET 1) capital after adjustments	30,686,859
Common Equity Tier 1 (CET 1) capital	32,204,715
Equity capital (stated capital)/assigned capital	11,228,269
Reserve fund	1,609,484
Published retained earnings/(accumulated retained losses)	17,020,748
Published accumulated Other Comprehensive Income (OCI)	343,969
General and other disclosed reserves	2,002,245
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	
Total adjustments to CET 1 capital	1,517,856
Goodwill (net)	–
Intangible assets (net)	363,451
Others*	1,154,405
Additional Tier 1 (AT 1) capital after adjustments	–
Total additional Tier 1 (AT 1) capital	–
Qualifying additional Tier 1 capital instruments	–
Instruments issued by consolidated banking and financial subsidiaries of the Bank and held by third parties	
Total Adjustments to AT 1 Capital	–
Investment in own shares	–
Others (specify)	–
Tier 2 capital after adjustments	5,764,305
Total Tier 2 capital	5,808,825
Qualifying Tier 2 capital instruments	5,227,575
Revaluation gains	581,250
Loan loss provisions	
Instruments issued by consolidated banking and financial subsidiaries of the Bank and held by third parties	
Total adjustments to Tier 2	44,520
Investment in own shares	–
Others	44,520
Total Tier 1 capital	30,686,859
Total capital	36,451,164

CET 1 capital increased during the year primarily due to 2017 profits and CET 1 was further supported by reducing of interest rates during 2017, and the available for sale portfolio valued at market value which was higher than its cost.

Risk-weighted assets (RWAs)

The RWAs increased in 2017 primarily due to growth in loans and advances of the Bank.

Basel III computation of capital ratios

	Amount (LKR '000) Reporting period 2017
Total risk weighted assets (RWA)	275,070,097
RWAs for credit risk	249,965,714
RWAs for market risk	1,027,022
RWAs for operational risk	24,077,361
CET 1 capital ratio (including capital conservation buffer, countercyclical capital buffer and surcharge on D-SIBs) (%)	11.16
of which: capital conservation buffer (%)	1.25
of which: countercyclical buffer (%)	–
of which: capital surcharge on D-SIBs (%)	–
Total Tier 1 capital ratio (%)	11.16
Total capital ratio (including capital conservation buffer, countercyclical capital buffer and surcharge on D-SIBs) (%)	13.25
of which: capital conservation buffer (%)	1.25
of which: countercyclical buffer (%)	–
of which: capital surcharge on D-SIBs (%)	–

Effective date for regulatory reporting of Basel III was 1 July 2017.

Computation of leverage ratio

Item	Amount (LKR '000) Reporting period 2017
Tier 1 capital	30,686,859
Total exposures	397,992,993
On-balance sheet items (excluding derivatives and securities financing transactions, but including collateral)	377,109,386
Derivative exposures	–
Securities financing transaction exposures	–
Other off-balance sheet exposures	20,883,607
Basel III leverage ratio (%) (Tier 1/total exposure)	7.71

Key regulatory ratios – capital and liquidity

Item	Minimum requirement	Reporting Period 2017	Previous reporting period 2016
Regulatory capital			
Common equity Tier 1 (LKR '000)	–	30,686,859	–
Tier 1 capital (LKR '000)	–	30,686,859	–
Total capital (LKR '000)	–	36,451,164	–
Regulatory capital ratios			
Common equity Tier 1 capital ratio (%)	5.75	11.16	–
Tier 1 capital ratio (%)	7.25	11.16	–
Total capital ratio (%)	11.25	13.25	–
Leverage ratio* (%)	3.00	7.71	–
Regulatory liquidity			
Statutory liquid assets			
Domestic banking unit (LKR '000)	–	77,783,808	64,070,857
Off-shore banking unit (USD '000)	–	41,711	34,342

Item	Minimum requirement	Reporting Period 2017	Previous reporting period 2016
Statutory liquid assets ratio			
Domestic banking unit (%)	20	23.57	22.68
Off-shore banking unit (%)	20	37.08	26.24
Liquidity coverage ratio – LKR (%)	80	160.30	129.27
Liquidity coverage ratio – All currency (%)	80	121.94	111.11

** Leverage ratio for regulatory reporting purpose will be effective from 1 January 2018.*

Current and future capital requirement

Capital planning

Overview and assessment process

The capital structure of banks is rigorously regulated by CBSL in view of the systemic risk that a bank failure carries and loss it can cause to the depositors and the consequent cost of bail-outs by the Government. Basel III focuses on risk management in the Bank and intends to link the business profile of the Bank to the risk profile and subsequently to the regulatory capital. There is thus an automatic calibration of business profile to the regulatory capital. Internal capital can, however, be different from the regulatory capital, which links require equity cushion to the risk profile of the Bank.

In practical terms, the role of capital in the Bank is to provide creditor protection. In other words, the role of capital is to act as a buffer against future unexpected losses, thereby protecting depositors and its other creditors. The amount of capital the Bank would hold therefore depends on the Bank's risk appetite, loss distribution (whether arising from credit, market or operational or any other kinds of risk), among other things.

The Finance Department prepares the budget with inputs from branches and business units. The budget prepared is sent to the CEO for challenge and review. After a thorough review of the plan, and a "go-ahead" signal, the Management submits the budget to the Board of Directors for final approval.

The Bank was well capitalised, with a total Capital Adequacy Ratio of 13.25% and a Tier 1 capital ratio of 11.16%, in excess of the mandatory regulatory requirements of the Basel III Tier 1 ratio of 7.25%, and total capital ratio of 11.25%.

Overall, the Statement of Financial Position remains strong and asset quality continued to gain traction with the net non-performing loan ratio reducing to 4.42%.

Sources of capital

The Bank raises the eligible Tier 1 as well as Tier 2 capital as and when required in order to expand the business and at the same time to meet the regulatory and internal capital requirements.

The following elements constitute the capital of the Bank, as deemed eligible by CBSL:

Tier 1 capital (core capital)

Core Capital items are:

Share capital, share premium, statutory reserve funds, published retained profits, General and other reserves, Surpluses/losses after tax arising from the sale of fixed and long-term investments.

Tier 2 capital (supplementary capital)

Supplementary capital includes, approved revaluation reserves, general provisions, Hybrid (debt/equity) capital items and Approved subordinated term debts.

Total capital base is the summation of the core capital (Tier 1) and the supplementary capital (Tier 2) less the necessary deductions.

Risk exposures in line with strategic plan

Strategic Plan 2017-2020

a. The Bank has devised a four-year Strategic Plan establishing targets across business segments. The business plan has been developed to double the Banking book over next four years at a Compound Annual Growth Rate (CAGR) of 20% and double profits by 2020 by taking into account the Bank's future growth outlook, average industry growth, peer growth and necessary inputs from CBSL published documents. Furthermore, the relevant macroeconomic parameters are factored in the calculations. Currently, the Bank employs a mix of top-down and bottom-up approach to arrive at the forecasts.

b. Capital requirements have been planned in line with the Bank 2017-2020 strategic plan. A capital augmentation plan is prepared quarterly forecasting the capital requirement of the Bank for the next three year period.

c. The capital augmentation plan is approved by the Board of Directors.

d. In line with the Bank's 2017-2020 Strategic Plan, a LKR 6 billion debenture issue (with an option to further increase the issue size by LKR 4 billion) will be raised as Tier 2 capital during the first half of 2018.

Basel III minimum capital requirements and buffers

The Banking Act Direction No. 01 of 2016 introduced capital requirements under Basel III for licensed commercial banks commencing from 1 July 2017 with specified timeliness to increase minimum capital ratios to be fully implemented by 1 January 2019. The CAR to be maintained by a bank having less than LKR 500 Bn. is given below. The Bank's position as at 31 December 2017 is produced below which provides testimony on the ability of the Bank to meet the stringent requirements brought in by the regulator from current perspective.

Banks with assets less than LKR 500 Bn.

Ratios %	Bank's position as at 31 December 2017 %	Minimum capital ratio prescribed by CBSL by 31 December 2017 %	Minimum capital ratio prescribed by CBSL by 1 January 2019 %
Common equity Tier 1 including capital conservation buffer	11.16	5.75	7.00
Total Tier 1 including capital conservation buffer	11.16	7.25	8.50
Total capital ratio including capital conservation buffer	13.25	11.25	12.50

However, the Bank acknowledges the challenges associated with increasing demand on capital as per the roadmap given by CBSL and is mindful about the contributory factors that require in recording a healthy CAR in the ensuing period.

Assessment of the adequacy of Bank's capital commensurate with all material risks and other capital needs in relation to its current and future activities;

The risk profile assessment of the Bank includes the assessment of all material risks i.e. credit risk, market risk, operational risk, credit concentration risk, residual risk, interest rate risk in the banking book, liquidity risk, strategic risk, compliance risk and reputational risk.

The Bank has adopted the standardised approach (SA) for credit risk capital calculation under Pillar 1. Credit concentration in the corporate loan portfolio has been analysed using the Normalised Herfindahl–Hirschman Index (HHI) method and an adjustment to the capital charge is administered in the light of concentration of the Bank's business in large size borrowers.

The Bank has adopted the standardised measurement Approach (SMA) for calculation of the market risk capital charge. The capital charge for market risk continues to remains low, considering the limited market operations of the Bank and exists due to interest rate risk, equity risk and foreign exchange risk to a lesser extent.

With regard to operational risk, the Basic Indicator Approach (BIA) has been adopted under Pillar 1. The Bank is also geared to move into the Alternative Standardised approach for operational risk calculation and has already done parallel computation which has shown improved capital adequacy requirement under operational risk.

Liquidity risk is managed by Treasury, Risk Management Unit and ALCO using the gap assessment and ratios. To ascertain the current liquidity position, the Bank has conducted strong stress tests to gauge the Bank's position under liquidity crunch of different intensities. The capital charge for interest rate risk in the banking book is calculated using the Economic Value of Equity (EVE) approach. Overall, the ALM process in the Bank is well-managed and monitored using various indicators of liquidity and interest rate risks.

For reputational and strategic risk, detailed scorecards have been developed and the scorecard results have been calibrated to capital charge. The result of strategic risk assessment indicates that the Bank has a dedicated strategy and planning unit under finance and is well-capitalised to achieve its strategic objectives going forward. The reputation risk assessment shows that the Bank's reputation which took a beating after the deposit run in 2008 has improved significantly signified by its high customer retention rate. The Board and Senior Management critically review the strategic direction of the Bank at the time the Strategic Plan are prepared and approved. Risk management is an integral part of the strategic planning process.

The Bank uses voting, non-voting shares and debentures as main instruments to raise capital. Main features of instruments used as part of Regulatory Capital is given below:

Description of the Capital instrument	Ordinary voting shares	Ordinary Non-voting shares	Debenture Issue – 2013 (5 years)	Debenture Issues – 2016 (5 years and 7 years)
Issuer	Seylan Bank PLC	Seylan Bank PLC	Seylan Bank PLC	Seylan Bank PLC
Unique Identifier (e.g, ISIN or bloomberg identifier for private placement)	SEYB-N	SEYB-X	SEYB-D	SEYB-D
Governing Law (s) of the Instrument	Provisions in the Banking Act, Rules of the Colombo Stock Exchange and the Securities and Exchange Commission of Sri Lanka, provisions of the Companies Act No. 07 of 2007 and The Articles of Association of the Bank	Provisions in the Banking Act, Rules of the Colombo Stock Exchange and the Securities and Exchange Commission of Sri Lanka, provisions of the Companies Act No. 07 of 2007 and The Articles of Association of the Bank	Rules of the Colombo Stock Exchange and the Securities and Exchange Commission of Sri Lanka, provisions of the Companies Act No. 07 of 2007 and The Articles of Association of the Bank, Prospectus of the Debenture Issue and the Trust Deed	Rules of the Colombo Stock Exchange and the Securities and Exchange Commission of Sri Lanka, provisions of the Companies Act No. 07 of 2007 and The Articles of Association of the Bank, Prospectus of the Debenture Issue and the Trust Deed
Original date of issuance	April 1988	September 2003	22 February 2013	15 July 2016
Par value of instrument	N/A	N/A	LKR 100.00 each	LKR 100.00 each
Perpetual or dated	N/A	N/A	dated	dated
Original maturity date, if applicable	N/A	N/A	21 February 2018	15 July 2021
Amount recognised in regulatory capital (in '000 as at the reporting date)	7,319,076	3,909,193	400,000	4,827,575
Accounting classification (equity/liability)	Equity	Equity	Liability	Liability
Issuer call subject to prior supervisory approval				
Optional call date, contingent call dates and redemption amount (LKR '000)	N/A	N/A	N/A	N/A
Subsequent call dates, if applicable	N/A	N/A	N/A	N/A
Coupons/dividends	Dividend as decided by the Board annually	Dividend as decided by the Board annually	Fixed Interest rate	Fixed and floating interest rates
Coupon rate and any related index	N/A	N/A	Refer note 40	Refer note 40
Non-cumulative or cumulative	Non-cumulative	Non-cumulative	Non-cumulative	Non-cumulative
Convertible or non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible

Legal risk

Legal risk arises from failure to comply with statutory and regulatory regulations, uncertainty of the outcome of all litigation and probable adverse consequences resulting from deficient documentation.

The Bank manages these legal risks effectively through the Legal Department where all contracts and security documentation is legally vetted taking into consideration the applicable laws and regulations. Interpretation of provisions of statutes that may be applicable are referred to the Legal Department by the business lines thus minimising the risk of non-compliance with laws and regulations.

Compliance risk management

The Compliance Department acts as the control point in monitoring and coordinating all regulatory requirements. It ensures that the Bank complies with all laws, regulations and best practices recommended by competent authorities. It is also a key responsibility of Compliance Department to ensure prevalence of a compliance driven culture within the Bank.

Compliance Department, in addition to its routine communication with the Board Integrated Risk Management Committee (BIRMC) which is its direct reporting line provides updates to the Board of Directors on the overall status of compliance of the Bank at their monthly meetings. Compliance related matters are also discussed at the quarterly meetings of the Board Governance and Compliance Committee of which the Compliance Officer is a member.

Strategic risk management

Strategic risk is the possibility of current and prospective impact on earnings or capital arising from adverse business decisions, improper implementation of decisions or lack of responsiveness to industry changes.

The Bank has developed a four-year Strategic Plan (2017–2020) and is in the process of implementation. Corporate Management and the Board takes the responsibility to lead the Bank, while maintaining its vision and mission in order to minimise the failures in the business environment.

In pursuing the Bank's strategic goals and business objectives, the Bank has established clear communication channels at all levels of the Organisation, allocate systems for operations and business lines and increase staff capabilities through staff development and recognition process.

Reputation risk management

Reputation Risk is a threat or danger to the goodwill or standing of a business or entity. As risk mitigating actions, the Bank has established sound policies and procedures such as customer complaint management, whistle-blowing policy to maintain the goodwill in a positive manner. For the purpose of extracting customer grievances, each business unit has a record of the same for the review of the inspections and responses, while such complaints are allowed to be made using telephones under the whistle-blowing policy. The Bank had a very few incidents on this type of events and successfully solve them without any damage.

The Bank also recognise the importance of making a positive contribution to society by promoting Corporate Social Responsibility (CSR) through ethical banking practices, environmental awareness and contribution to the community. Accordingly, the Bank's Board Sustainability Committee, quarterly monitors the progress of CSR contribution and its effectiveness.

Achievements during 2017 and outlook for 2018

1. Full roll-out of the Loan Origination System (LOS) across the network, thereby reducing the time taken to evaluate/approve facility, thus improving the quality of credit.
2. Setting up of SME Hubs on a regional basis with the objective of improving quality of credit evaluation and improving efficiency and reduce turnaround time (TAT) for SME credit approvals.
3. The issuance of lending guidelines, covering specific economic activity/industry segment, has enabled the business units to evaluate the counterparty risk.
4. Implementation of effective credit risk review process, where 36% of the value of advances granted have been independently reviewed and identified shortcomings mitigated to improve the credit quality.
5. Rigorous monitoring of non-performing advances by the Executive Credit Risk Management Committee enabled to reduce the NPA ratio.
6. Several training programmes were internally designed and conducted to improve the risk taking ability of the staff of business units.
7. Risk Officers to be assigned to area offices during 2018 with a view to broad basing risk oversight of medium size credit propositions.
8. Use data analytics to identify credit default behaviours in the product portfolio.
9. Obtain regulatory approval to compute capital adequacy of operational risk under the alternative standardised approach.
10. Upgrade the Bank's ALM and VaR systems used to monitor market risk of the Bank.
11. The Bank has obtained the services of KPMG India to conduct a gap study to assess the Bank's readiness to move to the IRB approach. The assignment is in progress and the final report is expected during the first half of 2018.
12. Bank has also commenced an independent validation of the existing credit rating models to facilitate introducing a risk based pricing mechanism in generating loans in 2018.

Differences between accounting and regulatory scopes and mapping of financial statement categories with regulatory risk categories

Item	Amount (LKR'000) as at 31 December 2017				
	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
Assets	408,125,839	410,327,230	410,327,230	6,384,300	407,971
Cash and cash equivalents	8,319,384	8,898,355	8,898,355	–	–
Balances with Central Bank	19,119,843	19,119,843	19,119,843	–	–
Placements with banks	1,455,115	1,454,925	1,454,925	–	–
Derivative financial instruments	60,165	–	–	–	–
Other financial assets held for trading	7,939,213	7,809,114	7,809,114	6,384,300	–
Securities purchased under resale agreements	1,750,855	1,749,752	1,749,752	–	–
Loans and receivables to banks	–	–	–	–	–
Loans and receivables to other customers	280,861,907	283,014,474	283,014,474	–	–
Financial investments – available for sale	53,507,037	–	–	–	–
Financial investments – held to maturity	21,529,778	70,365,713	70,365,713	–	44,520
Investments in subsidiaries	1,153,602	1,153,602	1,153,602	–	–
Investments in associates and joint ventures	–	–	–	–	–
Property, plant and equipment	4,436,108	4,436,108	4,436,108	–	–
Investment properties	–	–	–	–	–
Intangible assets	363,451	363,451	363,451	–	363,451
Deferred tax assets	–	–	–	–	–
Other assets	7,629,381	11,961,893	11,961,893	–	–
Liabilities	373,919,916	–	–	–	–
Due to banks	27,052,972	–	–	–	–
Derivative financial instruments	571,557	–	–	–	–
Other financial assets held for trading	–	–	–	–	–
Financial liabilities designated at fair value through profit or loss	–	–	–	–	–
Due to other customers	307,098,902	–	–	–	–
Other borrowings (Including Repos)	16,654,369	–	–	–	–
Debt securities issued	12,494,025	–	–	–	–
Current tax liabilities	1,022,378	–	–	–	–
Deferred tax liabilities	1,359,044	–	–	–	–
Other provisions	–	–	–	–	–
Other liabilities	6,521,559	–	–	–	–
Due to subsidiaries	1,145,110	–	–	–	–
Subordinated term debts	–	–	–	–	–

Item	Amount (LKR'000) as at 31 December 2017				
	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
Off-balance sheet liabilities	99,500,731	143,743,031	135,737,554	–	–
Guarantees	27,504,396	27,504,396	25,267,544	–	–
Performance bonds	–	–	–	–	–
Letters of credit	10,387,636	10,387,636	10,382,656	–	–
Foreign exchange contracts	(940,322)	46,167,503	46,167,503	–	–
Other contingent items	14,509,191	13,515,993	6,452,823	–	–
Undrawn loan commitments	47,467,028	46,167,503	47,467,028	–	–
Other commitments	572,802	–	–	–	–
Shareholders' equity					
Equity capital (stated capital)/ assigned capital	11,228,269	11,228,269	–	–	–
of which amount eligible for CET 1	5,799,630	4,864,689	–	–	–
of which amount eligible for AT 1	–	–	–	–	–
Retained earnings	17,178,024	17,483,546	–	–	–
Accumulated Other Comprehensive Income	–	–	–	–	–
Other reserves	–	–	–	–	–
Total shareholders' equity	34,205,923	33,576,504	–	–	–

Column a. presents the assets, liabilities and equity on standalone SLFRS basis. Pillar III disclosures at 31 December 2017 are presented in accordance with regulatory capital concepts and rules.

a. Explanations of differences between accounting and regulatory exposure amounts

(Total assets shown in column A and B above)	LKR '000
Total assets as per carrying values reported in published Financial Statements (Column A)	408,125,839
Total assets as per carrying values under scope of regulatory reporting (Column B)	410,327,230
Difference	2,201,391

Difference arises due to fair value adjustments on investments, impairment on loans and receivables and the classification changes of the line items of the balance sheet.

b. Methodologies used in valuation of financial assets

Financial assets-instrument type	Valuation technique	Inputs used for valuation
Treasury Bills	Price formula	Based on market yield published by CBSL
Treasury Bonds	Price formula	Based on market yield published by CBSL
Sri Lanka Development Bonds	Price formula	Similar instrument's rate (LIBOR)
Quoted Equities	Closing share price	Closing share price (CSE)
Unquoted Equities	Net assets per share	Net assets per share as per latest Audited Financial Statements
Debentures	Price formula	Similar instrument's yield (Treasury Bond yield)

The details on valuation frame work, the valuation models used by the Bank and fair value hierarchy are disclosed in Note 5 to the Financial Statement.