



## Pillar 3 Disclosures

31 December 2021



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## 1 INTRODUCTION

### 1.1 PURPOSE

Bank of China (UK) Limited (the Bank or BOC UK) was incorporated as a private limited company on 29th March 2007, a wholly owned subsidiary of Bank of China Limited (the Group). The Bank is regulated by the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) and is authorised by PRA as a full service credit institution offering retail, corporate and trade finance services in the UK since 24 September 2007. The Bank now operates four branches located within the UK and one branch located outside of the UK in Dublin, Republic of Ireland up to and including 31 August 2021.

### 1.2 BASIS AND SCOPE OF DISCLOSURES

These disclosures have been prepared in accordance with the requirements set out in the Fourth Capital Requirements Directive (CRD IV)<sup>1</sup>, the Basel Framework on Pillar 3 Disclosure and EBA implementing technical standards and guidance. The PRA supervises BOC UK on an individual basis and in accordance with Articles 6 of the CRR<sup>2</sup>, these disclosures have been prepared on an individual basis and do not take into account any subsidiaries. In addition, BOC UK meets Article 433b<sup>3</sup> of the CRR and has prepared these disclosures under the requirements for “small and non-complex institutions”.

It is recommended that these disclosures be read in conjunction with the Bank’s Annual Report and Financial Statement 2021. For accounting purposes, the Bank has availed itself of the exemption election from Section 401 of the Companies Act 2006 that permits an entity to prepare separate financial statements. (Referring to Note 2: Basis of Preparation in the Annual Report and Financial Statement 2021).

These disclosures have been prepared in accordance with regulatory capital adequacy concepts and rules, rather than in accordance with IFRS accounting standards. Some information in this report is not directly comparable with the Bank’s Annual Report and Financial Statement 2021. Explanations and notes are given where appropriate.

#### 1.2.1 Regulatory Framework of Disclosures

Pillar 3 rules apply to banks, building societies and investment banks. There are designed to promote market discipline through the disclosure of key information about risk exposures and risk management processes. CRD IV also made changes to rules on corporate governance, including remuneration, and introduced standardised regulatory reporting

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<sup>1</sup> Post Brexit Temporary Transitional Power (TTP) created under the Financial Services and Markets Act 2000 (Amendment) (EU Exit) Regulations 2019 allow UK banks to continue applying EU rules until 31 March 2022.

<sup>2</sup> CRD IV is comprised of the Capital Requirements Regulation (EU) No 575/2013 (“CRR”) and a Directive 2013/36/EU (“CRD”).

<sup>3</sup> Article 433b was introduced into the CRR under Regulation (EU) 2019/876 and applied from 28 June 2021

within the EU and UK. Prudential requirements under the Basel Framework are categorised under three pillars as described below:

- Pillar 1 – Minimum capital requirements: defines rules for the calculation of credit, market and operational risk;
- Pillar 2 – Supervisory review process: including a requirement for firms to undertake an Internal Capital Adequacy Assessment (ICAAP) and Internal Liquidity Adequacy Assessment (ILAAP) ; and
- Pillar 3 – Market discipline: requires expanded disclosures to allow investors and other market participants to understand capital adequacy, particular risk exposures and risk management processes of individual firms. As part of Pillar 3 framework, the Bank is required to disclose all the material risks.

### 1.2.2 Frequency

The Bank is required to publish Pillar 3 disclosures at least on an annual basis. To ensure the effective communication of the Bank's business and risk profile, the Bank continually assesses the need to publish some or all disclosures more frequently than annually.

### 1.2.3 Verification

This Pillar 3 disclosure document was approved by the Board on 16 December 2022. The Board has verified that it is consistent with the Bank's formal policies concerning production and validation. Whilst the disclosures presented within this document do not require validation through external audit, they have been subject to internal governance procedures, including review and approval by the Bank's Executive Committee, Chief Financial Officer (CFO) and Chief Risk Officer (CRO).

### 1.2.4 Immaterial disclosures

In line with Article 432 of the CRR, where the information required under a particular disclosure is considered by the Bank to be immaterial, such disclosures have been omitted. The determination of immateriality is based upon the guidance issued by the EBA.

### 1.2.5 Media and Location of Publication

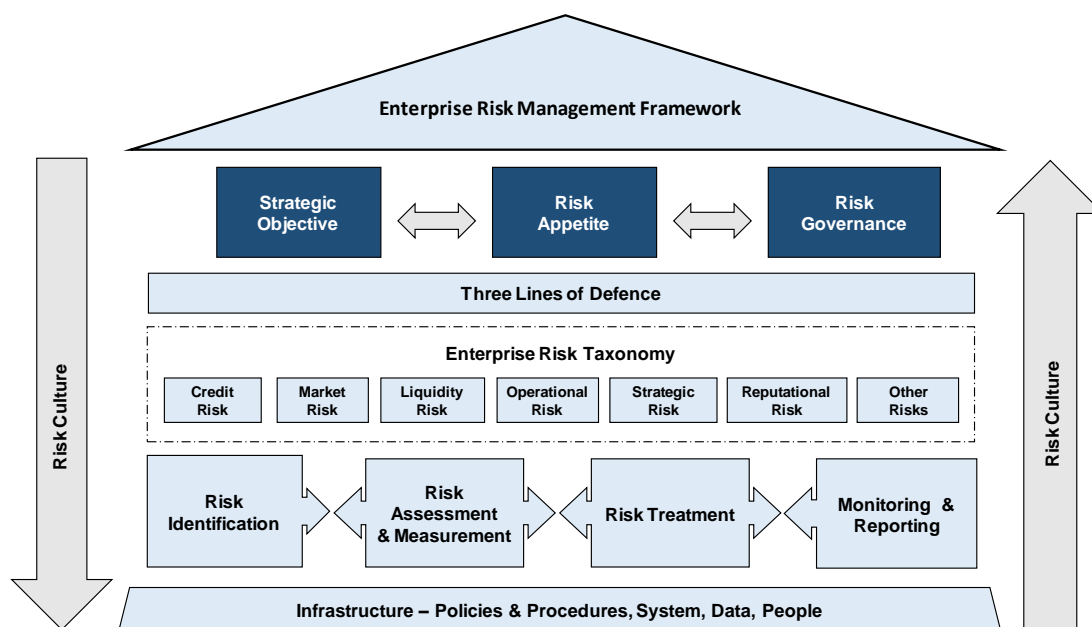
The Bank's Pillar 3 disclosures report is produced on an annual basis and with the Annual Report and Financial Statements for the corresponding period has been published on the Bank's website: <http://www.bankofchina.com/uk/aboutus>

## 2 RISK DECLARATION CONCERNING RISK MANAGEMENT ARRANGEMENTS

Bank of China (UK) Limited has satisfactory arrangements for risk management which are fit for purpose in relation to the Bank's business goal, overall risk profile and the risk strategy which the Board has decided for the operations.

### 3 RISK MANAGEMENT OVERVIEW

The Enterprise Risk Management Framework (ERMF) outline the enterprise-level fundamental principles on how risks should be managed in the Bank across each individual risk types. Figure 1 below provides an overview of the key ERMF components, details of which are elaborated in later sections.



**Figure 1: Enterprise Risk Management Framework**

The Chief Executive Officer (CEO) of the Bank assumes the ultimate executive management accountability of maintaining a sound ERMF, and overseeing and challenging the effectiveness of risk management activities and practices across the Bank. The CEO is supported by all executive managers including the Bank’s CRO, who has a direct reporting line from the Bank’s Chief Compliance Officer (CCO).

The Risk Management Department (RMD) in the Bank supports Senior Management and the Board in:

- Designing and maintaining the Bank’s ERMF, including three lines of defence policy and Enterprise Risk Taxonomy, and oversee and challenge the effectiveness of framework implementation across all risk types in the Bank;
- Maintaining effective risk governance within the Bank;
- Coordinating with the relevant Second line of defence (2LoD) functions in the setting and communication of the Bank’s risk appetites, and providing independent enterprise-level oversight on adherence of risk appetite;
- Engaging and coordinating with the relevant 2LoD functions in generating enterprise-level management information, and providing independent enterprise-level monitoring of risk profile against the risk appetite, and escalating any significant or beyond-appetite risks according to the Bank’s governance structure;
- Promoting a strong risk culture, including awareness and compliance with ERMF requirements and supporting the enhancement of risk management awareness and understanding across all businesses and functions through relevant trainings; and

- Designing and maintaining the Bank’s Enterprise Stress Testing Framework (if required), and oversee and challenge the effectiveness of implementation across relevant risk types in the Bank.

### 3.1 STRATEGIC OBJECTIVE AND RISK APPETITE

The risk appetite, which is described in qualitative and/or quantitative terms, refers to the aggregated level of exposure toward various risks that the Bank is willing to take or accept in pursuit of its strategic objectives and day-to-day running. The respective risk appetites are documented in the Bank’s Risk Appetite Statement (RAS), which is approved by Board, who also approves the Bank’s strategy.

As a result, it is the fundamental principle that the Bank’s risk appetite statement should be reviewed at least annually, so that the risk appetite would remain appropriate and proportionate, amid latest risk profile, strategy and internal and external operating environment of the Bank.

### 3.2 RISK GOVERNANCE

**The Board** is accountable for establishing the Bank’s overall strategy and significant policies with respect to risk management of specific risk type or in general. The responsibilities of the Board include:

- Approving ERMF and ensuring its integrity during implementation;
- Approving the Bank’s Risk Appetite Framework (RAF) and RAS, and ensuring it remains consistent with the Bank’s strategy, business and capital plans as well as compensation programmes;
- Ensuring that the Bank implements sound fundamental principles that facilitate the identification, measurement, treatment, monitoring and reporting of all risks;
- Ensuring that appropriate strategies and measures for managing individual risk element are in place;
- Ensuring that senior management as well as individuals responsible for managing individual risks possess the required expertise and knowledge to manage the risk effectively;
- Ensuring that the Bank maintains various risks at prudent levels; and

To support the Board to fulfil its accountability, the Bank has established a committee governance structure (Figure 2) at both the Board and executive management level to provide oversight and challenge on the implementation of ERMF fundamental principles across all areas and risk types in the Bank.

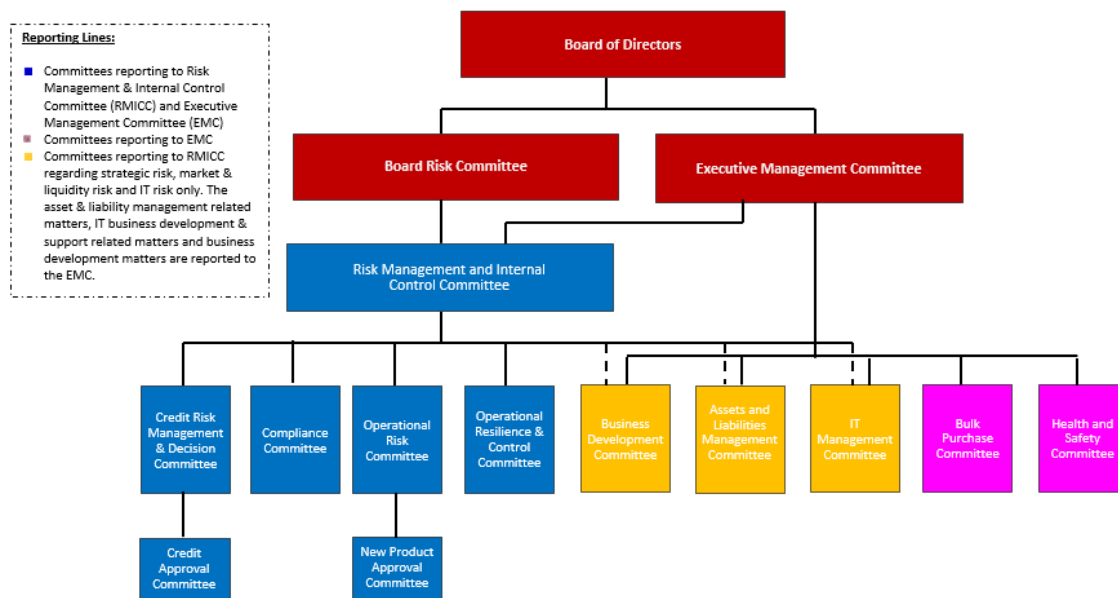
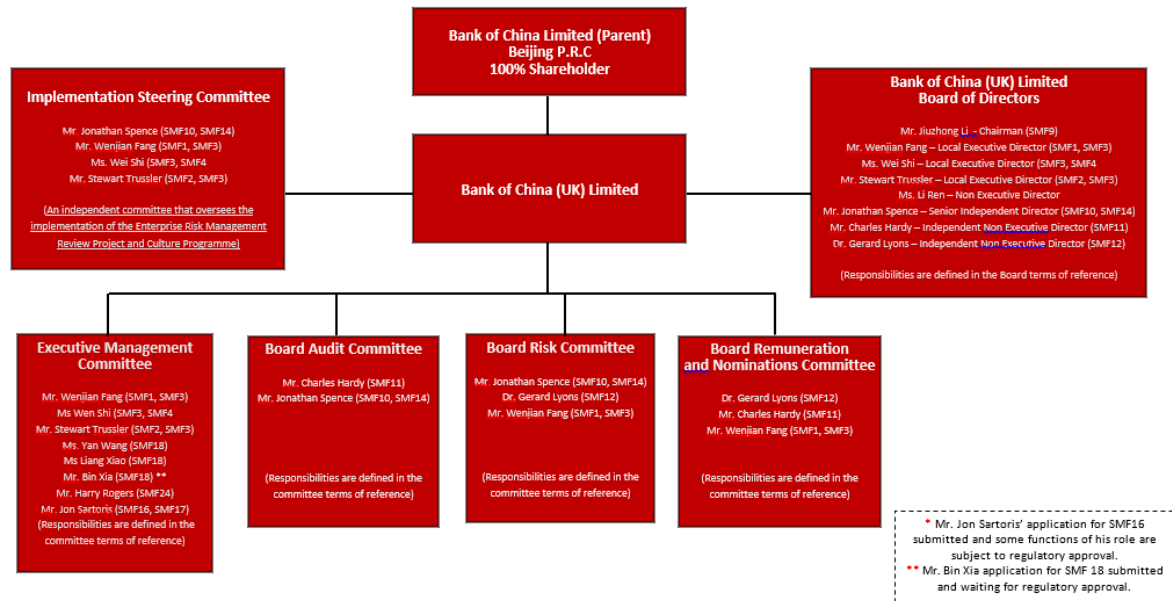


Figure 2: Committee Structure

**Board Risk Committee (BRC)** is mainly responsible for assisting the Board with established and ongoing review of risk strategies, rules and policies, defining risk appetite, oversight of overall risk profile and effectiveness in implementing the Enterprise Risk Management Framework and performing risk management activities.

**Board Audit Committee (BAC)** complements the BRC in respect of risk management. The Board is responsible for internal control, accounting policies, financial reporting, and their relevant compliance with regulatory financial reporting and best practices, approving the scope of internal audit reviews, discussing with the external auditor matters arising from the statutory audit. The BAC's main responsibility is to monitor, review, challenge and assist the Board in carrying out above responsibilities.

**Executive Management Committee (EMC)** is responsible for the overall monitoring of business development and operations, approval of expenditure budget and business budget, as well as dedicating sufficient resources and expertise to implement ERMF. It delegates its risk management responsibilities to the Risk Management and Internal Control Committee.

**Risk Management and Internal Control Committee (RMICC)** under the guidance and supervision of BRC and with the formal delegation from the EMC, is the top executive risk committee in the Bank. The committee, chaired by the Bank's CEO is accountable for:

- The development and implementation of procedures and practices that translate and embed the Board's goals, objectives and risk appetite into operating standards;
- Establishing lines of authority and responsibilities for managing individual risk elements in line with the Board's overall direction;
- Ensuring risk escalation and reporting procedures are implemented within risk management structure;
- Establishing effective internal controls over each risk management process; and
- Ensuring that the Bank's risk appetite and policy requirements are well documented and clearly communicated throughout the Bank such that staff at all levels are responsible for identifying the Bank's declared priority of risk management by recognising real and anticipated risks in their normal course of duty and taking appropriate action. This will ensure that the Bank's risk management culture is sustained throughout the operations.

Many specialised risk-related committees are established in the Bank to oversee the implementation of risk or control management framework and the effectiveness of risk management and control activities in relation to a given risk type(s) as below. The following committees report to RMICC on a quarterly basis.

- **Credit Risk Management & Decision Committee (CRDC):** Credit Risk, Counterparty Credit Risk
- **Operational Risk Committee (ORC):** Operational Risk
- **Compliance Committee:** Financial Crime Risk, Regulatory Compliance Risk (incl. Conduct Risk)
- **Operational Resilience & Control Committee (ORCC):** Business Continuity Risk, Outsourcing & Third Party Risk, Physical Security and Safety Risk
- The **Credit Approval Committee (CAC)** is a sub-committee of CRDC, responsible for credit approval matters, and the **New Product Approval Committee (NPAC)** is a sub-committee of ORC and is responsible for independent approval of new products or changes.

The following committees oversee certain risk types and report the risk specific matters to RMICC on a quarterly basis in addition to its formal reporting lines to EMC.

- **Asset & Liability Committee (ALCO):** Liquidity Risk, IRBBB & FX Risk and Traded Market Risk
- **IT Management Committee (ITMC):** Technology Risk, Information Security Risk (Inc. Cyber Risk), and Data & Information Management Risk

### 3.3 THREE LINES OF DEFENCE MODEL

It is a fundamental principle that an adequate and proportionate three lines of defence model should be established to manage each of the risk types under the risk taxonomy, which takes into account the unique nature and the characteristic of a given risk type. The Bank has adopted an activity-based approach in defining each line of defence in managing a given risk type as follow.

#### 3.3.1 The First line of Defence (1LoD)

1LoD in a given risk owns and manages financial or non-financial risks that it generates from its day-to-day operations, and should ensure adequate understanding of and full compliance with legal, regulatory, ethical and internal expectations.

Therefore, 1LoD is responsible for identifying, assessing and managing all risks generated from its operation, for undertaking the full control management lifecycle activities, identifying and remediating issues, for establishing and performing 1LoD risk reporting and monitoring, and for escalating risk events or material concerns to management and 2LoD.

In addition, the Bank has established dedicated Business Risk & Control teams (1B or 1.5LoD) or equivalent within certain 1LoD. These teams provide additional risk and control advisory and oversight capabilities as well as facilitation support on risk initiatives within 1LoD under its coverage.

#### 3.3.2 The Second line of Defence (2LoD)

A 2LoD role for a given financial and/or non-financial risk type provides supplementary and directional advisory to 1LoD and also carries out independent oversight/challenge on day-to-day 1LoD risk management activities for a given risk type. A 2LoD role is typically responsible for:

- Establishing the specific policies and/or principle requirements on how a given risk type should be managed.
- Providing independent oversight and challenge with respect to the 1LoD risk and control management activities individually (e.g. a specific 1LoD area) and holistically (i.e. the Bank) against the Bank's risk appetite.
- Conducting independent validation of the effectiveness of 1LoD controls (on a sample basis) for a given risk type as appropriate.

#### 3.3.3 The Third line of Defence (3LoD)

The 3LoD role in risk management is assumed by Internal / External Audit and provides fully independent and objective assurance to the Board, management and advice on the adequacy and effectiveness of the Risk Management Frameworks and activities in both 1LoD and 2LoD.

### **3.4 RISK MANAGEMENT PROCESS**

It is a fundamental expectation that iterative risk management lifecycle (i.e. Risk Identification, Assessment & Measurement, Risk Treatment, Monitoring & Reporting) should be developed and maintained in managing all risk types under the enterprise risk taxonomy. These processes manage all risk types and are a standard component in the risk management framework for a given type to guide day-to-day risk management activities.

### **3.5 RISK CULTURE**

Risk culture refers to the unified consensus on the Bank's risk awareness, risk-taking behaviour and risk management concept. The Bank is committed to build a bank-wide risk culture which focuses on bottom-line consensus, prudence and deliberation, initiative and pro-activeness, and value creation.

The Bank promotes its risk culture concepts through:

- Strong support from the Board and Senior Management;
- Accountability and risk ownership;
- Risk transparency communication & training; and
- Strong integrated risk management framework.

The Bank should establish the mechanism of cultivation, development and reserve of risk management talents through continuous development of professional risk management teams and optimise appropriate resourcing.

## **4 CAPITAL**

The Bank established its capital base externally through capital injection from BOC Group. The Bank retains the option to increase its capital internally by retained earnings. The capital resources comprise Tier 1 and Tier 2 capital. The PRA uses risk asset ratios as one of the measures for capital adequacy in the UK banking sector. All the risk asset ratios of the Bank are CRD IV compliant.

### **4.1 CAPITAL RESOURCES**

#### **4.1.1 CET 1 CAPITAL:**

As at 31 December 2021, the Bank's capital base was made up of £307 million (31 December 2020: £342 million) of CET 1 capital. CET 1 capital consists of ordinary share capital and retained earnings. Retained earnings are eligible for inclusion as regulatory Tier 1 capital once audited. Similarly, dividends are deducted from regulatory capital once declared. Therefore, as both events occur after the balance sheet date regulatory capital at the reporting dates will differ to the amount disclosed above.

#### 4.1.2 TIER 2 CAPITAL:

Tier 2 capital includes qualifying subordinated debt of £60 million, which was issued on 20 September 2007 on terms eligible for inclusion in the Bank's capital resources. The debt is repayable upon notice of 5 years and one day. In the event of the Bank's winding-up, the subordinated debt is subject to the claims of depositors and all other creditors of the Bank. Further details are in Note 28 of the Bank's Annual Report and Financial Statement 2021.

The Bank's policy is to maintain a strong capital base so as to maintain market confidence and sustainable business development. The impact of the capital level on shareholders' return is also recognised by the Bank to strike a balance between higher returns and greater gearing risk.

## 4.2 REGULATORY CAPITAL

The Bank complied with all externally imposed capital requirements during the current and prior year. The Bank's CET 1 capital was £275 million as at 31 December 2021 (31 December 2020: £307 million). The Bank's total capital was £335 million as at 31 December 2021 (31 December 2020: £367 million).

## 4.3 REQUIRED LEVELS OF OWN FUNDS

Article 92 of the CRR prescribes the methodology for calculating capital ratios for CET1, Tier 1 and Total Capital resources. The Bank at all times complies with these requirements.

As at 31 December 2021 the total capital adequacy ratio was 29.9% (31 December 2020: 31.9%) based on the CRR. The Bank has not issued any AT1 capital instruments. The current regulatory minimum CET1 and Tier 1 capital ratios of 4.5% and 6% respectively are met with CET1 capital.

The PRA expects the Total Capital Requirements (TCR)<sup>4</sup> to be met with at least 56% CET1 capital, no more than 44% AT1 capital and no more than 25% Tier 2 capital. The Bank strictly follows these requirements and TCR are fully met with CET1 capital.

## 4.4 LEVERAGE RATIO

The leverage ratio was introduced into the Basel III framework as a non-risk based limit, to supplement risk-based capital requirements. The leverage ratio measures the relationship between capital resources and total assets, as well as certain off balance sheet exposures. The purpose of monitoring and managing this metric is to enable regulators to limit the build-up of excessive leverage in the banking systems and at individual institutions.

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<sup>4</sup> Total Capital Requirement (TCR) refers to the sum of Pillar 1 capital requirements plus Pillar 2A capital requirements.

The leverage ratio is defined as the capital measure (the numerator) divided by the exposure measure (the denominator), with this ratio expressed as a percentage.

The capital measure for the leverage ratio is Tier 1 capital – comprising CET 1 and/or Additional Tier 1 capital instruments. The Bank’s leverage ratio at 31 December 2021 was 11.3% (31 December 2020: 14.3%) and was above the internal minimum of 4% at all times during 2021. The movement in the leverage ratio in the year was caused by the growth in the balance sheet. The Bank does not face an issue of excessive leverage.

#### 4.5 CAPITAL REQUIREMENTS

The Bank maintains sufficient headroom above regulatory minimum requirements as defined by the Bank’s ICAAP process. The CET1 ratio as at 31 December 2021 was 24.6% (31 December 2020: 26.7%), total capital ratio was 29.9% (31 December 2020: 31.9%), and regulatory leverage ratio was 11.3% (31 December 2020: 14.3%).

Table 1 sets out the Bank’s Risk Exposure Amounts (REA) and which also known as Risk Weighted Assets (RWAs) and Pillar 1 capital requirements. The Bank has applied the Standardised Approach to measure credit and market risk and the Basic Indicator Approach (BIA) for operational risk to measure RWAs.

**Table 1: Template EU OV1 – Overview of total risk exposure amounts (REA)**

		Minimum Capital requirements			
		2021	2020	2021	2020
		£'000	£'000	£'000	£'000
		(REA)	(REA)	(Capital)	(Capital)
<b>1</b>	Credit risk (excluding counterparty credit risk)	793,055	822,496	63,444	65,800
<b>2</b>	<i>Of which: standardised approach (SA)</i>	793,055	822,496	63,444	65,800
<b>10</b>	Credit valuation adjustment (CVA)	93,581	114,722	7,486	9,178
<b>20</b>	Market risk	14,056	11,621	1,124	930
<b>21</b>	<i>Of which: standardised approach (SA)</i>	14,056	11,621	1,124	930
<b>24</b>	Operational risk	218,688	202,676	17,495	16,214
<b>27</b>	<b>Total</b>	<b>1,119,380</b>	<b>1,151,516</b>	<b>89,550</b>	<b>92,121</b>

**Table 2: Capital Requirements**

	2021 (%)		2020 (%)	
	CET1	Total Capital	CET1	Total Capital
Pillar 1	4.50	8.00	4.50	8.00
Pillar 2A	1.99	3.56	1.81	3.24
<b>Total capital requirement (TCR)</b>	<b>6.49</b>	<b>11.56</b>	<b>6.31</b>	<b>11.24</b>
Capital conservation buffer	2.50	2.50	2.50	2.50
Countercyclical capital buffer (CCyB)	0.09	0.09	0.08	0.08
<b>Total (excluding PRA buffer)</b>	<b>9.08</b>	<b>14.15</b>	<b>8.89</b>	<b>13.82</b>

#### 4.5.1 PILLAR 1

Minimum capital requirements are referred to as Pillar 1 requirements. These requirements apply to the credit, market and operational risk generated by the Bank. Pillar 1 requirements also extend to other risk types like settlement and credit valuation adjustment risks and requirements associated with large exposures and the leverage ratio. Regulatory capital adequacy is measured through three risk-based ratios, CET1, Tier 1 and Total Capital Ratios.

The Bank uses the Standardised Approach for credit risk and the Basic Indicator Approach (BIA) for operational risk. Under the CRR, the Bank must set aside capital equal to 8% of total risk weighted assets to cover Pillar 1 capital requirements.

Under CRD IV, the minimum CET1, Tier 1 capital and Total capital adequacy ratios are supplemented by a number of capital buffers. The CRD IV capital buffers applicable to the Bank are collectively referred to as the Combined Buffer Requirement.

#### 4.5.2 PILLAR 2A

The Pillar 2 capital framework is intended to ensure the Bank has adequate capital to support the relevant risks in its business. In addition to the Pillar 1 and the Combined Buffer Requirement mentioned above, the PRA performs a periodic supervisory review of the Bank's ICAAP, which leads to a final determination by the PRA of TCR amount under Pillar 2A. The Pillar 2A requirement is an additional capital requirement that a firm need to hold to cover risks that are not adequately captured in Pillar 1. This is a point in time assessment of the minimum amount of capital the PRA considers that an entity should hold.

The PRA may also require firms to hold an additional capital buffer (referred to as the PRA buffer) to enable firms to meet its minimum capital requirements under stress. Any PRA buffer requirement is set after taking into account the existing amount of Capital Conservation Buffer (CCB) and Countercyclical Capital Buffer (CCyB) already held by the firm.

#### 4.5.3 ICAAP

The purpose of the Bank's ICAAP is to define the internal processes and methodologies applied to assess current and forecast capital requirements over the planning period as well as to present the results of this assessment.

The ICAAP represents the on-going assessment of the risks faced by the Bank and the level of capital that needs to be allocated for these risks to ensure that the Bank continues to meet its capital requirements. The document is designed so to provide the Board a comprehensive view on the sufficiency of the current and projected capital resources, material risks and exposures, risk management framework and risk quantification process, the estimated capital requirements and the projections under stress scenarios.

## 4.6 CAPITAL BUFFERS

In addition to the minimum capital requirements, CRD IV requires institutions to hold capital buffers that can be utilised to absorb losses in stressed conditions. The following capital buffers apply to the Bank.

### 4.6.1 CAPITAL CONSERVATION BUFFER (CCB)

The CCB introduced under CRD IV is designed to ensure that institution build up capital buffers outside periods of stress which can be drawn down as losses are incurred. As at 31 December 2021, the buffer was set at 2.50% of risk-weighted assets (31 December 2020: 2.50% of risk-weighted assets). This is the highest level required under the current rules.

### 4.6.2 COUNTERCYCLICAL CAPITAL BUFFER (CCyB)

The CCyB requires financial institutions to hold additional capital to reduce the build-up of systemic risk in a credit boom by providing additional loss absorbing capacity and acting as an incentive to limit further credit growth to protect the banking sector against losses that could be caused by cyclical systemic risks.

The Financial Policy Committee (FPC) in the UK is responsible for setting level of UK CCyB rate. On 11 March 2020, the Bank of England issued a statement on measures to respond to the economic shock from COVID-19. This listed several actions that the Bank of England would implement, including reducing the UK CCyB to 0% with immediate effect. On 13 December 2021, the FPC updated its guidance re-introducing 1% CCyB rate for UK exposures that will take effective from 13 December 2022. On 5 July 2022, the FPC announced that the UK CCyB rate will be increased from 1% to 2% from 5 July 2023.

## 5 CREDIT RISK

Credit risk is the risk that a borrowing client or treasury counterparty fails to repay some, or all, of the capital or interest advanced to them, due to lack of willingness to pay and/or lack of ability to pay. The principal source of credit risk relates to the Bank's loans and advances to customers.

### 5.1 CREDIT RISK MANAGEMENT FRAMEWORK

The Bank established credit risk appetite in accordance with the Bank's risk capacity, which reviewed on regular basis, in line with the Bank's strategic planning cycle, or more frequently in the event of significant changes in Strategy, internal or external conditions. Credit risk appetite is monitored and reported on a monthly basis through a suite of risk metrics derived from credit portfolio performance measures. Credit risk appetite limits and credit risk policies are reviewed regularly to ensure that the metrics continue to reflect the Bank's risk appetite appropriately.

The Bank manages credit risk through:

- Clear credit risk governance structure;
- Defining, implementing and re-evaluating its risk appetite
- Maintaining a strong culture of responsible risk taking and a robust risk policy and control framework;
- Identifying, assessing and measuring credit risk clearly and accurately across the Bank, from the level of individual facilities up to the total portfolio;
- Monitoring credit risk relative to limits;
- Regular credit inventory review;
- Regular credit portfolio MI reporting

## **5.2 CREDIT RISK EXPOSURES**

The standardised approach is applied for credit risk. The Bank's minimum capital requirement for credit risk is expressed as 8% of the Risk Exposures Amounts under each of the applicable standardised credit risk exposure classes.

Total credit risk exposures as at 31 December 2021 increased by £258 million to £2,189 million, primarily due to increases on lending secured on immovable property (£124 million) and Central Governments (£207 million) which was partially off-set by a decreased in Corporate lending.

The Bank actively aims to prevent undue concentration by ensuring a diversified credit portfolio. Single customer, industry, geography and maturity specific concentrations are actively assessed and managed against risk appetite limits.

## **5.3 IMPAIRMENT PROVISIONS**

The Bank assess on a forward-looking basis the Expected Credit Losses (ECL) associated with all loans and other debt financial assets following IFRS9 standard. The Bank calculates ECL using three main components, a probability of default (PD), a loss given default (LGD), and the exposure at default (EAD). ECL include impairment allowances (or provision in the case of commitments and guarantees) for the 12-month ECL and lifetime ECL.

The Bank's ECL as at 31 December 2021 increased to £28million, mainly due to two corporate customers which are negatively impacted by COVID-19 pandemic. These customers were credit impaired (stage 3) during the year as a result of being more than 90 days past due and restructured due to financial difficulties.

## **5.4 CREDIT QUALITY STEP (CQS)**

In the assessment of credit risk under Standardised Approach, the Bank uses ratings assigned by two of the recognised External Credit Assessment Institutions (ECAI) to calculate RWA.

Counterparties exposure under the standardised approach must be assigned to one of the six credit steps if a rating is available. After assignment to a quality step, exposure class and maturity are then used to determine the risk weight percentage. Where a credit rating is not available, a default treatment is applied as specified by regulatory guidance.

Gross exposure amount as at 31 December 2021 subject to the use of ECAs was £1,167 million (31 December 2020: 966 million). The exposures include on and off-balance sheet items. In the case of off-balance sheet exposures, the Bank applies a Credit Conversion Factor (CCF) as prescribed under CRD IV. The Bank's mortgages are not externally-rated but are internally assessed. The Bank considers the asset quality of its unrated counterparties to be good on the basis of their financial standing, credit profiles and low probability of default underpinned by well-structured credit and an identified source of repayment. The Bank follows the provision of the CRD IV where external ratings cannot be obtained.

## **5.5 CREDIT RISK MITIGATION (CRM)**

CRM is a key aspect of effective risk management. The Bank uses a range of approaches to mitigate credit risk. Credit risk mitigation and credit enhancements employed by the Bank are listed below:

- A first fixed charge over residential real estate is the main source of collateral for retail lending and more than half of BOC UK's portfolio are concentrated in mortgage lending. Mortgage properties are valued by an independent external specialist at loan initiation stage. For the rest of the loan life cycle, mortgage properties are regularly valued based on Nationwide housing price indices.
- For corporate lending, the Bank has different types of collateral, i.e. commercial real estate, standby letter of credit, aircraft, etc.

## **6 COUNTERPARTY CREDIT RISK (CCR)**

Counterparty credit risk refers to the risk that a counterparty to a transaction may default prior to the satisfactory final settlement of the cash flows of one of the following types of transactions: over-the-counter (OTC) derivatives, exchange-traded derivatives, long settlement transactions and securities financing transactions.

The Bank is a clearing member of the London Clearing House (LCH) which is a qualified central counterparty (QCCP). The Bank's CCR mainly arises from derivative transactions when acting as clearing counterparty for the Bank of China Group. The Bank has provided cash collateral in respect of derivative contracts with LCH under its QCCP standard.

The Bank does not hold any credit default swaps (CDS) or total return swaps (TRS), and therefore disclosures for credit derivative transactions is not applicable. The Bank measures the risk of counterparty default and a credit valuation adjustment (CVA) when calculate its total CCR capital charge.

## 6.1 CAPITAL CHARGES FOR DEFAULT RISK

The Bank applies mark to market method approach to calculate CCR exposure (CCR EAD) for derivatives. It is the sum of the replacement cost (RC) and the potential future exposure (PFE). The total CCR EAD is derived from the sum of RC and PFE.

The RC is obtained by marking the contracts to market. The PFE is reflected by add-on factors, which is an estimate of the total notional principle amount split by residual maturity. The PFE consist of a multiplier that allows for the partial recognition of excess collateral and an aggregate add-on, which is derived from add-ons developed for each asset class.

## 6.2 CAPITAL CHARGES FOR CVA RISK

The Bank is exposed to the risk of loss on FX and derivatives instruments caused by changes in the credit spread of counterparty due to changes in its credit quality. In order to address this risk, CVA is estimated as an adjustment to the mid-market valuation of the portfolio of transactions with a counterparty that reflects the current market value of the risk of the deterioration of counterparty credit quality at times of market stress and cyclical changes.

The Bank adopts the Standardised Approach set out by the CRR in order to calculate the CVA capital requirement. The approach uses the key drivers of the CVA, such as discounted EAD, applicable risk weights and effective maturity, defined as follows:

- Discounted EAD is the total EAD after applying discounting factor estimated in accordance with the regulatory requirements (maturity-based);
- Risk weights are based on the external credit rating of the counterparty;
- The effective maturity is the notional weighted average maturity.

The Bank's CVA for derivative portfolio is not hedged.

## 7 MARKET RISK

Market risk is defined as the risk that movements in market risk factors, including interest rate, foreign exchange rate, equity, commodity, and credit spread, will reduce the Bank's income or the value of its asset portfolio. The Bank has broken down market risk into two separate risk type – a) Traded Market Risk and b) IRRBB and FX Risk, and established appropriate risk management framework to manage them respectively.

### 7.1 TRADED MARKET RISK

Traded market risk is defined as the risk of losses from trading activities arising from adverse movements in market prices. The Bank does not undertake any proprietary trading activities, all trading activities are client-driven and are promptly squared, hence inherently has limited exposure to traded market risk.

## 7.2 FOREIGN EXCHANGE (FX) RISK

Foreign exchange risk is the risk that movements in various currencies could materially impact the financial statements. FX is monitored via dedicated FX gross position limits and covers both banking and trading book, excluding the accounting base currency GBP.

FX risk arises from the foreign currency profit and loss across all business lines and FX financial instruments. In order to manage this risk, the Bank squares the foreign currency profit and loss on a regular basis and uses FX financial instruments.

## 7.3 INTEREST RATE RISK IN THE BANKING BOOK (IRRBB)

The objective for IRRBB risk management is to minimise the sensitivity of the Bank's earnings and economic value to interest rate fluctuations.

IRRBB mainly stems from the re-pricing mismatch between assets and liabilities. The sources of interest rate risk include re-pricing risk, yield curve risk, basis risk and embedded option risk. Interest rate risk is managed based on the re-pricing of the underlying investments. There are no assumptions made on loan prepayments.

The Bank mainly utilizes the interest rate sensitivity gaps to analyse the re-pricing risk on a static basis from both the near-term earnings perspective and the long-term earnings perspective. Interest-generating assets, interest-bearing liabilities and the off-balance sheet position are classified into different time buckets; interest rate-sensitive liabilities in each time bucket are subtracted from the corresponding interest rate-sensitive assets to produce a re-pricing gap for that time bucket.

The Bank adopts two key risk indicators (KRIs) for the purpose of monitoring, reporting, and managing the IRRBB:

- Change in Net Interest Income ( $\Delta$ NII) is an earnings metric that measures the potential impact of a specified interest rate change on the net interest income for banking book over specified reporting period; and
- Change in Economic Value of Equity ( $\Delta$ EVE) is a valuation metric that measures the potential impact of a specified interest rate change on the economic value of equity (the net economic value of all on and off balance sheet assets and liabilities using present value calculations).

## 8 OPERATIONAL RISK

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. The scope includes legal risk, but excludes strategic and reputational risk.

Operational risk is inherent in the Bank’s business activities and the impact can be financial as well as non-financial such as customer detriment, reputational or regulatory censure. However, it’s not cost effective, and in many cases impossible, to eliminate all operational risk, and operational risks losses are expected to occur and are accepted as part of the normal course of business activities. Therefore, the Bank has established a comprehensive Operational Risk Framework in line with the CRD IV and Basel guidelines in order to manage operational risk within its risk appetite.

The Bank uses the BIA to calculate the operational risk capital requirement, which is 15% of the average annual gross income over the previous three years.

**Table 3: Template EU OR1 - Operational risk own funds requirements and risk-weighted exposure amounts**

Banking Activity (In '000)		Relevant Indicator			Own Fund Requirements 2021	Risk Exposure Amount 2021
		2019	2020	2021		
1	Banking activities subject to basic indicator approach (BIA)	114,561	115,237	120,103	17,495	218,688

## 8.1 OPERATIONAL RISK MANAGEMENT APPROACH

The Bank adopts an industry standard 3LoD model for Operational Risk Management. The 1LoD act as risk owners and is responsible for the design and implementation of effective controls to mitigate these risks. The 2LoD consist of a functionally independent Operational Risk Management (ORM) Team in the Risk Management Department, who is responsible for establishing and maintaining a sound Operational Risk Management Framework and for overseeing on the Bank’s overall operational risk profile and effectiveness of 1LoD operational risk management activities (e.g. implementation of operational risk management policy requirements).

In addition to ORM, a group of specialist support functions in the Bank also provide independent control oversight within its respective area(s) of expertise aligned to the operational risk taxonomy as follows.

- **Risk Management:** Model Risk
- **Financial Crime & Compliance:** Financial Crime Risk, Regulatory compliance Risk (incl. Conduct)
- **Data & Process Management Office:** Data & Information Management Risk, Information Security (incl. Cyber) Risk, Technology Risk
- **Financial Management:** Financial Reporting & Tax Risk
- **Human Resource & Training:** People Risk
- **Legal & Company Secretariat:** Legal Risk
- **Operations Services:** Business Continuity Risk, Outsourcing & Third Party Risk
- **GA Facilities:** Physical Security & Safety Risk

The 3LoD provide independent assurance on the effectiveness of operational risk framework and risk management activities in the Bank and report directly to the Board Audit Committee

The 1LoD operates a set of tools to enable them to identify, assess, monitor, report and mitigate operational risk, subject to oversight and challenge from the 2LoD and control oversight functions. The output from these risk management activities is reported to the ORC and, where appropriate, the relevant specialised risk committees (e.g. Compliance Committee), with escalation to RIMCC and Board committees. Any non-financial risks that exceed risk appetite are subject to a formal escalation and ongoing governance process to ensure that they are mitigated to within risk appetite.

## **9 LIQUIDITY & FUNDING RISK MANAGEMENT**

Liquidity risk refers to the risk that the Bank is unable to fund its assets and/or meet its obligations as they become due or can only do so at excessive cost.

The Bank has adopted a 'cautious' approach to liquidity which is fully reflected in the conditions set within its own stress scenarios, and is aligned to the Bank's business profiles and to the liquidity risk measures prescribed by the PRA. As such the Bank aims to maintain sufficient and adequate liquidity resources in terms of both quality and quantity at all times, during both businesses as usual and periods of stress.

The Bank achieves these objectives through the establishment of policies, liquidity risk limits, ongoing monitoring and management, stress testing and by maintaining a sufficient stock of high quality liquid assets which at present is cash deposited at the Bank of England.

### **9.1 GOVERNANCE**

The Board takes ultimate responsibility for liquidity and funding risk management of the Bank. It has delegated the responsibility of developing and implementing policies and procedures for managing liquidity and funding risk to the EMC, which in turn has delegated these responsibilities to the ALCO.

The EMC and the ALCO ensure that the decision of the Board as the governing body are integrated into the Bank's liquidity and funding risk management process. Liquidity risk is managed by the Treasury ALM function within the Financial Management Department as mandated by the ALCO.

The ALCO discusses, reviews and approves all liquidity and funding risk related policies, assessments and governance matters as often as is required and at least annually, or more frequently should any member of the Board request. Following ALCO approvals, the governance framework requires notification to the RMICC and for some key policies, such as the ILAAP submission to the BRC and the Board for their respective approvals. The challenge and review provided by the ALCO, BRC and the Board ensure that the liquidity and funding risk governance and management framework are up to date and continue to remain appropriate for the Bank's current and projected business and economic environment.

The policies and procedures related to liquidity and funding risk are defined and formalised in the Liquidity Policy, Funds Transfer Pricing Policy, the Liquidity Risk Pricing Policy, the Liquidity Stress Testing Policy and the Recovery Plan, which have all been effectively communicated throughout the Bank via the ALCO.

## 9.2 LIQUIDITY AND FUNDING RISK MANAGEMENT

**Overall liquidity adequacy:** In line with the PRA's liquidity rules, the Bank produces an ILAAP document at least annually to assess how the Bank achieves overall liquidity adequacy, in both normal times and during potential stressed conditions, which involves an internal quantitative and qualitative assessment of its management systems and controls and assessment of the adequacy of its liquidity and funding resources. The conclusion of the Board approved ILAAP is that the Bank continues to maintain sufficient and adequate liquidity resources in terms of both quality and quantity and that the Bank has the appropriate governance structure and operational infrastructure to identify, measure, monitor and manage compliance with the regulatory and internal liquidity risk appetite.

The ILAAP also aligns with the EBA guidelines on common procedures and methodologies for the Supervisory Review and Evaluation Process (SREP) and complies with the guidance provided by the PRA. In addition, the Bank regularly updates the Recovery Plan which details the actions the Bank might take in the event of a liquidity stress. The Recovery Plan details how limit breaches are handled, including the escalation, invocation, communication plans and procedures, starting from the point at which any deterioration in metrics is first observed to enable management sufficient time to take remediating actions.

**Liquidity Stress Testing:** The Bank performs liquidity stress testing on a monthly basis and as a part of the quantitative assessments of the ILAAP to ensure and test the adequacy of the Bank's liquidity resources under various stressed scenarios and to ensure that the Bank can continue to operate under such stressed conditions.

**High Quality Liquid Assets (HQLA):** The Bank's liquidity risk appetite specifies the level of HQLA that should be maintained on an ongoing basis in order to meet both regulatory (i.e. Pillar 1 and Pillar 2) and internal requirements during business as usual and stressed conditions.

**Liquidity Risk Appetite:** The Board approved liquidity risk appetite defines the aggregate level and type of risk that the Bank is willing to assume within its risk capacity to achieve its strategic objectives and business plan and adopted a 'cautious' approach to take liquidity risk. The liquidity risk appetite is directly linked to the Bank's stress testing results and to regulatory requirements and also determines the size of the Bank's liquidity buffers. The liquidity risk appetite embeds an early warning threshold mechanism by way of RAG (Red, Amber, Green) rating the defined metrics to ensure that minimum regulatory liquidity requirements are not likely to be breached. The Bank's risk appetite statement metrics are reviewed at least annually.

**Liquidity Coverage Ratio (LCR):** The LCR assesses whether the Bank has an adequate stock of unencumbered HQLA that can be converted easily and immediately into cash to meet its liquidity needs for a 30 calendar day liquidity stress scenario. The regulatory minimum LCR set at 100%. Since the ratio's formal introduction, the Bank has assigned the daily measurement, monitoring and reporting of the LCR to the Regulatory Reporting Team within the Financial Management Department.

The LCR is measured, monitored and reported daily. The Bank met the LCR regulatory requirement at all times during 2021. At 31 December 2021, the average LCR was 179% (31 December 2020: 243%). The LCR declined over the year due to the increase in liabilities that carried a higher outflow rate.

## **10 OTHER RISK CONSIDERATIONS**

### **10.1 OPERATIONAL RESILIENCE**

Operational Resilience is a key area of focus for both PRA and FCA and the Bank has undertaken a transformation project, led by the dedicated operational resilience team and the Bank's Chief Operating Officer (SMF24) to design and implement an Operational Resilience programme and a Third Party risk management framework.

Operating as part of the ERMF, and aligned with the recent Bank of England, FCA and PRA supervisory statement (SS2/21, PS2/22) requirements, this programme has supported EMC and the Board in developing a sound understanding of Operational Resilience and the Impact Tolerance of their Important Business Services (IBS).

In respect to operational resilience, the Bank undertook a Self-Assessment before the end of March 2022, against the outcomes expected in the supervisory statements. The Bank identified and highlighted relevant vulnerabilities within the operational resilience Self-Assessment and will follow through on a programme of work that is designed to meet the March 2025 dateline. The Self-Assessment is a Board approved living document that will be continuously updated to reflect the framework, governance and operational resilience status and infrastructure in order to meet UK regulatory requirements.

Components include:

- BOC Operational Resilience Framework
- Important Business Services including rationale for determining the list of IBS
- Impact Tolerance, including the rationale for each IBS
- Mapping
- Scenario Testing
- Communications Strategy
- Outsourcing
- Vulnerabilities and Remediation Plans
- Metrics

In respect to Third Party management, the bank has identified material and non-material arrangements and has established an inventory of third party and outsourced service providers categorised by materiality. The Bank is performing risk assessments for all new and renewed third party providers and updating agreements, in line with regulatory expectations.

The Bank focus for 2022 is on addressing the vulnerabilities identified in the operational resilience self-assessment, which are:

- Continuing the programme of scenario and wider testing,
- Implementation of the operational resilience and third party risk SaaS solution.
- Filling any ownership gaps on dependencies identified through mapping and testing.

## **10.2 CLIMATE CHANGE**

According to Bank of England, climate-related financial risks could arise from two primary risk factors or drivers – a) Physical Risk and b) Transition Risk, and these could manifest, for example, as increasing credit or market risk for firms.

In light of UK regulatory requirement (SS3/19), the Bank, in line with most of our industry peers and regulatory expectation, considers climate-related physical and transition risk factors as thematic factors that cut across various the existing risk types (e.g. credit risk, market risk etc.). Management of climate related risks has been proportionately embedded into the Bank's existing risk management framework of the impacted risk types respectively for sound management.

Under the embedding approach, financial impact of climate-related physical and/or transition risk factors on the relevant risk type will be managed through the respective 3LoD model, subject to oversight from respective risk-related committee (e.g. CRDC, ALCO, ORC, ORCC etc.).

The Bank considers that the climate-related risk factors are likely to have more incremental financial impact on the Bank's credit risk profile amongst the main risk types, and hence it has been decided that CRDC should assume additional responsibility to lead the other risk-related committees in overseeing the management of climate-related risk factors with a view that RMICC will take the lead in the future once practices are appropriately embedded and matured, subject to regular reporting into BRC and the Board of Directors.

In addition, Business Development Committee (BDC), as the Bank's 1LoD risk governance forum, will also oversee the overall impact from climate-related risk factors and effectiveness in managing such from the 1LoD perspective.

### **Climate Change Impact Assessment**

The Bank has used a subjective rating methodology to assess impact of physical and transition risk on the sectors within its existing asset book. The rating scale is between 1-10, where 1-3 is considered low risk, 4-7 medium risk and 8-10 high risk. Given the current composition where retail mortgages dominate the portfolio and to a lesser degree

corporates; the overall BOC UK portfolio is considered to have low physical risk impact and medium transition risk impact.

## **11 ASSET ENCUMBRANCE**

Asset encumbrance is the process by which assets are pledged in order to secure, collateralise or credit-enhance a financial transaction from which they cannot be freely withdrawn. An asset shall be treated as encumbered if it has been pledged or if it is subject to any form of arrangement to secure, collateralise or credit enhance any transaction from which it cannot be freely withdrawn.

As at 31 December 2021 the Bank had £14 million (31 December 2020: £14 million) of encumbered assets. The collateral relates to the Bank's default fund contributions required at the LCH under QCCP standard.

## **12 REMUNERATION**

In alignment with the Capital Requirements Regulation remuneration disclosure requirements, the FCA's General Guidance on Proportionality: The Remuneration Code (the Code) (SYSC 19) and the PRA's LSS8/13, "Remuneration Standards: The Application of Proportionality", the Bank has been classified as a proportionality Level Two firm.

The following constitutes the Bank's remuneration disclosure under Pillar 3 and sets out the details required under the Code and Pillar 3 Disclosures on Remuneration as they apply to the Bank for the year ended 31 December 2021.

### **12.1 REMUNERATION AND NOMINATIONS COMMITTEE (RNC) – GOVERNANCE**

The Bank has a robust governance framework with an independent Remuneration and Nominations Committee (RNC), which is responsible for the implementation of the Bank's effective remuneration governance and related risk management practices.

It consists of two independent non-executive directors, one of whom chairs the Committee. The Chief Executive Officer, the Head and Deputy Head of Human Resources attend the committee meetings and have the right to speak, but not to vote. The RNC includes representatives from the Board Audit and Board Risk Committees who bring their relevant experience to the process.

The RNC's Terms of References set out the committees' duties which is reviewed annually by the Bank. The RNC's primary purpose is to be responsible for the Bank's remuneration policy, structure, and practices.

The RNC has oversight for people risk which can simply be defined as being the risk that people do not follow the Bank's procedures, practices and/or rules, thus deviating from expected behaviour in a way that could potentially harm the business's performance and reputation. The Bank has a strong organisational culture and a clearly developed governance

structure that, in conjunction with required policies, procedures and processes, supports the management of people risk accordingly.

The RNC is also supported by the Bank's Board Risk Committee on risk related matters including the specific measures and wider issues relating to risk and business protection, and also by the Financial Crime and Compliance Department on risk and performance related issues.

In performing its duties, the RNC has sought external advice in relation to the application of the FCA Remuneration Code, and remuneration benchmarking including market practice and peer group methodology.

## **12.2 REMUNERATION POLICY**

The RNC is guided by the overarching principles of the Bank's Remuneration Policy. The objective of the policy is to clearly document the practices of the Bank in regards to the remuneration of its employees.

The policy recognises and supports the fact that appropriate levels of remuneration and compensation are necessary to attract, retain and motivate high calibre staff required to lead, manage and serve the Bank in a competitive financial services environment whilst complying with all relevant regulatory requirements.

The Bank has a robust framework in place to ensure that the level and composition of remuneration:

- Is reasonable and both clearly and measurably linked to performance;
- Is appropriate for results achieved; and
- Encourages behaviour consistent with the Bank's core competency model and core values which leads to excellence and the appropriate balance in financial performance, governance, controls, risk management, customer service, people management, brand and reputation management.

In addition, the policy operates in conjunction with the Bank's business goals and its other HR policies. It is compliant with the provisions of the Equality Act 2010 and ensures that remuneration practices are fair and consistent with the Bank's view on equality and diversity.

## **12.3 REMUNERATION FRAMEWORK**

The composition of remuneration and benefits comprise:

- Basic salary; which is determined by reference to external market remuneration benchmarking data and reviewed, although not necessarily changed, annually. Increases are typically to ensure appropriate pay positioning relative to market range and relative pay of others doing the same or similar role;
- Benefits; which are also determined by having regard to external market benchmarking data and are designed to be market competitive, to meet the requirements of the Bank's

employees and ensure they make appropriate health and lifestyle decisions as part of a wider flexible benefit scheme;

- Discretionary Bonus (both cash and deferred elements) which is performance based variable remuneration determined by the outcome and achievement of performance measures and competences applied to employees within a balance scorecard framework.

Discretionary awards as referred above qualify as “variable remuneration” as defined in the Code. These three elements are managed together to ensure that total reward is appropriate and aligned with the Bank business objectives, strategy and risk appetite.

The RNC discuss and review Risk and Compliance/Senior Management employee’s remuneration on an annual basis to ensure they are remunerated independently of the businesses they oversee. This process is completed in the first quarter annually to align to annual remuneration reviews. Independent Non-Executive Directors do not participate in variable pay arrangements.

#### **12.4 LINK BETWEEN PAY AND PERFORMANCE**

The Bank’s remuneration policies are designed to allow the Bank to attract and retain talented individuals needed to deliver the business strategy. The Bank manages the risk implications of its remuneration arrangements in a number of ways, including:

- Striking the optimal balance between ‘fixed’ elements of pay (base salary, benefits and pension), and ‘variable’ pay (annual discretionary bonus) to ensure variable pay overall and on an individual-by-individual basis remains an appropriate proportion of total pay;
- Ensuring performance for all variable pay plans is measured by reference to a range of factors including non-financial objectives, which take into account risk, sustainability of performance and the Bank’s core competences and values in order to take a rounded view of performance;
- Retaining the requirement to effect clawback and malus provisions of the Remuneration Code. Clawback and malus will be initiated and enforced in line with the Bank’s Risk Management adjustment and performance assessment and the Bank’s disciplinary procedure; and
- Ensuring that any discretionary bonus scheme will not be applied unless the Bank achieves performance objectives as determined at the beginning of each financial year.

#### **12.5 RISK AND PERFORMANCE ADJUSTMENTS**

The Risk and Performance Adjustment considerations that are applied by the Bank are:

- Consideration of the ongoing performance of the Bank that could be impacted by an individual, including profitability, specific losses incurred or written off and any new provisions made during any variable award period;

- That during any variable award period investigations by external auditors and regulators are without material qualification or disclose undue risk (taken by an individual);
- That future risks to be considered for Credit and Market Risk include the non-performing loans (NPLs) ratio and VAR; and
- That any misstatement or misconduct or breach of policy or procedure by any individual be considered accordingly with Compliance, Operational Risk, Internal Audit or any other internal reports to be considered as appropriate.

## **12.6 APPLICATION OF MATERIAL RISK TAKERS**

The Remuneration Code requires that banks identify relevant staff who could be determined as Material Risk Takers; the Bank currently considers the following categories of staff to be material risk takers

- Staff who perform significant influence functions for the Bank (as defined within the FCA Handbook);
- Staff with responsibility for management and supervision, and who report directly to the governing body, a member of the governing body, the CEO, or an Executive Management member responsible for significant business lines;
- Staff engaged in control functions;
- Staff whose total remuneration takes them into the same bracket as Senior Management; and
- Staff whose professional activities could have a material impact on the firm's risk profile including market, credit and interest rate risk, and funding, liquidity, reputational and operational risk, with particular focus on risk in relation to the Bank's capital.

It is recognised that in applying the EBA's extended scope of CRD IV in relation to remuneration that Regulatory Technical Standards (RTS) (qualitative and quantitative) have been established and define specific criteria to further identify categories of employees whose activities have a material impact on institutional risk (Material Risk Takers).

## **12.7 ANNUAL DISCRETIONARY BONUS AWARD FOR MATERIAL RISK TAKERS**

Material Risk Takers participate in the annual discretionary bonus scheme that aims to recognise and reward an employee's personal contribution to the success of the Bank. As referred to above, contribution and success is typically based on the measure of a mix of corporate and personal pre-agreed objectives for the year which results in a performance rating for the individual.

For the majority of Material Risk Takers, discretionary bonus awards will be paid from a discretionary bonus pool which is determined following the end of the financial year based

on the Bank's performance. This is paid as a cash award in March following the end of the financial year.

Individual discretionary bonus awards will be reduced where the Bank becomes aware of any action by an individual who has exposed the Bank to any form of unplanned risk (including, but not limited to, regulatory, legal or reputational risk).

The Bank's Remuneration Policy enables deferral of discretionary bonus awards in alignment with regulatory requirements. The deferral of variable remuneration applies to defined material risk takers only who fall outside of the current "de Minimis" rules.

## 12.8 REMUNERATION AWARDED

The EBA requirements on remuneration state that variable pay shall not exceed 100% of fixed pay (can be increased to 200% subject to shareholder approval) and this requirement is included in the Bank's Remuneration Policy.

*Table 4: Template EU REM1 - Remuneration awarded for the financial year*

	31 December 2021 (£)
Total fixed pay	29,958,879
Total variable pay (including discretionary bonus award, allowances and overtime)	9,024,859
Total deferred remuneration paid out	810,800
Total non-deferred variable remuneration paid out	6,734,166
Total outstanding deferred remuneration (to be paid 2022 -2028)	897,451
Total severance payments made	69,493
<b>Total Remuneration</b>	<b>47,495,651</b>
<b>Variable pay/Fixed pay ratio</b>	<b>30%</b>

*Table 5: Template EU REM5 - Information on remuneration of staff by professional activities*

31 December 2021	Management Body	Senior Managers	Others	Total
Number of Code Staff	10	22	46	78
Fixed Pay (£)	1,974,934	2,934,939	4,145,260	9,055,133
Variable Pay (£)	684,775	933,804	1,111,086	2,729,665

All remuneration payments were made by cash. The Bank does not have any non-cash vehicles in place. There are no staff at the Bank who were paid over £840K (equivalent to €1 million converted to Euros using the exchange rate at 31 December 2021. £1 = €1.1898). The highest paid Director was paid £315K (equivalent to €375k) in 2021.