1. Risk Management Processes and the Risk Management Framework

The Bank adds value to customers and generates returns for shareholders by taking and managing risk in line with strategy and risk appetite. Risk management is the set of end-to-end activities through which the Bank makes risk-taking decisions and controls and optimises its risk-return profile. It is a Bank-wide activity and starts right at the front-line.

The management of risk lies at the heart of the Bank's business. Effective risk management is a central part of the financial and operational management of the Bank and fundamental to its ability to generate profits consistently and maximise shareholder value. The foundation of all risk assessment is aligned to the Group's Risk Management Framework (RMF). Under this framework, there are three lines of defence.

- The **First Line of Defence** is that all employees are required to ensure the effective management of risks within the scope of their direct organisational responsibilities.
- The **Second Line of Defence** comprises the Risk Control Owners supported by their respective control functions. They are responsible for ensuring that the residual risks within the scope of their responsibilities remain within appetite.
- The **Third Line of Defence** comprises the independent assurance provided by the Group Internal Audit (GIA) function, which has no responsibilities for any of the activities it examines. GIA provides independent assurance of the effectiveness of management's control of its own business activities (the First Line) and of the processes maintained by the Risk Control Functions (the Second Line). As a result, GIA provides assurance that the overall system of control effectiveness is working as required within the RMF.

2. General governance

There are three main Governance Committees in the Bank – i.e. Country Management Group (CMG), Assets and Liability Committee (ALCO) and Credit Risk Committee (CRC).

The CMG, which is the substitute for Board representation locally, drives and executes the business and governance agenda bringing alignment across the businesses and the functions so as to maximise and protect the value of the Group's operations in Sri Lanka. The CMG is comprised of the senior executive members of the Bank, but has no collective authority beyond the delegated authority of individual members.

The Bank's committee governance structure ensures that risk-taking authority and risk management policies are cascaded down from Group Asset & Liability Committee (GALCO) and Group Chief Risk Officer (GCRO) to the appropriate functional and divisional committees. Information regarding material risk issues and compliance with policies and standards is communicated through the business and functional committees up to the Group-level committees, as appropriate.

The composition and responsibilities of the local ALCO and CRC are as follows:

Committee (delegated authority from)	Purpose	Membership	Frequency of meetings
ALCO (GALCO)	Responsible for the management of capital and liquidity and the establishment of and compliance with policies relating to balance sheet management, including management of the Bank's liquidity, capital adequacy and approval of the Bank's ICAAP document.	Chief Executive Officer ("CEO") (Chair) Chief Financial Officer ("CFO") Country Chief Risk Officer ("CCRO") Head of C&I Head of Retail Clients Head of Financial Markets	Monthly
CRC (GCRO)	Responsible for the management of all risks, except those for which ALCO has direct responsibility. Risk limits and risk exposure approval authority frameworks are set by the CRC in respect of all risks including credit risk, country risk, market risk, and approval of the stress scenario and stress testing results.	CEO (Chair) CCRO (Alternate Chair) CFO Head of C&I Head, Retail Clients Head, Legal & Compliance	Once in Two Months

3. Credit risk

Credit risk is the potential for loss due to failure of a counter party to meet its obligations to pay the Bank in accordance with agreed terms.

The CCRO is the RCO responsible for credit risk. The Credit Issues Committee ("CIC"), formerly referred to as the Early Alert Committee ("EAC"), is a subcommittee of CRC. It is responsible for identifying and monitoring corporate customers showing potential signs of weakness and/or may be exposed to higher risks. The CIC reviews the existing Early Alert ("EA") portfolio and new accounts presented to the committee. It is chaired by the CEO and meets monthly.

3.1 Credit Policies

The Credit Initiation and Approval Policy and the Retail Lending Policy govern the extension of credit to Corporate and Institutional Clients (CIC), Commercial Clients (CC) and Retail Clients (RC) respectively. Each policy provides the framework for lending to counterparties, global account management, product approvals and other product related guidance, credit processes and portfolio standards. All credit exposure limits are approved within a defined credit approval authority framework.

3.2 Credit Monitoring and MIS

The CIC & CC Monitoring and Control Policy and the RC Management Information Systems and Reporting Framework provide the outline for how credit risk should be monitored and managed in the Bank.

3.3 Risk Assessment

Risk measurement plays a central role, along with judgment and experience, in informed risk taking and portfolio management decisions. It is a primary area for sustained investment and senior management attention across the group.

The grading is based on our internal estimate of probability of default over a one -year horizon, with customers or portfolios assessed against a range of quantitative and qualitative factors. The numeric grades run from 1 to 14 and some of the grades are further sub-classified A, B or C. Lower credit grades are indicative of a lower likelihood of default. Credit grades 1A to 12C are assigned to performing customers or accounts, while credit grades 13 and 14 are assigned to non-performing or defaulted customers.

3.4 Credit Approval

Credit approval authorities are delegated by the GRC to individuals based both on their judgment and experience and a risk-adjusted scale that takes account of the expected loss, tenor and maximum exposure from a given customer or portfolio. Credit origination and approval roles are segregated.

3.5 Credit Issues Identification

The Credit Issues Committee (“CIC”) derives authority from CRC. It is responsible for identifying and monitoring customers showing potential signs of weakness and/or may be exposed to higher risks. The CIC reviews the existing Early Alert (“EA”) portfolio and new accounts presented to the committee. It is chaired by the Chief Executive Officer (“CEO”) and meets monthly.

3.6 Credit Concentration Risk

Credit concentration risk can arise from pools of exposures with similar characteristics which may lead to highly correlated changes in credit quality, for example individual large exposures or significantly large groups of exposures whose likelihood of default is driven by common underlying factors.

Credit concentration risk is governed by the Credit Initiation and Approval Policy; adherence to which is monitored by the CRC. Effectively, this policy is managed via portfolio standards and within concentration caps set for counterparties or groups of connected counterparties, and for industry sectors, credit grade bands, business segments as well as collateralization for CIC and CC; and by products in RC. Credit concentration risk is principally managed based on three components: single name borrower exposure, industry concentrations and product concentration. Limits are established by the CRO and Head, Corporate and Institutional Clients, in conjunction with Group CIC & CC Risk and approved by CRC in line with the Credit Reference Level framework (“CRL”).

This is managed within concentration caps set by counterparty or groups of connected counterparties, and having regard for correlation, by industry in Corporate & Institutional Client Banking; and by product in Retail Banking. Locally, credit concentrations are monitored by the CRC against internal ‘Portfolio Standards’ as well as the regulatory thresholds imposed by the SBL (Single Borrower Limit).

The industry sector wise analysis of the customer assets portfolio as at 30.06.15 are provided below:

Industry Sector	% of Exposure
Manufacturing	35%
Trading	6%
Agriculture and fishing	16%
Transport	4%
New economy	11%
Financial and Business Services	1%
Infrastructure	0%
Construction	1%
Tourism	1%
Other Customers (Retail Banking Clients included)	24%
Total	**100%**

Product Category	% of Exposure
Overdrafts	17%
Trade finance	27%
Credit cards	8%
Staff loans	2%
Personal Loans	14%
Corporate Loans	32%
Total	**100%**

The Bank's largest single individual borrower/group exposure as at 30th June 2015 was 36% of the total prudential capital (net of permitted collateral).

As at end June 2015, credit cards and personal loans, both of which are unsecured, accounted for 76% of the Retail Banking loans and advances portfolio. These unsecured exposures accounted for 20% of the total bank's total exposure.

3.7 Credit monitoring

We regularly monitor credit exposures, portfolio performance, and external trends that may impact risk management outcomes.

Internal risk management reports are presented to risk committees, containing information on key environmental, political and economic trends; portfolio delinquency and loan impairment performance; and IRB portfolio metrics including credit grade migration.

Clients or portfolios are placed on early alert when they display signs of actual or potential weakness. For example, where there is a decline in the client's position within the industry, financial deterioration, a breach of covenants, non-performance of an obligation within the stipulated period or there are concerns relating to ownership or management.

Such accounts and portfolios are subjected to a dedicated process of oversight by CIC. Client account plans and credit grades are re-evaluated. In addition, remedial actions are agreed and monitored. Remedial actions include, but are not limited to, exposure reduction, security enhancement, exiting the account or immediate transfer of the account into the control of Group Special Assets Management (GSAM), our specialist recovery unit.

3.8 Problem credit management and provisioning

The local branch follows the Group accounting policy on loan loss provisioning, which is discussed in the ensuing sections.

Accordingly, loan loss provisions are established to recognize incurred impairment losses either on specific loan assets or within a portfolio of loans and advances. Individually impaired loans are those loans against which individual impairment provisions have been raised.

Estimating the amount and timing of future recoveries involves significant judgment, and considers the level of arrears as well as the assessment of matters such as future economic conditions and the value of collateral, for which there may not be a readily accessible market. Loan losses that have been incurred but have not been separately identified at the balance sheet date are determined on a portfolio basis, which takes into account past loss experience as a result of uncertainties arising from the economic environment, and defaults based on portfolio trends.

Actual losses identified could differ significantly from the impairment provisions reported as a result of uncertainties arising from the economic environment.

(a) Non-performing loans

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

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

(b) Trigger points for identification of impairment

There is no single factor which determines whether a loan is impaired; the following factors are indicators of impairment and should be considered in conjunction with the Group Impairment Provisioning Policy:

- Borrower's inability to honour the financial commitments like breach of contractual terms, default or delinquency in interest or principal payments.
- Significant financial difficulties of the borrower.
- Probable indication of borrower going into bankruptcy proceedings or other financial re-organization.
- The lender granting to the borrower a concession that the lender would not otherwise consider and the concession is due to economic or legal reasons relating to the borrower's financial difficulty.
- Indication of significant deterioration in a borrower's financial condition, severe slowdown in the economic climate in which the borrower operates.
- In the case of a group of financial assets, observable data indicating decrease in the estimated future cash flows. [e.g.: a) adverse changes in the payment status of the borrowers in a group b) local adverse economic conditions like rising unemployment rates in the region, decrease in property prices for mortgages, unfavourable industry conditions/ prospects in which the borrower operates.]

(c) Impairment in CIC and CC:

- When assessing impairment the primary consideration is objective evidence that a loss event has impacted the expected future cash flow from the assets that can be reliably estimated. Impairment losses are recognized by means of impairment provisions which include Individual Impairment Provisions - Principal ("IPP") and Individual Impairment Provisions - Discount ("IPD").

- Should any of the following events occur, the obligor is considered to be impaired and an immediate downgrade to CG13 or CG14 is required depending on the perceived severity (this list is not exhaustive):
  - a balance is more than 90 days past due
  - an obligor files for bankruptcy protection (or the local equivalent) where this would avoid or delay repayment of its obligation
  - the Bank files to have the obligor declared bankrupt or files a similar order in respect of a credit obligation
  - the Bank consents to a restructuring of the credit resulting in a diminished financial obligation demonstrated by a material forgiveness of debt or postponement of scheduled payments
  - the Bank places an account on non-accrual status or the equivalent
  - the Bank sells a credit obligation at a material credit-related economic loss (defined as a 15% loss on the face value of the obligation).

(d) Impairment in RC:

Provisioning within Retail Banking reflects the fact that Retail Banking product portfolios consist of a large number of comparatively small exposures. As a result, much of the provisioning is initially done at a product level on a portfolio basis. For each particular product, an Individual Impairment Provision (IIP) is raised when that exposure exceeds a set number of days past due (as set out below). This uses criteria that apply to all the accounts within a given product portfolio.

PRODUCT INDIVIDUAL IMPAIRMENT	PRODUCT INDIVIDUAL IMPAIRMENT
Lending – Mortgage, Auto, Credit Cards, Personal Loans and Revolving Credit	150 days past due
Restructured Lending - Mortgage	120 days past due
Restructured Lending - Other	90 days past due
Consumer Finance - Secured	150 days past due
Consumer Finance - Unsecured	90 days past due
Small Business	150 days past due
Restructured Small Business - Secured	120 days past due
Restructured Small Business - Unsecured	90 days past due
Wealth Mgmt - Securities Backed Lending	90 days past due
Wealth Mgmt - Temporary OD or Excess	60 days past due

Provisioning for Loan Impairment

i) Individual Impairment Provisioning

The provisions are based on the estimated present values of future cash flows, in particular those resulting from the realization of security. Following such realization any remaining loan will be written off. The days past due used to trigger write -offs and IIPs are broadly driven by past experience, which shows that once an account reaches the relevant number of days past due, the probability of recovery (other than by realizing security where appropriate) is low.

ii) Portfolio Impairment Provisioning

The PIP methodology provides for accounts for which an individual impairment provision has not been raised, either individually or collectively. PIP is raised on a portfolio basis for all products, and is set using expected loss rates, based on past experience supplemented by an assessment of specific factors affecting the relevant portfolio. These include an assessment of the impact of economic conditions, regulatory changes and portfolio characteristics such as delinquency trends and early alert trends. The methodology applies a larger provision against accounts that are delinquent but not yet considered impaired.

3.9 Credit quality analysis

The tables below set out the loan portfolio analysed between those loans that are neither past due nor impaired, those that are past due but not individually impaired and those that are individually impaired. The overall credit quality of the portfolio remains good, with over 98 per cent of the portfolio neither past due nor impaired.

As at 30th June 2015 (All in Rs. '000)	Neither past due nor individually impaired	Past due but not impaired	Individually impaired	Total
Loans and Receivables	47,917,936	848,660	12,296	48,778,892
Less: Individual Impairment Provision				(19,724)
Less:: Portfolio Impairment Provision				(302,321)
Net Loans and Receivables				48,456,847

3.10 Credit risk mitigation

Lending is primarily based on risk and cash flow and is supplemented by collateral such as immovable and movable mortgages, Bank guarantees, cash collateral etc., as a secondary source of repayment.

A secured loan is one where the borrower pledges an asset as collateral that the Bank is able to take possession of in the event that the borrower defaults. All secured loans are considered fully secured if the fair value of the collateral is equal to or greater than the loan at the time of origination.

Credit residual risk is the risk of partial performance or failure of credit risk mitigation techniques (e.g. collateral, derivative based hedging, insurance), owing to undervaluation or ineffective enforceability.

The CIC and CC Credit Documentation Policy and the Securing Documentation Operation Policy govern credit residual risk and are monitored by CRC. Adherence to these policies is managed by CRC. Key controls in respect of credit residual risk include standard documentation that ensures enforceability and clearly defined valuation policies. Enforceability is monitored by the Bank's Legal & Compliance Unit. Collateral valuation is undertaken by the Bank's approved panel of Valuers on an annual basis.

3.11 Country cross-border risk

Country cross border risk ("CCBR") is the potential for loss due to the inability to obtain payment from customers or third parties on their contractual obligations, as a result of certain actions taken by foreign governments, chiefly relating to convertibility and transferability of foreign currency (otherwise known as transfer risk).

The Country Cross Border Risk Policy governs CCBR and is managed by the CRC. Locally, the CEO is responsible for country cross border risk and for establishing and monitoring limits although the responsibility of day-to-day management is with the Chief Risk Officer.

Where CCBR arises, appropriate country cross border risk limits must be in place prior to any transaction being undertaken or committed. CCBR limits must cover the net exposure (after risk transfers) and must also reflect the underlying term of the risk, and it is only the ultimate CCBR that is required to be marked against the respective CCBR limits. CCBR limits are split into short- and medium-term as determined by the original tenor of the loan / instrument. As the Bank has not historically incurred any losses and given the level of strong local governance in connection with CCBR, the Bank is of the view that this aspect of credit risk is well managed.

4. Liquidity risk

Liquidity risk is the potential that the Bank either does not have sufficient liquid financial resources available to meet all its obligations and commitments as they fall due, or can only access these financial resources at excessive cost.

The Liquidity Risk Framework governs liquidity risk and is managed by ALCO. In accordance with the framework, the Bank maintains a liquid portfolio of marketable securities as reserve assets. The level of the Bank's aggregate liquid reserves is in accordance with local regulatory minimum liquidity requirements.

4.1 Maturity Analysis

The Bank prepares a Maturities of Assets and Liabilities based on contractual residual maturities. This analysis however, does not consider the core proportion of customer assets and deposits which remain with the Bank on a rollover/revolving basis. As such, based on empirical data, core balance percentages are derived and applied to forecast the 'most likely' expected cash flows, The MCO is calculated daily and monitored against pre-set limits. There were no limit breaches reported in the 6 months ended 30th June 2015.

4.2 Stress Scenarios

The branch conducts two tests routinely: an acute 8-day name specific stress test and a 30-day market wide stress test. The 8-day stress test is further broken down currency wise to ensure that we are able to withstand stresses in FCY and LCY.

The 8-day stress test is performed daily and the minimum marketable securities requirement is observed daily. This is intended to ensure that, in the unlikely event of an acute loss of confidence in the Group or the Branch, there is sufficient time to take corrective action. Every country must pass this test on a stand-alone basis.

In addition, the resilience to unexpected local market disruptions (e.g. interbank money or foreign exchange markets) is tested by a 30-day market wide stress on a monthly basis.

4.3 Liquidity metrics

The Bank monitors the liquidity position (on a pan-Bank basis) using key liquidity metrics on a regular basis, which includes both internal measures and those recommended in the Integrated Risk Management Framework (IRMF), issued by the Central Bank of Sri Lanka:

Advances-to-Deposits Ratio (ADR)	2015**		2014***	
	LCY*	FCY*	LCY	FCY
Period-end	79%	53%	86%	57%
Maximum	101%	62%	99%	72%
Minimum	66%	49%	66%	37%
Average	84%	56%	83%	56%

*LCY – Local currency customer Assets to Deposits Ratio

*FCY – Foreign currency customer Assets to Deposits Ratio

** 2015 Period-end : 30th June 2015

***2014 Period-end : 31st Dec. 2014

	2014 June	2014 Sept.	2014 Dec.	2015 Mar.	2015 Jun
Liquid Asset Ratio - DBU (%)	77%	70%	72%	67%	77%
Liquid Asset Ratio - FCBU (%)	94%	63%	71%	58%	74%
Liquid Assets to Short term Liabilities Ratio (%)	74%	66%	65%	63%	72%
Net Loans to Total Assets Ratio (%)	46%	52%	51%	48%	46%
Large Liabilities (minus) temporary investments to earning assets (minus) temporary investments (%)	0%	1%	4%	1%	9%
Purchased Funds to Total Assets Ratio (%)	41%	39%	42%	42%	42%
Commitments to Total Loans Ratio (%)	38%	30%	30%	38%	34%
Medium Term Funding (MTF) Ratio LCY (%) *	217%	244%	255%	350%	481%
Medium Term Funding (MTF) Ratio FCY (%) *	651%	734%	305%	300%	461%

* Medium Term Funding (MTF) Ratio: The MTF ratio is an internal ratio used to evaluate the coverage of assets with a maturity of over 1 year by liabilities over 1 year. The ratio is calculated for Local Currency (LCY) and Foreign Currency (FCY) assets and liabilities separately.

5. Market Risk

The Bank recognizes market risk as the potential for loss of earnings or economic value due to adverse changes in financial market rates or prices. The Bank is exposed to market risk arising principally from customer-driven transactions. The objective of the Bank's market risk policies and processes is to obtain the best balance of risk and return while meeting customers' requirements. The primary categories of market risk for the Group/Bank are interest rate risk and currency exchange.

5.1 Market risk governance

The GRC) approves the Group's market risk appetite taking account of market volatility, the range of products and asset classes, business volumes and transaction sizes. The Group Market and Traded Risk Committee (MTCRC), under authority delegated by the GRC, is responsible for setting VaR limits within the Group's risk appetite. The MTCRC is also responsible for policies and other standards for the control of market risk and overseeing their effective implementation. These policies cover both trading and non-trading books. At a country level, there is oversight from the Chief Risk Officer on the implementation and monitoring of Group market risk policies/limits and exposures in accordance with Group and local governance/regulatory norms.

Market Risk (MTCR) approves the limits within delegated authorities. Additional limits are placed on specific instruments and position concentrations, where appropriate. Sensitivity measures are used in addition to VAR as risk management tools. For example, interest rate sensitivity is measured in terms of exposure to a one basis point increase in yields, whereas, foreign exchange, sensitivities are measured in terms of the underlying values or amounts involved. Option risks if any, are controlled through revaluation limits on underlying price and volatility shifts, limits on volatility risk and other variables that determine the options' value.

The CRC, in conjunction with MTCR, provides market risk oversight, reporting and management of the market risk profile.

5.2 Foreign Exchange Exposure

The foreign exchange exposures comprise trading and non-trading foreign currency translation exposures. Foreign exchange trading exposures are principally derived from customer driven transactions.

5.3 Interest Rate Exposure

The interest rate exposures arise from trading and non-trading activities. Structural interest rate risk arises from the differing re-pricing characteristics of commercial banking assets and liabilities.

5.4 Interest Rate Risk in the Banking Book

Interest rate risk from across the non-trading book portfolios is transferred to FM where it is managed by the local ALM desk under the supervision of ALCO. The ALM desk deals in the market in approved financial instruments in order to manage the net interest rate risk, subject to approved VaR and risk limits. VaR and stress tests are applied to non-trading book exposures in the same way as for the trading book.

The Branch uses the following techniques to manage the market risk arising due to foreign exchange exposure and the interest rate exposure.

a. Value at Risk

The Bank measures the risk of losses arising from future potential adverse movements in market rates, prices and volatilities using a VAR methodology. VAR, in general, is a quantitative measure of market risk that applies recent historical market conditions to estimate the potential future loss in market value that will not be exceeded in a set time period at a set statistical confidence level. VAR provides a consistent measure that can be applied across trading businesses and products over time and can be set against actual daily trading profit and loss outcome. VAR is calculated for expected movements over a minimum of one business day and to a confidence level of 97.5 per cent. This confidence level suggests that potential daily losses, in excess of the VaR measure, are likely to be experienced six times per year.

b. Market risk changes

Daily value at risk (VaR at 97.5%, one day)

By Risk Type	2015			
	Highest* Rs. '000	Lowest* Rs. '000	Average* Rs. '000	30th June Rs. '000
FX Risk – Trading	17,811	4,017	9,508	9,342
Interest Rate Risk – Non Trading	27,319	12,86	16,337	15,958

* For the six months ended 30th June 2015.

By Risk Type	2014**			
	Highest Rs. '000	Lowest Rs. '000	Average Rs. '000	31st Dec Rs. '000
FX Risk – Trading	21,386	1,312	10,102	2,230
Interest Rate Risk – Non Trading	50,118	13,251	33,194	17,843

** For the 12-months ended 31st Dec. 2014.

c. Stress testing

Losses beyond the confidence interval are not captured by a VAR calculation, which therefore gives no indication of the size of unexpected losses in these situations. MTCR complements the VAR measurement by regularly stress testing market risk exposures on a monthly basis to highlight potential risk that may arise from extreme market events that are rare but plausible.

Stress testing is an integral part of the market risk management framework and considers both, historical market events and forward looking scenarios. A consistent stress testing methodology is applied to trading and non-trading books. The stress testing methodology assumes that scope for management action would be limited during a stress event, reflecting the decrease in market liquidity that often occurs. Stress scenarios are regularly updated to reflect changes in risk profile and economic events.

Regular stress test scenarios are applied to interest rates, credit spreads and exchange rates thereby covering asset classes in the Financial Markets (FM) non-trading and trading books. Ad hoc scenarios are also prepared reflecting specific market conditions and for particular concentrations of risk that arise within the businesses.

d. Interest rate sensitivity analysis of assets and liabilities (SAL)

The interest rate sensitivity profile of assets and liabilities, prepared as per the guidelines provided in the Integrated Risk Management Framework (IRMF) is provided in Appendix – I.

6. Operational Risk

6.1 Overview

Operational risk is the potential for loss arising from the failure of people, process or technology or the impact of external events. Operational risk exposures are managed through a consistent set of management processes that drive risk identification, assessment, control and monitoring.

Operational risks can arise from all business lines and from all activities carried out by the Bank. We seek to systematically identify and manage operational risk by segmenting all of the Bank's activities into manageable units. Each of these has an owner who is responsible for identifying and managing all the risks that arise from those activities as an integral part of their first line responsibilities. Products and services offered to clients are also assessed and authorized in accordance with product governance procedures, as required by the Group.

6.2 Managing Operational Risk

Although operational risk exposures can take many varied forms, we seek to manage them in accordance with standards that drive systematic risk identification, assessment, control and monitoring. These standards are challenged and reviewed regularly to ensure their ongoing effectiveness.

The Standard Chartered Group ensures completeness of its management of operational risk by maintaining a complete process universe defined for all client segments, products and functions processes.

The process universe is the complete list of end-to-end processes that collectively describe the activities of the Group and is the reference for the application of the operational risk management approach.

This represents all Group activities, the owners of these activities, and the risk and control standards that are defined by risk and process owners. It also serves as the foundation for policy delivery, as well as risk identification, measurement, management and reporting. The operational risk management approach requires:

- 'Industrial strength' processes for all Group activities
- Control tolerances for detection and rectification of defects within a defined time period
- Standardised processes in all countries except for legitimate system or regulatory exceptions
- Gross and residual risk assessments by first line and approved by second line
- Monthly risk and control monitoring
- Prompt execution of risk treatment actions to closure

The operational risk management approach is being rolled out on a prioritized basis by risk and market as part of the ORF program. Progression to all markets and lower risk processes in the Group will take place by the end of 2015.

6.3 Business Continuity Process

Business Continuity Management (BCM) is the planning and preparation for continuity of critical business operations and infrastructure to ensure their ongoing availability in the event of any significant business interruption. There are three disciplines under BCM which are Crisis Management, Business Continuity Planning (BCP), and IT Disaster Recovery (IT DR). Crisis Management governs the manner in which the Group responds to control a crisis. BCP and IT DR create and manage our predetermined responses to a crisis, enabling us to mitigate impact from significant business interruption.

The Bank has seven identified recovery solutions that can be implemented for a robust recovery strategy. (Split Operations, use of common office areas, Home working, host / Refugee, cross Border transfer of activities, dedicated BCP seats - Leased or owned properties, dedicated BCP seats - Vendor Contract).

The Bank's Disaster Recovery Centre (DRC), which is situated at Malabe, is fully equipped with all the infrastructure facilities, Information Technology equipment and communication facilities. All the critical processes and systems of the Bank are tested twice a year at the above DRC.

6.4 Role of Insurance

The Bank avails insurance coverage as an external mitigant for 'low probability – high impact' and uncontrollable operational events, which are insurable. Accordingly, insurance coverage has been obtained to cover risks such as cash holdings, cash-in-transit, combined crime/civil liability, directors and officers liability, personal accident, public and product liability, damage to property, business interruption and destruction from terrorism.

6.5 Outsourcing

The Bank has comprehensive guidelines on outsourcing, which is a combination of local regulations and SCB Group policy and procedures on outsourcing. Internal and external outsourcing arrangements are managed by a specialized unit under Governance and Controls.

Supplier due diligence is carried out at pre outsourcing stage and BAU (Business As Usual) stage to ensure any risks are identified and effectively managed. Roles and responsibilities during pre outsourcing stage and BAU stage are clearly defined.

The bank performs appropriate business, operational and technical evaluation and analyses to ensure viability of the external outsourcing arrangements. External outsourcing is designed to ensure that the supplier has adequate service delivery capabilities to deliver the agreed service levels, whilst responsibility and control of the outsourced activities remains fully with the Bank. A business requirement document is produced as a result of these evaluations. An inventory of all outsourced activities are maintained and monitored by the bank through a group mandated system. Details of outsourced activities are reported to the Central Bank of Sri Lanka, annually.

6.6 Procurement Management

The Bank is guided by Procurement and Vendor Management Policies issued by the Group and has a Global Sourcing function, which performs due diligence reviews on material, potential vendors/service providers before on-boarding them for procurement, subject to risk and materiality levels specified.

6.7 Stress testing and Sensitivity analysis

The Bank will undertake ad hoc stress tests as mandated by the CRC or ALCO. It also performs Sensitivity Analysis on Capital and Liquidity on a quarterly basis. The Sensitivity Analysis simulates the impact of key variables on the Capital Adequacy and Liquid Asset Ratios.

6.8 Conduct

Conduct of business, or conduct, is a term that is used in a broad number of ways across the financial services industry At its broadest, good conduct is the appropriate execution of business, by the Group or any individual acting on its behalf, Risk and Capital review in accordance with our strategic intent, risk management principles and risk appetite. More narrowly, it refers to specific regulations designed to achieve fair outcomes for customers and the effective operation of markets.

Good conduct is evidenced through disciplined adherence to our overall framework of systems and controls outlined in the risk management framework and the standards of individual behaviour set out in the Code of Conduct (the ‘Code’), which are followed by the Bank at a Country level.

Standard Chartered Bank, Sri Lanka Branch manages its operational risk in line with the Group’s guidelines and it’s monitored through the Country Risk Committee (CRC) chaired by the CEO.

7. Reputational risk

Reputational risk is the potential for damage to the Group's franchise, resulting in loss of earnings or adverse impact on market capitalisation as a result of stakeholders taking a negative view of the Group or its actions. Failures in behaviours or systems may affect stakeholders' perceptions of the Group's commitment to its Here for good brand promise. Reputational risk could arise from the failure of the Group to effectively mitigate the risks in its businesses, including one or more of country, credit, liquidity, market, regulatory, legal, strategic or other operational risk. Damage to the Group's reputation could cause existing clients to reduce or cease to do business with the Group and prospective clients to be reluctant to do business with the Group. All employees are responsible for day-to-day identification and management of reputational risk.

These responsibilities form part of the Code and are further embedded through values-based performance assessments. Risk control owners must identify material reputational risks arising from any business activity or transaction that they control and ensure that these are escalated and controlled in accordance with the Group's Reputational Risk Policy and applicable procedures.

Reputational risk may also arise from a failure to comply with environmental and social standards. Our primary environmental and social impacts arise through our relationship with our clients and the financing decisions we take. We have mechanisms in our origination and credit processes to identify and assess environmental and social risks, and a dedicated Environmental and Social Risk Management team that reviews proposed transactions with identified risks.

The Group Risk Committee provides Group-wide oversight on reputational risk, sets policy and monitors material risks. The Group Head of Corporate Affairs is the overall risk control owner for reputational risk.

At country level, the Country Head of Corporate Affairs is the Risk Control Owner for reputational risk. It is his or her responsibility to protect the Bank's reputation in that market with the support of the Country Management Group. The Head of Corporate Affairs and Country Chief Executive Officer shall actively:

- Promote awareness and application of our policies and procedures regarding reputational risk
- Encourage business and functions to take account of our reputation in all decision-making, including dealings with customers and suppliers
- Implement effective in-country reporting systems to ensure they are aware of all potential issues in tandem with respective business committees
- Promote effective, proactive stakeholder management through ongoing engagement

8. Pension risk

Pension risk is the potential for loss due to having to meet an actuarially assessed shortfall in the Group's pension schemes. The risk assessment is focused on our obligations towards our major pension schemes, ensuring that our funding obligation to these schemes is comfortably within our financial capacity. Pension risk is monitored quarterly, at a Group level and on an annual basis at a country level.

The Group Pension Risk Committee is the body responsible for governance of pension risk across the Group and it receives its authority from the Group Risk Committee.

9. Capital Maintenance

The Bank has been well capitalized throughout the financial year as reflected by the Capital Adequacy Ratios depicted below.

The Bank's Capital Adequacy Ratios were as follows:

	As at 30th June 2015	As at 31ST Dec. 2014*
Tier 1 Capital Ratio (min. 5%)	20.61%	23.56%
Total Capital Ratio (min. 10%)	20.84%	23.79%

*Calculation is based on values extracted from audited financial statements

Internal Capital Adequacy Assessment Process (ICAAP)

The ICAAP process evaluates the Bank's resilience under stressed conditions. Stress testing and scenario analysis are used to assess the Bank's ability to maintain operations [that are consistent with its risk tolerance level] during the periods of severe but plausible stress conditions, and to simulate a set of feasible management actions and their impact on the Bank's earning, risk profile and capital position, should such conditions materialize. These conditions may arise from economic, liquidity, legal, political or physical events, or from materialization of risks that are unique to the Bank, which are evaluated under Pillar 2.

The simulated stress testing exercise performed, indicated that the Bank was able to meet the minimum capital requirements over the 3-year forecast period, under extreme, but plausible economic/business conditions assumed.

The Bank submitted its 2015 ICAAP report to the Central Bank of Sri Lanka on 30th June 2015.

Appendix – I

Sensitivity of Assets and Liabilities (SAL) as at 30th June 2015

(LKR'000)

NO.	Assets and OBS	Up to 1 Month	1-3 Months	3-6 Months	6-12 Months	1-2 Years	2-3 Years	3-4 Years	4-5 Years	Non Sensitive	Total
1	Cash on Hand	-	-	-	-	-	-	-	-	694,938	694,938
2	Deposits with CBO	-	-	-	-	-	-	-	-	2,691,578	2,691,578
3	Balances due from HO / Affiliates / Branches	-	-	-	-	-	-	-	-	4,339,673	4,339,673
4	Balances due from Other Banks	24,764,111	-	-	-	-	-	-	-	650,156	25,414,267
5	Investments	5,384,690	11,610,274	14,859,847	3,636,011	7,159,458	769,635	51,849	1,840	-	43,473,605
6	Bills of Exchange and Promissory Notes	11,502,688	-	-	-	-	-	-	-	-	11,502,688
7	Overdrafts	8,204,826	-	-	-	-	-	-	-	-	8,204,826
8	Loans and Advances	3,903,368	11,226,161	655,870	1,207,485	3,328,006	-	386,935	7,862,724	-	28,570,550
9	Non Performing Loans	-	-	-	-	157,614	-	7,454	-	13,715	178,783
10	Fixed Assets	-	-	-	-	-	-	-	-	660,997	660,997
11	Net Inter-branch Transactions	-	-	-	-	-	-	-	-	-	-
12	Accrued Interest	-	-	-	-	-	-	-	-	343,689	343,689
13	Other Assets	-	-	-	-	-	-	-	-	800,185	800,185
14	Reverse Repo	-	-	-	-	-	-	-	-	-	-
19	Others (Specify)	-	-	-	-	-	-	-	-	-	-
	Total	**44,112,677**	**22,836,435**	**15,515,717**	**4,843,496**	**10,645,078**	**769,635**	**446,238**	**7,864,564**	**10,194,929**	**126,875,778**
Liabilities and OBS		-	-	-	-	-	-	-	-	-	-
1	Demand Deposits	-	-	-	-	-	-	-	-	24,348,226	24,348,226
2	Savings Deposits	35,662,472	-	-	-	-	-	-	-	-	35,662,472
3	Time Deposits	4,939,118	5,144,499	2,426,467	1,837,475	1,713,458	-	362,921	1,765,301	-	18,189,239
4	Other Deposits	10,718,766	-	-	-	-	-	-	-	-	10,718,766
5	Balances due to HO / Affiliates / Branches	-	-	-	-	-	-	-	-	1,015,589	1,015,589
6	Balance due to other Banks	-	-	-	-	-	-	-	-	397,966	397,966
7	Certificate of Deposits	-	-	-	-	-	-	-	-	-	-
8	Other Borrowings	-	-	-	-	-	-	-	-	-	-
9	Net Inter-branch Transactions	-	-	-	-	-	-	-	-	-	-
10	Bills Payable	-	-	-	-	-	-	-	-	1,097,427	1,097,427
11	Interest Payable	-	-	-	-	-	-	-	-	515,431	515,431
12	Provisions (others)	-	-	-	-	-	-	-	-	728,117	728,117
13	Capital	-	-	-	-	-	-	-	-	2,626,643	2,626,643
14	Reserves	-	-	-	-	-	-	-	-	2,026,614	2,026,614
15	Retained Earnings	-	-	-	-	-	-	-	-	20,909,598	20,909,598
16	Subordinated Debts	-	-	-	-	-	-	-	-	-	-
17	Other Liabilities	-	-	-	-	-	-	-	-	8,639,690	8,639,690
18	Repos	-	-	-	-	-	-	-	-	-	-
	Total	**51,320,356**	**5,144,499**	**2,426,467**	**1,837,475**	**1,713,458**	**-**	**362,921**	**1,765,301**	**62,305,301**	**126,875,778**
	Gap	**(7,207,678.96)**	**17,691,936**	**13,089,251**	**3,006,021**	**8,931,621**	**769,635**	**83,317**	**6,099,264**	**(52,110,371.63)**	