BAIDURI BANK

PILLAR 3
DISCLOSURES

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In compliance with the requirements under AMBD's Notice to Banks Notice No: BU/N-3/2018/53 Pillar 3 – Public Disclosure Requirements, various additional quantitative and qualitative disclosures have been included in this report.

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.

In 2018, an independent Group Risk Department was established in order to strengthen the Group's risk management framework. 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.

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 50 of the Consolidated Financial Statements.

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 Bank 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.

[1] Under Baiduri Finance Berhad

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.

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 Bank 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 Bank 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 Bank Credit Committee has sub-delegated a small portion of its lending authority to the Retail Banking and Hire Purchase business-lines. Nevertheless, all retail 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 Credit Risk & MIS 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.

Further disclosures on the Group's management of credit risk, including quantitative disclosures can be found in pages 55 – 67 and 69 – 70 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

[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

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[3]

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[4], as at the reporting period only cash and Brunei Government guarantees have been considered as allowable CRM for capital calculation purposes.

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 85 of the Consolidated Financial Statements.

[3] 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.

[4] Refer to pages 66 – 67 of the Consolidated Financial Statements for further details on collateral held and other credit enhancements

Quantitative disclosures for credit risk not covered in the Report of the Directors and Consolidated Financial Statements December 31, 2018 (“Consolidated Financial Statements”)

The gross exposures and total exposure that is covered by eligible financial collateral and guarantees for each standard portfolio[5] are as follows:

	Bank B$'000	**Group B$'000**	**Bank B$'000**		**Group (B$'000)**	
			Total Exposure that is covered by:			
	Gross Exposures		Eligible financial collateral	Gov't Guarantees	Eligible financial collateral	Gov't Guarantees
Sovereign	199,505	256,631	-	-	-	-
Public Sector Entities (PSE)	-	-	-	-	-	-
Banks	1,757,741	1,760,747	-	-	-	-
Corporate	673,490	708,574	134,531	5,000	134,531	5,000
Regulatory Retail (including claims on SMEs eligible for 75% risk weight)	242,053	998,305	2,603	-	2,603	-
Residential Retail (Qualifying for 35% risk weight only)	33,689	33,689	380	-	380	-
Equity	-	-	-	-	-	-

The resulting capital requirements for each standard portfolio listed above are as follows:

	Bank B$'000	**Group B$'000**
Capital Requirements for:		
Sovereign	-	-
Public Sector Entities (PSE)	-	-
Banks	45,434	45,736
Corporate	50,190	53,698
Regulatory Retail (including claims on SMEs eligible for 75% risk weight)	18,019	74,737
Residential Retail (Qualifying for 35% risk weight only)	1,166	1,166
Equity	-	-

[5] AMBD, Jan 2018, s.3.2.2. *“Guidelines on Pillar 3 – Public Disclosure Requirements”*

The Bank and the Group's geographic distribution of credit exposures are as follows:

	Bank B$'000	Group B$'000
Loans & Advances		
Brunei Darussalam	1,376,688	2,190,853
Other Asia	13,614	13,614
Investment Securities		
Singapore	63,033	63,033

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 2018, 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 73 – 78 of the Consolidated Financial Statements.

Quantitative disclosures for market risk not covered in the Consolidated Financial Statements

	Bank B$'000	Group B$'000
Market Risk Capital Requirements for:		
Interest Rate Risk	-	-
Equity Position Risk	-	-
Foreign Exchange Risk	190.4	202.3
Commodity Risk	-	-
Total	190.4	202.3

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.

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. In all cases, the Group's policy requires compliance with all applicable legal and regulatory requirements.

Operational risk (including technology risk) is monitored by the Board via the Risk Management Committee, which reviews key operational and IT Risk indicators on a quarterly basis.

The Group maintains policies and procedures to manage operational risk, supported by a robust culture of internal control. Dedicated resources are present within large departments to manage their day-to-day operational risk.

Various committees have been established to maintain oversight over specific areas where operational risks may arise, including the Procurement Committee, Business Continuity Management Committee and Fraud Committee.

The Group Technology Department manages the Group's technology risk, with oversight from a senior management level IT Steering Committee ("ISTEER"). The ISTEER reviews major technology projects and decisions as well as the results of periodic technology risk assessments.

The Group Risk Department and Group Internal Audit provide second and third-line of defense respectively.

The Group maintains a Business Continuity Management Program which produces Business Continuity Plans to protect the organization, including its people, brand, reputation, stakeholders and wider community. It serves to safeguard critical operations and protect the interests of the Group by ensuring that the impact of potential issues and serious events can be effectively managed to an acceptable level as well as build resiliency and capability for an effective response in times of crisis.

Quantitative disclosures for operational risk not covered in the Consolidated Financial Statements

	Bank **B$'000**	**Group** **B$'000**
Capital Requirements for:		
Operational Risk	25,053	30,875

EQUITY INVESTMENTS IN THE BANKING BOOK

Details on the Group's equity investments in the banking book can be found in page 79 – 81 of the Consolidated Financial Statements.

INTEREST RATE RISK IN THE BANKING BOOK

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 73 – 76 of the Consolidated Financial Statements.

FUNDING AND LIQUIDITY RISK

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 69-72 of the Consolidated Financial Statements.

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 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.