BAIDURI BANK GROUP

PILLAR 3 DISCLOSURE

AS AT 31 DECEMBER 2019

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1. SCOPE OF APPLICATION

The Pillar 3 Disclosure is prepared on a bank solo as well as on a consolidated basis of the Group, i.e. the Bank ("Baiduri Bank Berhad") and its subsidiaries ("Baiduri Finance Berhad" & "Baiduri Capital Sdn Bhd"). The financial statements of the Bank and the Group have been prepared in accordance with the Brunei Darussalam Companies Act, Cap. 39, the Brunei Banking Order, 2006 and International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

2. CAPITAL

On June 11, 2019, the issued share capital was increased to $180,000,000 through the issuance of 30,000,000 ordinary shares of $1 each.

The newly issued shares rank pari passu in all respects with the existing shares of the Bank.

The holders of ordinary shares are entitled to receive dividends as declared from time to time. At any General Meeting, every member present in person, shall have on a show of hands have one vote. All ordinary shares rank equally with regard to the Bank and Group's residual assets.

COMPOSITION OF CAPITAL

	Bank	
	2019	**2018**
	B$'000	**B$'000**
Tier 1 Capital	**394,811**	**374,329**
Paid-up Ordinary Shares/Assigned Capital (after deduction of holdings of own capital)	180,000	150,000
Statutory Reserve Fund	129,811	145,753
Published Retained Profits (after deduction of proposed dividends)	79,846	73,422
General Reserves	5,154	5,154
Tier 2 Capital	**19,631**	**21,174**
Collective Impairment/Allowance	23,065	21,791
Collective Impairment/Allowance – Allowable (Capped at 1.25% of Credit Risk)	**19,631**	**21,174**
Sub-Total of Tier 1 and Tier 2 Capital	**414,442**	**378,503**
Deduction for Investments in Subsidiaries	(47,949)	(47,949)
Total Regulatory Capital (Capital Base)	**366,493**	**347,554**

COMPOSITION OF CAPITAL (CON'T)

	Group	
	2019	2018
	B$'000	B$'000
Tier 1 Capital	**496,653**	**475,877**
Paid-up Ordinary Shares/Assigned Capital (after deduction of holdings of own capital)	180,000	150,000
Statutory Reserve Fund	166,050	178,486
Published Retained Profits (after deduction of proposed dividends)	145,449	142,237
General Reserves	5,154	5,154
Tier 2 Capital	**23,955**	**22,752**
Collective Impairment/Allowance	23,955	22,752
Collective Impairment/Allowance – Allowable (Capped at 1.25% of Credit Risk)	23,955	22,752
Sub-Total of Tier 1 and Tier 2 Capital	**520,608**	**498,629**
Total Regulatory Capital (Capital Base)	**520,608**	**498,629**

3. CAPITAL ADEQUACY

The Group's regulator, Autoriti Monetari Brunei Darussalam ("AMBD") sets and monitors capital requirements for the Group.

The Group's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The impact of the level of capital on shareholders' return is also recognised and the Group recognises the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position. The Group's overall strategy remains unchanged from the previous financial year.

The capital structure of the Group consists of equity of the Bank (comprising issued capital, reserves, and retained earnings).

The Group has complied with all imposed capital requirements at all times during the reporting period.

INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS ("ICAAP")

Under the current regulatory framework, capital requirements are divided into two pillars:

- Pillar 1 – defined by a set of mathematical formulas prescribed by the regulator in order to calculate Risk Weighted Assets ("RWAs") for Credit Risk, Market Risk and Operational Risk. The minimum capital requirement is 10% of the total RWAs.

- Pillar 2 – contains a framework to assess the risks to which the Group is exposed as well as the risk management processes in place to avoid, manage and mitigate those risks. It requires an evaluation of capital adequacy relative to its risks; and considers the potential impact on earnings and capital from stress events.

While Pillar 1 entails the calculation of capital requirements on the basis of uniform rules for all banking groups operating in Brunei Darussalam, the ICAAP under Pillar 2 takes into account the individual characteristics of a given institution and covers all relevant risk types, including risks not addressed under Pillar 1.

The Group's approach to calculate its own internal capital requirements has been to take the minimum capital required for Risk Weighted Assets under Pillar 1 as the starting point, assess whether this is sufficient to cover the risks, and then identify other risks and assess prudent levels of capital to meet them. Various stress scenarios and methodologies have been employed to measure and assess Pillar 2 capital requirements for each key risk type.

Quantitative disclosures on the Group's capital adequacy can be found in page 48 of the Consolidated Financial Statements.

	Bank		Group	
	2019	2018	2019	2018
	B$'000	B$'000	B$'000	B$'000
Capital				
Core Capital (Tier I Capital)	**394,811**	374,329	**496,653**	475,877
Supplementary Capital (Tier II Capital)	**19,631**	21,174	**23,955**	22,752
Less: Investment in Subsidiaries	**(47,949)**	(47,949)	**-**	-
Total Capital base	**366,493**	347,554	**520,358**	498,629
Risk-weighted amount				
Risk-Weighted amount for Credit Risk	**1,570,495**	1,693,901	**2,212,715**	2,333,188
Risk-Weighted amount for Operational Risk	**265,271**	250,534	**324,674**	308,754
Risk-Weighted amount for Market Risk	**1,802**	1,904	**1,779**	2,023
Total Risk-weighted amount	**1,837,568**	1,946,339	**2,539,168**	2,643,965
Capital Ratios				
Core Capital (Tier I) Ratio, %	**21.49%**	19.23%	**19.56%**	18.00%
Total Capital Ratio, %	**19.94%**	17.86%	**20.50%**	18.86%

CAPITAL REQUIREMENTS FOR STANDARD PORTFOLIOS AS AT DECEMBER 31, 2019

	Bank B$'000	Group B$'000
Capital requirements for:		
Sovereign	-	-
Public Sector Entities (PSE)	-	-
Banks	40,044	40,364
Corporate	60,102	64,354
Regulatory Retail (including claims on SMEs eligible for 75% risk weight)	17,739	73,805
Residential Retail (Qualifying for 35% risk weight only)	619	619
Equity	-	-

4. DISCLOSURES ON RISK MANAGEMENT FRAMEWORK

The Group recognizes that a robust risk management framework is critical to support continued business expansion as well as sustainable growth in shareholder value. The Risk Management Committee ("RMC") is established as a Board subcommittee to assist the Board of Directors in fulfilling its oversight responsibilities for the Group's risk management framework and the Group's corporate risk structure including the strategies, policies, processes, procedures, and systems established by the Senior Management to identify, assess, measure, manage, and monitor the Group's significant financial, operational, and other risk exposures. The RMC monitors the Group's risks through a comprehensive risk monitoring and assessment framework which covers the various risks faced by the Group, ranging from Credit, Treasury & Market Risk, Operational, Financial Strength and Performance Risk to Strategic, Governance and Reputation Risks.

A Group Risk Appetite Statement ("RAS") has been issued, which identifies the major types of risks and express the level of such risks that the Group is willing to accept or avoid in order to achieve its strategic objectives. Senior Management as well as staff at all levels are required to have regard to the RAS in their decision-making process and in carrying out their day-to-day responsibilities.

Senior Management committees have been established and delegated authority for overseeing the day-to-day management of various risks. These include the Credit Committee as well as the Asset and Liability Committee ("ALCO").

Individual business lines and support functions act as the first line of defense and are responsible and accountable for the ongoing management of risks inherent in their activities. They are also required to ensure adherence to various policies and procedures including ensuring compliance with internal limits as well as laws and banking regulations.

The Group Risk Department acts as a second line of defense and is responsible for overseeing the Group's risk-taking activities and assessing risks and issues independently from the business line.

The Group Compliance Department also forms part of the second line of defense and is responsible for the identification, assessment, mitigation, monitoring and reporting of the Group's compliance risks.

Internal audit provides assurance on the implementation of the Group's overall risk management framework, as well as an assessment of the efficiency and effectiveness of the control environment. The Group Internal Audit is independent and reports directly to the Audit Committee.

5. CREDIT RISK

Credit risk is the risk of financial losses to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations and arises principally from the Group's loans and advances to customers, counterparties and investment debt securities.

Credit risk is diversified across the Group's business lines – Corporate Banking, Retail Banking, Hire Purchase Financing[1] and Treasury activities.

The Group has a robust credit risk management framework, supported by prudent lending policies and a conservative delegation framework. The Board of Directors, via the Executive Committee ("EXCO"), has delegated authority to the Group Credit Committee, who is responsible for approval of lending policies & procedures, product programs, corporate banking exposures, large retail or hire purchase financing, as well as overseeing the day-to-day management of credit risks. EXCO is directly responsible for overseeing the Group's treasury activities and the associated risks including credit risk. For the day to day management of the treasury activities, EXCO is supported by ALCO.

Credit risk-taking activities are guided by the Group Credit Risk Strategy Statement, which defines the Group's Credit Granting Principles as follows:

- The Group is firmly committed to ensure all credit facilities are granted in compliance with local regulatory rules and regulations.
- The Group generally provides credit facilities to residents of Brunei Darussalam. Similarly, credit facilities are generally only granted to companies incorporated or registered in Brunei Darussalam. Credit exposures outside of Brunei Darussalam require exceptional approval.
- The Group does not provide credit facilities in support of illegal activities, prohibited or unlicensed businesses, or any other activities deemed to pose unacceptable environmental, ethical, social or reputational risk to the Group and the wider community.
- Credit should only be granted when a clear understanding of the borrower, purpose of the facilities and identification of sources of repayment have been established. While collateral is often obtained as a form of credit risk mitigation, it should not be a substitute to ensuring the borrower has the income or equity to support its overall debt burden.
- The Group monitors and manages its concentration risk to groups of related counterparties as well as overall exposure to various industry sectors.
- The pricing of credit shall consider the overall risks of the borrower and facility, including collateral, as well as the funding and operating costs of the Group in order to ensure an acceptable return on capital.

The Group measures and monitors credit risk through Key Risk Indicators in the monitoring and assessment framework. The framework also includes the monitoring of Treasury-related credit risk indicators and are reported to the Board of Directors, via the RMC on a quarterly basis.

[1] Under Baiduri Finance Berhad

Corporate risk exposures are graded according to an internal rating scale which is determined by the combination of intrinsic risk of the borrower and the assessment of credit risk mitigants, including the quality and nature of collateral provided. Factors which are considered for the intrinsic risk of the borrower include the industry environment, position within its sector, management capability, financial performance and repayment capacity.

All Corporate exposures are under the responsibility of the Group Credit Committee, within its delegated limits. Risk is further managed through a set of policies and procedures, which provide for credit criteria, credit assessment, annual review of credit exposures, management of collateral, management of problem accounts as well as independent review of credit files.

Credit risk for retail customers is generally managed on a portfolio level, with credit assessment and approval being guided by product programmes. Product programmes, which are approved by the Group Credit Committee, define the product's target customer segments, customer eligibility and exclusions; as well as the product's parameters in terms of pricing, fees, maximum limits and maximum tenor for both secured and unsecured lending products.

The Group Credit Committee has sub-delegated a small portion of its lending authority to the Corporate Banking, Retail Banking and Hire Purchase business-lines. Nevertheless, all credit exposures are individually assessed and approved within a limit authority matrix. Risks are monitored through portfolio delinquency reports, which monitor the distribution of exposures by product, delinquency status and credit rating, including historical trend analysis.

Within Retail Banking, the Retail Credit Management department is responsible for day-to-day credit risk management.

With regards to the Group's treasury activities, authority to approve credit risk limits remains at the EXCO level, who have delegated monitoring responsibilities to the Group's ALCO. This covers credit exposures to financial institutions, counterparty and correspondent bank limits, as well as credit risk in the bank's investment portfolio, i.e. bonds / sukuk. Group Treasury and Institutional Banking is responsible for day-to-day management of such risks and provides regular updates to ALCO and EXCO.

The definitions of credit-impaired financial assets and descriptions of the Group's approaches for specific and collective impairment provisions can be found in pages 30 to 32 and page 54 of the Consolidated Financial Statements. Further disclosures on the Group's management of credit risk, including quantitative disclosures can be found in pages 56 to 70 and 72 to 75 of the Consolidated Financial Statements.

External Credit Assessment Institutions ("ECAIs")

The Group refers to ratings published by the following ECAIs[2] for the purposes of assigning risk weights to assets:

- S&P Global Ratings
- Moody's Investors Service
- Fitch Ratings

GROSS CREDIT EXPOSURES BY MAJOR TYPE OF CREDIT EXPOSURE AS AT DECEMBER 31, 2019

	Brunei B$'000	Singapore B$'000	United States of America B$'000	Malaysia B$'000	Others B$'000	Total B$'000
Bank						
Cash and Short Term Funds	199,180	1,450,734	9,178	100	20,089[3]	1,679,281
Derivative Assets	596	-	-	-	-	596
Investment Securities	-	79,756	-	-	305	80,061
Loans and Advances	1,250,924	-	-	1,026	28,450[4]	1,280,400
On-Balance Sheet Total	1,450,700	1,530,490	9,178	1,126	48,844	3,040,338
Commitments and Contingencies	927,298	-	-	-	-	927,298
Group						
Cash and Short Term Funds	205,812	1,450,734	9,178	100	20,089	1,685,913
Derivative Assets	596	-	-	-	-	596
Investment Securities	-	79,756	-	-	305	80,061
Loans and Advances	2,053,572	-	-	1,026	28,450	2,083,048
On-Balance Sheet Total	2,259,980	1,530,490	9,178	1,126	48,844	3,849,618
Commitments and Contingencies	927,298	-	-	-	-	927,298

[2] ECAIs are used to assign risk weights to claims on banks and financial institutions as well as rated corporate exposures within the Group's investment portfolio

[3] Others include Australia, Canada, France, Germany, Hong Kong, Indonesia, Japan, Luxembourg, New Zealand, Philippines, Sweden, Thailand, United Arab Emirates and United Kingdom.

[4] Others include India and Panama.

CONCENTRATION OF CREDIT RISK BY SECTOR

An analysis of concentrations of credit risk from loans and advances and other commitments is shown below:

	Loans and Advances		Contingencies and Other Commitments		Total	
Bank	**2019**	**2018**	**2019**	**2018**	**2019**	**2018**
	B$'000	**B$'000**	**B$'000**	**B$'000**	**B$'000**	**B$'000**
Agriculture	**3,997**	4,884	**3,381**	3,694	**7,378**	8,578
Constructions and Property Financing	**464,690**	486,175	**82,231**	63,417	**546,921**	549,592
Financial	**-**	-	**64,857**	67,257	**64,857**	67,257
Infrastructure	**5,186**	6,682	**3,842**	671	**9,028**	7,353
Manufacturing	**49,839**	57,243	**81,990**	86,675	**131,829**	143,918
Personal and Consumption Loans	**206,523**	216,416	**9,802**	10,636	**216,325**	227,052
Services	**176,039**	159,484	**361,479**	271,498	**537,518**	430,982
Telecommunication and Information Technology	**6,916**	9,195	**6,190**	3,871	**13,106**	13,066
Tourism	**20,248**	21,340	**3,563**	2,375	**23,811**	23,715
Traders	**174,794**	172,741	**137,762**	139,258	**312,556**	311,999
Transportation	**172,168**	236,968	**172,201**	181,097	**344,369**	418,065
Total	**1,280,400**	1,371,128	**927,298**	830,449	**2,207,698**	2,201,577

CONCENTRATION OF CREDIT RISK BY SECTOR (CON'T)

	Loans and Advances		Contingencies and Other Commitments		Total	
Group	**2019**	**2018**	**2019**	**2018**	**2019**	**2018**
	B$'000	**B$'000**	**B$'000**	**B$'000**	**B$'000**	**B$'000**
Agriculture	**3,997**	4,884	**3,381**	3,694	**7,378**	8,578
Constructions and Property Financing	**464,690**	486,175	**82,231**	63,417	**546,921**	549,592
Financial	**-**	-	**64,857**	67,257	**64,857**	67,257
Infrastructure	**5,186**	6,682	**3,842**	671	**9,028**	7,353
Manufacturing	**49,839**	57,243	**81,990**	86,675	**131,829**	143,918
Personal and Consumption Loans	**206,523**	216,416	**9,802**	10,636	**216,325**	227,052
Services	**176,039**	159,484	**361,479**	271,498	**537,518**	430,982
Telecommunication and Information Technology	**6,916**	9,195	**6,190**	3,871	**13,106**	13,066
Tourism	**20,248**	21,340	**3,563**	2,375	**23,811**	23,715
Traders	**174,794**	172,741	**137,762**	139,258	**312,556**	311,999
Transportation	**974,816**	1,051,133	**172,201**	181,097	**1,147,017**	1,232,230
Total	**2,083,048**	2,185,293	**927,298**	830,449	**3,010,346**	3,015,742

NON-PERFORMING LOANS

The Bank and Group regards a loan and advance as non-performing if it is in arrears for more than 3 months or if there is objective evidence of impairment.

Bank	Total Credit Exposure		Non-Performing Loans		%	
	2019	2018	2019	2018	2019	2018
	B$'000	B$'000	B$'000	B$'000		
Agriculture	**7,378**	8,578	**-**	-	**0.00%**	0.00%
Constructions and Property Financing	**546,921**	549,592	**28,066**	33,215	**5.13%**	6.04%
Financial	**64,857**	67,257	**-**	-	**0.00%**	0.00%
Infrastructure	**9,028**	7,353	**-**	-	**0.00%**	0.00%
Manufacturing	**131,829**	143,918	**1,558**	882	**1.18%**	0.61%
Personal and Consumption Loans	**216,325**	227,052	**16,908**	22,795	**7.82%**	10.04%
Services	**537,518**	430,982	**7,012**	29,972	**1.30%**	6.95%
Telecommunication and Information Technology	**13,106**	13,066	**723**	-	**5.52%**	0.00%
Tourism	**23,811**	23,715	**542**	-	**2.28%**	0.00%
Traders	**312,556**	311,999	**29,646**	26,827	**9.49%**	8.60%
Transportation	**344,369**	418,065	**492**	-	**0.14%**	0.00%
Total	**2,207,698**	**2,201,577**	**84,947**	**113,691**		

NON-PERFORMING LOANS (CON'T)

Group	Total Credit Exposure		Non-Performing Loans		%	
	2019	2018	2019	2018	2019	2018
	B$'000	B$'000	B$'000	B$'000		
Agriculture	**7,378**	8,578	**-**	-	**0.00%**	0.00%
Constructions and Property Financing	**546,921**	549,592	**28,066**	33,215	**5.13%**	6.04%
Financial	**64,857**	67,257	**-**	-	**0.00%**	0.00%
Infrastructure	**9,028**	7,353	**-**	-	**0.00%**	0.00%
Manufacturing	**131,829**	143,918	**1,558**	882	**1.18%**	0.61%
Personal and Consumption Loans	**216,325**	227,052	**16,908**	22,795	**7.82%**	10.04%
Services	**537,518**	430,982	**7,012**	29,972	**1.30%**	6.95%
Telecommunication and Information Technology	**13,106**	13,066	**723**	-	**5.52%**	0.00%
Tourism	**23,811**	23,715	**542**	-	**2.28%**	0.00%
Traders	**312,556**	311,999	**29,646**	26,827	**9.49%**	8.60%
Transportation	**1,147,017**	1,232,230	**9,423**	11,670	**0.82%**	0.95%
Total	**3,010,346**	**3,015,742**	**93,878**	**125,361**		

6. CREDIT RISK MITIGATION ("CRM")

The Group employs various credit risk mitigation techniques which include appropriate facility structuring, obtaining of tangible collateral as well as non-tangible security. Covenants / facility conditions are frequently imposed on credit facilities.

Acceptable types of collateral / security[5]

Cash including Certificate of Deposit	Assignment of project receivables
Investment funds	Assignment of development agreement
Debentures	Assignment of sale & purchase agreement
Property (residential and commercial)	Guarantee from banks
Motor Vehicles	Assignment of insurance policy
Stocks and Shares (private or listed)	Corporate guarantee
Ships and vessels	Personal guarantee
Aircraft	Letter of comfort or awareness

The market value of collateral may be determined through independent valuation by third-party panel valuer firms, or through internal formulas. Haircuts may be applied to the market value of collateral held to determine its financial effect.

Although the Group accepts various forms of collateral[6], as at the reporting period only cash and Brunei Government guarantees have been considered as allowable CRM for capital calculation purposes.

GROSS EXPOSURE AND TOTAL EXPOSURE THAT IS COVERED BY ELIGIBLE FINANCIAL COLLATERAL AND GUARANTEES FOR STANDARD PORTFOLIOS AS AT DECEMBER 31, 2019

	Bank	Group	Bank		Group	
	B$'000	B$'000	B$'000	B$'000	B$'000	B$'000
			Total Exposure that is covered by:			
	Gross Exposure		Eligible financial collateral	Gov't Guarantees	Eligible financial collateral	Gov't Guarantees
Sovereign	235,857	288,937	-	-	-	-
Public Sector Entities (PSE)	-	-	-	-	-	-
Banks	1,494,537	1,497,739	-	-	-	-
Corporate	654,696	697,355	113,897	-	114,040	-
Regulatory Retail (including claims on SMEs eligible for 75% risk weight)	236,917	984,641	4,386	-	4,562	-
Residential Retail (Qualifying for 35% risk weight only)	18,114	18,114	422	-	422	-
Equity	-	-	-	-	-	-

[5] The listing is not intended to be exhaustive, representing the main types of collateral/security taken. The bank may accept other forms of collateral/security in order to mitigate its credit exposures

[6] Refer to page 69-70 of the Consolidated Financial Statements for further details on collateral held and other credit enhancements

7. COUNTERPARTY CREDIT RISK

Counterparty Credit Risk is the risk arising from the possibility that the counterparty may default on amounts owned on a derivative transaction. Derivatives are financial instruments that derive their value from the performance of assets, interest or currency exchange rates, or indexes.

All limits for Counterparty Credit Risk are approved at the EXCO level. Limits are primarily to support Spot Transactions, Foreign Exchange Contracts as well as other derivative products (Swaps). Counterparty exposures are generally limited to banks which have been rated BBB+ by S&P (or Moody's/Fitch equivalent) or better.

The Bank and the Group's position on derivative financial instruments can be found on page 90 of the Consolidated Financial Statements.

8. MARKET RISK

Market risk is the risk that changes in market prices, such as interest rates, equity prices and foreign exchange rates will affect the value of the Group's holdings of financial instruments (non-banking book). The objective of the Group's market risk management is to manage and control market risk exposures within acceptable parameters in order to ensure the Group's solvency while optimizing the return on risk.

The EXCO is responsible for authorising all market risk limits and has delegated responsibility for the monitoring of market risk to ALCO, with the Group Treasury Department being responsible for the day to-day management of the Group's market risk positions.

The Group has limited risk appetite and exposure to market risk. As at 31 December 2019, the Group has minimal foreign exchange risk exposure and no market risk exposure to interest rate risk (trading book), equity position risk, or commodity risk.

Further disclosures on the Group's management of market risk, including quantitative disclosures can be found in pages 77 – 82 of the Consolidated Financial Statements.

CAPITAL REQUIREMENTS FOR MARKET RISK AS AT DECEMBER 31, 2019

	Bank B$'000	Group B$'000
Market Risk Capital Requirements for:		
Interest Rate Risk	-	-
Equity Position Risk	-	-
Foreign Exchange Risk	180	178
Commodity Risk	-	-
Total	180	178

9. OPERATIONAL RISK

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, and includes legal risk. Operational risk is inherent to every aspect of our business.

The Group's objective is to manage operational risk to balance the avoidance of financial losses and/or damage to the Group's reputation with overall cost effectiveness and innovation.

The Board is ultimately responsible for all aspects of operational risk management. The Board delegates these responsibilities to the Risk Management Committee to oversee the management of operational risks.

The Group's operational risk management framework sets out to identify, assess, control, mitigate, report and monitor operational risk.

The Group maintains policies and procedures to manage operational risk, supported by a robust culture of internal control. Senior management is overall responsible for implementing the operational risk management framework, its associated policies and procedures, to anticipate and mitigate operational risk for the Group.

The Three Lines of Defence approach is applied to operational risk management.

The first line of defence – business line management including support functions – is directly responsible for identifying and managing day-to-day operational risks. The second line of defence is provided by the Group Risk Department where it coordinates, facilitates and oversees the effectiveness and integrity of the Group's operational risk management framework. The third line of defence involves the Internal Audit function to provide independent assurance to the Board and senior management on the effectiveness and quality of governance, risk management and internal control processes.

The Group employs the Basic Indicator Approach to compute operational risk capital.

Additional risk management systems in place to address specific areas include, but are not limited to, the following:

Technology risk – All activities are governed by a set of Information Technology (IT) policies, guidelines, processes, procedures and mitigation programmes – including disaster recovery planning. These outline the governance and oversight structure, communication and escalation criteria, monitoring frequency, assessment and mitigation measures. IT incidents are assessed and evaluated by the Group's IT department according to its impact to the technologies, business operations and all stakeholders. Incidents are escalated to Chief Technology Officer, Group Risk Department and senior management for direction, depending on its severity.

Cyber and Information Security risk – risk associated with cyber and information security are managed through security policies, processes, procedures and solutions. The Group's Information and Technology Security department is responsible for securing the network, infrastructure and information. The Group employs comprehensive assessments, penetration testing, firewall reviews and incident handling and response plans.

Fraud risk – risks associated with fraud are governed by Fraud policy with oversight by a dedicated Fraud committee.

Business disruptions – Business Continuity Management ("BCM") framework is embedded under a BCM programme which aims to safeguard the critical business operations, all stakeholders and protect the interests of the Group. It is to ensure that the impact of potential issues and adverse events are effectively managed to an acceptable level and communicated efficiently. Planning for resilience includes risk assessments and review, identification of critical business functions through Business Impact Analysis, continuity strategies, recovery and resumption plans, annual testing and exercising as well as maintenance of Business Continuity Plans ("BCP").

New products and services risk – the Group's policy is in place to ensure operational risks are considered and assessed as new products, services and business activities are developed. Comprehensive post-implementation evaluation of new products or services is performed to ensure no risk remains unidentified or unaddressed.

Vendor, third party and outsourcing risk – the Group has implemented Vendor Management and Outsourcing policies, respectively. The policies are to govern vendor selection criteria, approved vendors, vendor evaluation and assessment, vendor review and outsourcing arrangements.

CAPITAL REQUIREMENTS FOR OPERATIONAL RISK AS AT DECEMBER 31, 2019

	Bank B$'000	Group B$'000
Capital Requirements for:		
Operational Risk	26,527	32,467

10. EQUITY INVESTMENTS IN THE BANKING BOOK

Details on the Group's equity investments in the banking book can be found in page 83 – 86 of the Consolidated Financial Statements.

11. INTEREST RATE RISK IN THE BANKING BOOK (IRRBB)

Due to different movements in interest rates of assets and liabilities, the Group's earnings are exposed to Interest Rate Risk in the Banking Book ("IRRBB"). Group ALCO, assisted by Group Treasury Department as well as Finance Department, is responsible for managing interest rate risk.

Interest rate risk is managed principally through an Asset-Liability reports, which provides Senior Management with details on the level of and return generated from interest generating assets, compared against funding sources and associated costs. The Group also reports on maturity gaps on its asset and liability position.

The Board of Directors maintains oversight over interest rate risks through the monitoring of various Key Risk Indicators, which are reported quarterly to the Risk Management Committee.

Although the movement of interest rates is primarily driven by external market forces, certain mitigating strategies are taken which include ensuring sufficient margins (particularly on longer maturity exposures) on credit facilities. The bank further ensures that most of its credit exposures are priced against an internal reference rate, which may be adjusted in the event of material changes in the funding market.

Quantitative disclosures on the Group's interest rate risk can be found in pages 77– 80 of the Consolidated Financial Statements.

	Bank		Group	
	+0.10%	**-0.10%**	**+0.10%**	**-0.10%**
	B$'000	**B$'000**	**B$'000**	**B$'000**
As at December 31, 2019	**301**	**(301)**	**(514)**	**514**
As at December 31, 2018	321	(321)	(551)	551

<u>FUNDING AND LIQUIDITY RISK</u>

Funding & liquidity risk is defined as the current and prospective risk to earnings, shareholder funds or reputation arising from the Group's inability to efficiently meet present and future funding needs or regulatory obligations when they are due, which may adversely affect our daily operations and incur unacceptable losses.

The Group seeks to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions. The Group also seeks to ensure that it has an adequate level of stable funding from diversified sources.

The Board has delegated responsibility for liquidity risk management to the Group's ALCO. The ALCO Policy provides guidelines for its members with regards to the measurement, assessment and mitigation of liquidity risk.

The key elements of the Group's liquidity strategy are as follows:

1) Maintaining a diversified funding base consisting of customer deposits (both retail and corporate) and wholesale market deposits, as well as maintaining contingency facilities with other banks;
2) Carrying a portfolio of highly liquid assets, diversified by currency and maturity;
3) Monitoring liquidity ratios, maturity mismatches and behavioural characteristics of the Group's financial assets and liabilities.

The Group Treasury Department manages the Group's day-to-day liquidity position. The Group maintains a portfolio of short-term liquid assets, largely made up of short-term liquid investment securities, money market placements with banks and other inter-bank facilities, to ensure that sufficient liquidity is maintained.

The measure used by the Group for managing liquidity risk is the ratio of liquid assets to deposits from customers and short-term liabilities. For this purpose, liquid assets are considered as including cash and cash equivalents, bank placements and debt securities for which there is an active and liquid market.

The Group monitors the net stable funding ratio of both the bank and its finance subsidiary on a solo basis, in order to ensure a stable and sustainable funding structure with assessment of funding risk across its balance sheet.

Quantitative disclosures on the Group's funding and liquidity can be found in pages 72-75 of the Consolidated Financial Statements.

12. COMPLIANCE RISK

Compliance risk is defined as the risk of legal or regulatory sanctions, financial loss or reputational damage which the Group may suffer as a result of its failure to comply with legal and regulatory requirements applicable to its activities. The Group aims to ensure effective compliance risk management through the careful observation and compliance of applicable laws, regulations, rules – including principles outlined in the Group's Code of Conduct and established good ethical business standards on integrity in its activities.

The Group's Risk Appetite Statement in relation to Compliance states –

"The Group shall comply with all applicable laws, regulations and guidelines prescribed by the authorities. The Group shall also observe international practices and guidelines on anti-money laundering and combating the financing of terrorism. There should not be any material breaches of such laws, regulations or guidelines."

The Board of Directors has delegated overall compliance risk oversight to the RMC.

Senior Management and Heads of Departments remain primarily responsible for ensuring that their activities comply with all applicable laws and regulations.

The Group Compliance Officer ("GCO") – reporting to the RMC as well as the Chief Executive Officer – leads the Group Compliance Department and is responsible for the identification, assessment, mitigation, monitoring and reporting of the Group's compliance risks. The GCO provides quarterly compliance reports to the RMC. Such reports include the monitoring of several compliance Key Risk Indicators, including overall compliance with various financial ratios and non-financial requirements, assessment of the impact of new regulations, as well as customer complaints. Additionally, reports on key money laundering/terrorist financing ("ML/TF") risks and vulnerabilities, transaction monitoring data and trends, including Suspicious Transaction Reports ("STRs") filed with the regulator, are provided to the RMC.

The Group recognizes AMBD's commitments to comply with international best practices with regards banking regulations and financial reporting standards. To this end, several regulatory notices and guidelines were issued in 2018 and 2019, and the expectation is that there will be further expansion of regulatory requirements over the medium to long term future.

The Group accepts that this will result in increases in the cost of compliance. Already well underway are the expansion of the Compliance and Risk Management functions, as well as investments into systems and technology in order to meet the increased data demands. Aside from tangible investments towards strengthening second and third line of defense resources and capabilities, there are several planned initiatives to reinforce the 'tone from the top' as well as ensuring that a robust compliance culture is maintained throughout the Group.