



## **Philippine National Bank (Europe) Plc**

### **Pillar 3 Disclosures**

**31 December 2016**

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## INTRODUCTION

### Overview – Scope and Purpose

This document sets out the Pillar 3 disclosures (the “document”) for Philippine National Bank (Europe) Plc (“PNBE” or “the Bank”) as at 31 December 2016. PNBE is a UK-registered bank authorized by the Prudential Regulation Authority (“PRA”) and regulated by the Financial Conduct Authority (“FCA”) and the PRA.

These disclosures have been prepared to give information on the basis of calculating capital requirements and on the management of risks faced by the Bank. This document has been developed in accordance with the rules laid out in Part 8 of Capital Requirements Regulation (“CRR”) and the related European Banking (“EBA”) guidelines. The Bank has also considered the Basel Committee on Banking Supervision’s Standards “Revised Pillar 3 disclosure requirements” published in January 2015

The provision of meaningful information about common key risk metrics to market participants is an important aspect of a sound banking system. It reduces information asymmetry and helps promote comparability of bank’s risk profiles within and across jurisdiction. Pillar 3 of the Basel III framework aims to promote market discipline through regulatory disclosure requirements. These requirements enable market participants to access key information relating to bank’s regulatory capital and risk exposures in order to increase transparency and confidence about a bank’s exposure to risk and the overall adequacy of its regular capital.

The Basel III Framework is structured around three pillars:

- Pillar 1: sets the minimum capital requirements for credit, market and operational risk
- Pillar 2: requires that each bank undertakes an Internal Capital Adequacy Assessment Process (“ICAAP”) to assess its own risk profile and to determine the level of additional capital required over and above the Pillar 1 requirements, to cover risks either not covered, or not fully covered, by the Pillar 1 requirements (e.g. credit concentration risk), and factors external to the firm (e.g. external stresses).
- Pillar 3: aims to promote market discipline by enhancing the level of disclosure made by banks to their stakeholders, allowing them to assess a bank’s key risk exposures and the adequacy of bank’s risk management process to mitigate these risks.

Pillar 3 complements Pillar 1 and Pillar 2.

This disclosure document should be read in conjunction with the Bank’s Annual Report and Financial Statements for the year ended 31 December 2016 and is published on the Bank’s website: <http://www.pnb.com.ph/europe>.

The Bank has no subsidiaries and accordingly disclosures are on un-consolidated basis.

These Pillar 3 disclosures are not subject to external audit. The document has been reviewed by the Audit, Risk and Compliance (“ACR”) Committee and approved by the Board of Directors (“the Board”).

### Background

The Bank is a wholly owned subsidiary of Philippine National Bank (Manila). It was originally set up as PNB London Branch in 1976 and then converted in 1997 into a UK-registered bank with a full banking license. In 2007, the Bank opened its branch in Paris, France. In April 2014, the PNBE has merged with Allied Bank Philippines (UK) Plc

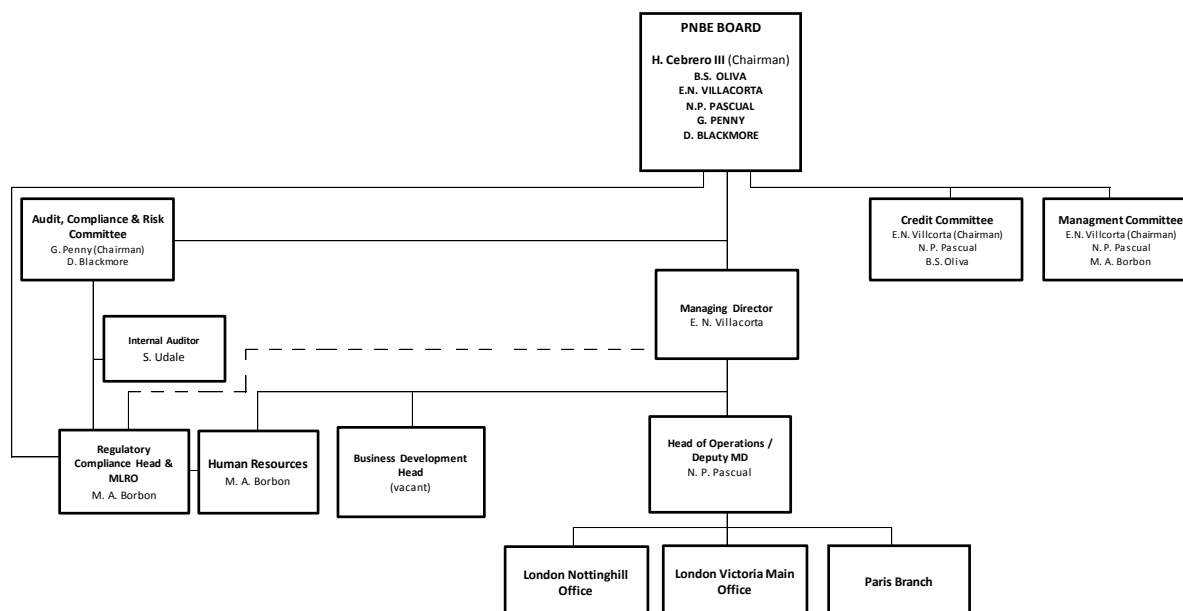
Its principal activity is the provision of banking and payments services primarily to Filipino customers in the United Kingdom, France through its Paris branch as well as other European countries where the Bank has cross-border passport licenses.

## RISK MANAGEMENT OBJECTIVES AND POLICIES

### Governance

The Bank’s governance policies are set by the Board and implemented by the management team. The chart below illustrates the Organization structure of the Bank.

Philippine National Bank (Europe) Plc  
Organization Chart



**The Board** has ultimate responsibility for setting the Bank’s strategy, risk appetite and control framework; and measures performance against targets. It normally meets a minimum of four times a year. The Board is also responsible for discharging the Bank’s responsibilities

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under the remuneration policy; approving the appointment of senior executives; and agreeing authority levels and the delegation of authority. To assist it in discharging these responsibilities, the Board has instituted a number of high level committees governed by clear term of reference.

**Audit, Compliance and Risk Committee** – Chaired by a Non-Executive Director. This Committee includes another Non-Executive Director as member. The Internal Auditor acts as a secretary to the Committee. Senior Management to include the Managing Director, the Deputy Managing Director and the Compliance Officer are invited to attend all the meetings.

This Committee, which normally meets a minimum of four times a year, is responsible for evaluating the Bank's risk principles, risk policies, risk capacity and risk appetite and makes appropriate recommendations to the Board. It monitors the effectiveness of the Bank's risk policies in practice and evaluates the risk of new business proposals. The Committee utilises the Internal Audit function to provide assurance in this respect.

This Committee is also responsible for transparency in the financial performance of the Bank, including high quality and timely reporting and disclosure in line with regulatory requirements, good corporate governance and recognised best practice. The Committee also considers the nature and scope of audit reviews and the effectiveness of the system of internal control, compliance and risk management. The Bank's external auditors are also invited to attend the meetings when necessary.

**Management Committee** – Chaired by the Managing Director, this Committee comprises the other members of the senior management to include the heads of Operations, Business Development and Compliance. It is responsible for implementing Board policy and the day-to-day running of the Bank. It reviews risks and controls that mitigate the risks. This includes the identification, assessment and reporting of risks together with regular monitoring to confirm that risks are within the levels agreed by the Board. The Committee meets monthly or as required.

**Credit Committee** – Chaired by the Managing Director, this Committee includes the Deputy Managing Director and the Manila-based Executive Director who is representing the Parent bank as members. It operates as a working committee, accountable to the Board through the Audit, Compliance and Risk Committee and has a duty to consider all credit applications from customers and counterparties that do not exceed any delegated authority from the Board. Meetings are held as and when necessary and or according to business needs.

## **OWN FUNDS, CAPITAL REQUIREMENTS AND CAPITAL BUFFERS**

### **Own Funds**

Throughout 2016, the Bank complied fully with the Capital Requirements set out by the PRA. On 31 December 2016, all of the Bank's capital was comprised as follows:

<b>Own Fund Composition</b>		
<b>GBP '000</b>	<b>As at 31 Dec 2016</b>	<b>% to Total Own Funds</b>
Share capital	10,914	97.20%
Profit and loss reserve	(6,454)	-57.48%
Merger reserve	6,768	60.28%
Own Funds (Total capital)	11,228	100.00%

Tier 1 capital comprises ordinary share capital plus reserves. The Bank does not hold any Tier 2 capital.

### **Capital Requirements**

Overall responsibility for capital management rests with the Board of Directors. Responsibility for oversight on a day-to-day basis has been delegated to the Managing Director who has, in turn, delegated responsibility for the management, review and reporting and capital management to the Deputy Managing Director who is in charge of Financial Control of the Bank. The use of Bank's capital to support current and future activities is monitored on a continuous basis through daily management information produced by Financial Control and sent to the senior management team and also reported during the regular meetings of the Audit, Compliance and Risk Committee and the Board.

The Bank produces an ICAAP. It includes an assessment of the Bank's capital needs based upon the minimum regulatory requirements and additional capital charges that the Bank deems prudent to include. These additional capital charges take account of factors such as: the current quality of the credit exposures; the risks associated with any existing concentrations in particular geographical areas or industry sectors; risk identified from stress testing and scenario analysis particularly in the area of the Bank's view of how potential economic changes may affect the banking industry or its customers; and capital charges for planned business projects.

The ICAAP represents Bank's views on the necessary Pillar 2A capital requirement which are the Banks' capital requirements for the risks that are not covered, or fully covered, under Pillar 1. In completing the ICAAP assessment PNBE considers as Pillar 2A capital requirement the higher of its own Pillar 2A and the Individual Capital Guidance ("ICG") set by regulators.

The Bank's Capital Requirements are determined in accordance with the CRR relevant articles, the related EBA Technical Standards and the rules defined in the prudential guidelines by the PRA.

The Bank has adopted the Standard Approach ("SA") to Credit Risk and Market Risk and the Basic Indicator Approach ("BIA") to Operational Risk for the calculation of Pillar 1 capital requirements.

The Bank's Pillar 1 capital requirements are presented in the table below:

GBP '000	As at 31 Dec 2016	
	RWAs	Capital Requirements
Credit and counterparty credit risk	7,635	611
Market risk	351	28
Operational risk	4,188	335
Total Pillar 1 capital requirements	<u>12,174</u>	<u>974</u>
<i>100% Base capital requirement (equivalent of €5m)</i>		<u>4,263</u>

The Bank has considered the higher of total Pillar 1 capital requirement and the initial (base) capital requirement of equivalent to €5 million as its minimum capital requirement.

### Capital Buffers

The Bank calculates the CET1 capital ratio as per CRR requirements. As shown in table below, the Bank is compliant with the regulatory limits set in Article 92.

	31 December 2016
	RWAs
CET1 capital ratio <sup>1/</sup>	92.23%

<sup>1/</sup> Being CET1 capital the same as Tier 1 capital and Total capital, the CET1 capital ratio is equal to Tier 1 capital ratio and Total capital ratio.

From 1 January 2016, PRA buffer, expressed as percentage of RWAs, has replaced the Capital Planning Buffer ("CBP"). The Bank is required to keep a PRA buffer in excess of the ICG and CRD IV combined buffer. The PRA expects the PRA buffer to be met with at least 25% of CET1 capital during 2016, at least 50% of CET1 capital by 1 January 2017, at least 75% of CET1 capital by 1 January 2018 and 100% of CET1 capital by 1 January 2019.

The CRD IV buffer combines the capital conservation buffer and countercyclical buffer and must be met with CET1 capital. The Capital Conservation Buffer ("CCB") has been introduced from 1 January 2016 and it follows a transitional pattern to its full implementation at 2.5% in 2019. In 2016, the CCB is at 0.625%

The Countercyclical Capital Buffer ("CCyB") requires firms to build up capital when aggregate credit growth is judged to be associated with a build-up of system-wide risk to ensure the banking system has a buffer of capital to protect it against future losses. The buffer can then be drawn down to absorb losses during stressed periods. From 2016 firms are required to calculate their firm-specific CCyB rate as a weighted average of the buffer rates in effect in jurisdictions to which they have a relevant credit exposure, subject to a maximum total of 2.5% of risk-weighted exposures.

## CREDIT RISK

### Qualitative Disclosure

Credit risk is the risk that financial institutions and other counterparties will be unable to meet their obligations to the Bank which may result in financial losses. The Bank's credit risk exposure arises out of its short term deposit held with its correspondent banks.

Counterparty risks with correspondent banks relate to spot delivery of currency arising out of the Bank's remittance business and reimbursements under trade related letters of credit.

The Bank does not provide material credit facilities to its customers.

The Bank manages credit risk by establishing individual counterparty limits with which it undertakes business within the terms of Bank's Business Risk and Risk Appetite policies.

### Quantitative Disclosure

The Bank adopts the Simplified Method of calculating risk weight under Standardised Credit Risk which is considered to be the most appropriate for its business given the nature and size of its activity.

#### Standardised Approach – credit risk exposure as at 31 December 2016

Asset classes (GBP '000)	On-balance sheet amount	Off-balance sheet amount	RWAs
Exposures to central governments or central banks	1,110	0	0
Exposures to regional governments or local authorities	23	0	5
Exposures to institutions	19,121	0	6,198
Exposures to corporates	471	0	471
Exposures to retail	216	0	162
Other items	973	0	799
Total	21,914	0	7,635



**Standardised Approach – exposures by asset classes and risk weights as at 31 December 2016**

Asset classes (GBP '000)	Assets split by the risk weight to be applied to them								RWAs
	0%	20%	35%	50%	75%	100%	150%	Total	
Exposures to central governments or central banks	1,110							1,110	0
Exposures to regional governments or local authorities		23						23	5
Exposures to institutions		12,587		5,705		829		19,121	6,198
Exposures to corporates						471		471	471
Exposures to retail					216			216	162
Other items	153			42		778		973	799
<b>Total</b>	<b>1,263</b>	<b>12,610</b>		<b>5,747</b>	<b>216</b>	<b>2,078</b>		<b>21,914</b>	<b>7,635</b>

### Geographic distribution by Exposure Class

The table below shows the Bank's geographic concentration risk as at 31 December 31 2016:

(GBP '000)	UK	Europe	Philippines	Total
Exposures to central governments or central banks	1,110			1,110
Exposures to regional governments or local authorities	23			23
Exposures to institutions	17,618	674	829	19,121
Exposures to corporates	202	213	56	471
Exposures to retail	216			216
Other items	880	93		973
Total	20,049	980	885	21,914

### Exposures to Institutions by geographic distribution and risk weights

Considered the main credit risk, the Bank's exposure to financial institutions and counterparty correspondent banks broken down by geographical location and risk weights associated with each credit quality step as at 31 December 2016 are as follows:

(GBP '000)	Credit Quality Step	Exposures	RWAs
United Kingdom	1	3,147	629
	2	9,597	2,474
	unrated	4,875	2,132
Europe	3	176	35
	unrated	497	99
Philippines (group banks)	3	829	829
Totals		19,121	6,198

Ratings based on Moody's

### MARKET RISK

Market risk is the risk that changes in interest rate, foreign exchange rates, or other prices and volatilities will have an adverse effect on the Bank's financial condition or results.

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## Foreign Exchange Risk

The Bank does not actively trade in foreign currency on its own account but maintains working balances with its correspondent banks to facilitate its remittance business and the foreign currency assets and liabilities are detailed on page 22 of the 2016 Annual Report and Financial Statements. The Bank does not enter into forward or other foreign exchange instruments.

Senior management is responsible for the management of market risk.

## Liquidity Risk

The principal objective is to ensure that at all times there are sufficient liquid assets to satisfy the Bank's payment obligations and potential obligations to the depositors, together with other business liabilities, as they fall due, without incurring unacceptable shortfalls.

Under the PRA's liquidity rules, the Bank is regarded as a stand-alone entity and prepares an Individual Liquidity Adequacy Assessment Process ("ILAAP") annually to determine the amount of liquidity resources required. A buffer of highly liquid government securities is held to mitigate the Bank's liquidity risk.

Liquidity risk is monitored daily to ensure it remains within the FCA/PRA guidelines and the Bank's own limits.

Senior management is responsible for the management of liquidity risk.

## OPERATIONAL RISK

### Definition and source of risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, employees and IT systems, or from external events, including legal risk, but excluding strategic and reputational risk. It is a pervasive risk that involves all aspects of the business as well as other people with whom the Bank deals. When such risks materialise, they have not only immediate financial consequences for the Bank but also an effect on its business objectives, customer services and regulatory responsibilities.

Operational risk is one of the principal risks in the overall Risk Management Framework. There are many major types of operational risks faced by the Bank, including internal fraud, external fraud, clients, products, business practice, execution, delivery and process management, employment system and workplace safety, damage to physical assets, and IT events.

### Risk management and monitoring

As operational risk is inherent in the Bank's processes, the objective of operational risk management is not to remove operational risk altogether but to manage and control operational risk in a cost effective manner consistent with the Bank's risk appetite. In achieving this we:

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- Seek to minimise the impact of losses suffered in the normal course of business (expected losses) and avoid or reduce the likelihood of suffering a large extreme (or unexpected) loss; and
  - Seek to improve the effective management of operations and thus strengthen the Bank's reputation.

The Bank's operational risk management framework consists of the following key components:

- Identification and categorisation of the key operational risks faced by the business areas, including defining risk appetites;
- Risk assessments, including financial and non-financial impact assessment for each of the key risks to which the business is exposed;
- Control assessments, evaluating the effectiveness of the control framework covering each of the key risks to which the business is exposed;
- Loss and incidental management;
- The development of Key Risk Indicators for management;
- Scenarios for estimation potential loss exposures for material risks;
- Purchases of insurance to mitigate certain operational risk events.

Under the Basel II rules, the Bank has adopted the Basic Indicator Approach to operational risk; therefore the Bank's operational risk capital requirement ("ORCR") is equal to 15% of the three-year average of the sum of the Bank's net interest income; and the Bank's net non-interest income. The Bank's operational risk charge at 31 December 2016 was GBP 335k.

## **OTHER RISKS**

- **Business Risk** - The business income source is dependent on one product (remittances) which is subject to competitive pricing it being noted that remitters have strong connections to only one geographical location (Philippines).
- **Reputational Risk** – This is a key area of risks for banks. The Bank ensures compliance with regulatory rules through a strong compliance culture and seeks to minimise complaints by providing its customers with high level of service. Particular attention is paid to anti-money laundering requirements with comprehensive "Know Your Customer" requirements and screening of payments passing through the Bank to minimise the risk of handling 'suspicious' money.
- **Litigation Risk** – The Bank takes care to avoid disputes by ensuring that all documentation comprehensively covers the risks involved. Where appropriate, it seeks specialist legal advice. Systems and procedures are reviewed regularly to safeguard the Bank against any legal or regulatory lapses.

Professional Conduct Risk – The Bank is aware of the risks it faces from the improper professional conduct of its employees. The Conduct of Business Policy as well as other relevant Bank policies detail the measure in place to protect the Bank from risks arising from bribery, gifts and hospitality, conflicts of interests and market abuse. The staff are required to certify, at least annually, that they agree to adhere to the letter and the spirit of the policy

- Pension Liability Risk – The Bank operated a defined pension benefit scheme whose assets are independent of the Bank’s finances. From 01 March 2005, the directors have closed the defined benefit scheme to future accrual. Rights earned by members up to that date have been preserved and are defined for each member by their salary on that date. A full actuarial valuation was carried out on 01 October 2013 on the defined benefit scheme and has been updated by the actuary on an FRS 102 basis as at 31 December 2016. The amount of recognized pension plan liability in said FRS 102 report was GBP 198k

## REMUNERATION

The Bank has no Remuneration Committee and remuneration arrangements such as bonus are reviewed and determined by the Board of Directors.

The Bank does not provide incentives or compensation schemes to reward Staff for performance other than the statutory 13<sup>th</sup> month pay given to the staff of Paris Branch which is equivalent to one month salary. The Bank provides all permanent employees with a non-contributory pension scheme based on salary.

The aggregate quantitative data on remuneration for those members of staff in employment at the end of 2016 and whose professional activities are considered to have a material impact on the bank’s risk profile (Code Staff = 6) are provided below:

Total remuneration in 2016 (All forms of payments or benefits)	GBP 216k
Number of identified Code Staff	6
Total fixed remuneration in 2016 (Salaries & other fixed benefits including pension contributions)	GBP 212k

Details of directors’ remuneration are provided on page 18 of the 2016 Annual Report and Financial Statements.