CITIBANK N.A. SRI LANKA

Risk Management Disclosures

As at 30.06.2016

Introduction and Overview

Citi is a leading global bank with over 200 years' experience and approximately 200 million customer accounts in more than 160 countries and jurisdictions. With well-seasoned and time tested systems and processes for effective risk management, Citi (herein after referred to as "Bank") provides consumers, corporations, governments and institutions with a broad range of financial products and services, including consumer banking and credit, corporate and investment banking, securities brokerage, transaction services, and wealth management.

The Bank's mission is to serve as a trusted partner to its clients by responsibly providing financial services that enable growth and economic progress. Core growth activities include safeguarding assets, lending money, making payments and accessing the capital markets on behalf of clients. Public trust is maintained through constant adherence to the highest ethical standards. Decision making is guided under three key assessments: they are in the clients' interests; they create economic value, and are always systemically responsible. Cumulatively, these goals are targeted towards creating positive financial and social impacts on the communities served and demonstrating the potential of a bank with global impact.

Citigroup's presence in Sri Lanka dates back to 1979. In line with Citi's global strategy Citibank, N.A. Sri Lanka ("Branch") is primarily focused in providing banking services to Multinational Corporates, Top tier local Corporates, Financial Institutions and Public Sector clients under its Institutional Clients Group (ICG).

The Branch is primarily exposed to credit risk, operational risk, liquidity risk and market risk, the latter being subdivided into trading and non-trading risks. Risk is inherent in the Branch' activities but it is managed through the process of ongoing identification, measurement and monitoring subject to risk limits and other controls. This process of risk management is critical to the Branch' continuing profitability and each individual within the Branch is accountable for the risk exposures relating to his or her responsibilities.

Risk Management Structure

The Branch adopts global / regional risk management policies and procedures whilst adhering to local regulatory directives. Risk Management Functions (RMF) are organized along the key risks it monitors, viz. credit risk, liquidity risk, market risk and operational risk with each risk family reporting into regional lines. Within the Branch, an overall risk coordinator is designated to ensure a holistic view of the exposures.

Risk Measurement and Reporting Systems

The risk policies require that all exposures are recorded and reported in a timely manner by parties independent from the business units. Where exposures have to be estimated (for example, exposures from derivative transactions), risk personnel at regional office who are independent from the business and trading unit determine such estimates. Risks are assessed and discussed at various forums such as the Integrated Risk Management Committee (IRMC), Business Risk, Compliance and Control Committee (BRCC), the Risk Council etc. at varying intervals viz. monthly and quarterly. A complete review of all material risks are reviewed and assessed annually through a comprehensive Internal Capital Adequacy Assessment Process (ICAAP).

Excessive Risk Concentrations

Concentration arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Branch's performance to developments affecting a particular industry or geographic location.

In order to avoid excessive concentration of risk, the Branch's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly.

The management of the Branch is responsible for establishing and monitoring compliance with policies governing large exposures and credit risk concentrations of the Branch. The management reviews these policies regularly (at least annually) to ensure that they remain adequate and appropriate for the Branch. Subsequent changes to the established policies are approved by the management.

The Branch reviews the policies for managing each risk which are summarized as follows:

1. Credit risk

Credit risk is the risk that a counterparty may be unable or unwilling to make a payment or fulfil contractual obligations. This may be characterized in terms of an actual default or by deterioration in counterparty's credit quality. The Branch manages credit risk in various forms viz. stringent credit evaluation and approval processes, regular individual and portfolio reviews, daily limits monitoring including regulatory limits etc. In addition, Branch obtains collateral where appropriate, enters into master netting agreements /collateral arrangements with counterparties, and limits the duration of exposures.

The maximum exposure of the Branch's financial instruments to credit risk reflects the end of the period exposures, before taking into account collateral held or other credit enhancements:

Collateral is an asset, group of assets, or revenue stream(s) given as security to the Branch in the form of a legally enforceable pledge for payment of a loan(s), performance of a contingent obligation(s), and/or settlement of a counterparty transaction(s). Whilst the cash flows generated from the obligor's business is considered as the primary way out, in the event of default, the Branch could mitigate the credit risk to a greater extent through legally enforceable collateral held. Any kind of asset or property, which preferably has a ready and stable market, can be used as a facility collateral type. The main types of collateral, which could be obtained by the Branch are cash deposits, stand-by LCs, corporate guarantees, various property, equipment and assignments over stocks and book debts. Depending on the credit risk appetite for individual obligors and/or facilities, the Branch would call for collateral as a secondary source of repayment.

All collaterals are monitored through a collateral management system that enable timely monitoring of the earliest date of collateral expiration or facilities, and currency mismatches between collateral and facilities.

Given the highly selective and top tier clients under Target Market and Risk Acceptance Criteria Framework of the Sri Lanka Institutional Clients Group (ICG) business, eligible collateral is rarely the basis of extending credit facilities. However, Branch aim to maintain pari-passu status with other lenders on particular facilities. In certain instances facilities are secured by guarantees, mainly corporate guarantees and Stand-by LCs from obligors' parent, subsidiaries and banks acceptable to the Bank. Credit derivatives, comprising chiefly of plain vanilla, are booked for approved counterparty obligors whose suitability and acceptance has been screened.

Credit risk rating

Per the Branch's Credit Manual, all obligors and all credit facilities must be rated. Obligors with external ratings assigned by certain rating agencies may be used for internal ratings provided these are at least of a certain grade. Otherwise, obligors are rated using internally approved credit models that are developed by a team responsible for all models used by the Branch.

Models are developed along geographic and industry lines. All obligor risk ratings are reviewed annually. Assigned obligor ratings may differ from ratings generated by the model to factor in likely occurrence of certain quantitative or qualitative aspects that may change the probability of default over a 12 month horizon. Risk policy establishes approval criteria for changes to model derived risk ratings.

In addition, all risk rating models are subject to periodic review for appropriateness and validity. Model validation and changes are done at a global level.

The obligors risk ratings (ORR) represents the probability that an obligor will default within a one year time horizon. ORRs are assigned on a scale of 1 to 10, with sub-grades, where "1" is the best quality risk and "7-" is the worst for obligors that are not in default. The risk rating of "8" is used solely for facilities classified as non-performing due to a cross-border event. ORRs of "9+", "9" and "10" are assigned to obligors meeting the definition of default under Basel when either or both of the following have occurred:

- When the obligor is past due more than 90 days on any material credit obligation to Citi. Overdrafts are considered to be past due once the customer has breached an advised limit or been advised of a limit smaller than the current outstandings.

- When the bank considers that the obligor is unlikely to pay its credit obligations to Citi in full without recourse by Citi to actions such as realizing security (if held), collecting against a guarantee or other form of support, or filing a claim against the insurer.

Facility risk ratings (FRR) represent an expected loss rate, or 'Loss Norm' for each facility and is the product of two components: the default probability of the obligor associated with the final ORR, and Loss given default.

FRRs are assigned on a scale of 1 to 10, with sub-grades, where"1" is the best quality risk and "7-" is the worst for performing facilities. The "8", "9" and "10" categories indicate facilities that have been placed on non-performing status. As such these FRR could correspond to IFRS definition as follows.

	ORR	FRR
Standard	1 – 6	1 – 6
Substandard	7	7
Past Due	8-10	8-10

Impairment process of loans

For loan impairment assessment, the key considerations are:

- whether any payment of principal or interest are overdue by more than 90 days,
- counterparties have difficulties in their cash flows,

- downgrade of credit rating
- Infringement of original terms of the contact.

The Branch first assesses and categorizes loans whether evidence of loan impairment exists individually or collectively. Individually assessed loans for impairment are reduced through the use of an allowance account on an individual basis and the amount of loss is charged to the statement of profit or loss. Impairment losses are evaluated on a quarterly basis, unless unforeseen circumstances require more careful attention. Collective impairments are assessed using the expected loss norms relative to internal credit risk ratings of obligors. The methodology and assumptions used for estimating future cash flows for individual loan impairment are reviewed regularly by the Branch to reduce gap between loss estimates and actual loss experience.

2. Liquidity risk and funding management

Liquidity Risk is the risk that the Branch will not be able to efficiently meet both expected and unexpected current and future cash flow and collateral needs without adversely affecting either daily operations or the financial condition of the branch.

The following tools were adopted by the Branch to manage the inherent risk in its contractual maturities:

GAP analysis: market access report
This is a key tool in monitoring the current liquidity position of the Branch as it quantifies the daily and cumulative liquidity gap in a business-as-usual environment. The gap for any given tenor bucket represents the potential borrowings from or placements to the markets that are required to replace the maturing liabilities or assets.

Stress scenarios
Stress tests are intended to quantify the likely impact of an event on the balance sheet and the net potential cumulative gap over a 12-month period, and to ascertain what incremental funding may be required under any of the defined scenarios. The Branch adopts a stress scenario on which the impact is being analysed and reported to management on a timely basis.

Liquidity ratios
Liquidity ratios are used to measure and monitor changes in the Statement of Financial Position's financial liquidity.

Cross-currency Funding Limit
Cross Current Funding measures the amount of local currency assets funded by foreign currency liabilities. CCFL restricts the proportion of local currency assets funded by foreign currency liabilities and is monitored on daily basis.

Market triggers
Market triggers are internal or external market and economic factors that may imply a change to market liquidity or the Branch' access to the markets.

Significant funding source
In order to properly manage the liquidity risk, the Branch has a threshold for determining which single name liquidity providers, as well as which groups of liquidity providers, are significant funding sources.

Contingency funding plan
The purpose of the Contingency Funding Plan (CFP) is to ensure that Citibank Sri Lanka is able to continue to fund assets & meet any financial obligations, on timely basis at fair market costs & under any market conditions. The plan also ensures that Citibank Sri Lanka is operationally prepared for managing any contingency.

Financial Assets
Maturities of debt securities at Fair Value through P&L (FVPL) and Available for Sale (AFS) investments are based on the contractual maturity on which these assets will be realized.

Financial liabilities
Maturities of financial liabilities are based on the remaining period from the end of the reporting date to the contractual maturity date.

3. Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates, foreign exchange rates, and equity prices.

The Branch is integrated into the overall Citigroup risk and control framework, balancing senior management oversight with well-defined independent risk management functions. It is the responsibility of the senior management of the Branch to implement Citigroup policies and practices, to oversee risk management, and to respond to the needs and issues in the Branch. The Branch's policy is to control material market risks through a framework of limits & triggers which are approved by ALCO and to manage any residual exposure through a series of stress tests and robust controls over calculating, monitoring and reporting results.

The risk appetite is largely determined and controlled due to regulatory limits on foreign exchange. The spot foreign exchange exposure is limited through Net Open Position which is approved by CBSL. The aggregate interest rate exposures on trading account is limited by limits on PV01. Currently, Citi Sri Lanka is trading in simple products such as FX spot, FX Forwards and Government Bonds.

Risk is measured in terms of:

(a) Factor sensitivities – impact of change of rates by one basis point for interest rate products (PV01) and FX Delta (FXDL) for Spot positions. These measures & limits are further sub-divided for each yield curves and currencies.

(b) Value-at-risk Trigger, which measures maximum potential loss at 99% confidence level over 1-day holding period based on the day's outstanding risk positions across the entire mark-to-market exposures.

(c) Loss Triggers: The Trading book and available for sale book profit and loss monitored against month-to-date (for Trading book) and rolling 21-days / inception-to-date (for available for sale) Loss Triggers.

All market risk taking activity in the Branch is centralised with Treasury and undertaken by authorised dealers. The Treasury is subject to limits and triggers across all products and risk factor. The Branch's has a defined process and procedures of limit approvals, changes, delegation, reporting and escalation in case of limit excesses and trigger breaches. The independent Market Risk Management reports and monitors the trading risk exposures against approved limits and triggers on a daily basis. An excess or a breach is reported and dealt with appropriately for corrective action with reporting to ALCO, and Senior Market Risk Management and Corporate Treasury.

VaR assumptions/parameters

The VaR is calculated using Monte Carlo simulation model with a 99.0% confidence level based on the volatilities of, and correlations between, market risk factors, The Branch uses its in-house globally-linked Global Market Risk (GMR) System database to gather all data information required and calculate the daily VaR figures.

The GMR VaR model used by the Branch incorporates the following features;

- Volatility and correlation matrix is based on a 3 year time series and is updated monthly;
- Uses Monte-Carlo simulations to generate market moves estimated for the market risk factors underlying the portfolio;
- 1-day VaR is reported at 99.0% confidence level are calculated;
- VaR is reported by different market risk factors (for e.g. interest rates, FX)
- Component VaR (CVaR) is calculated to measure the relative contribution of each risk factor to the total VaR.

Objectives and limitations of the VaR methodology

VaR estimates the potential decline in the value of a position or a portfolio, under normal market conditions, over a one day holding period, at a 99.00% confidence level. The VaR method used by the Branch incorporate the factor sensitivities of the trading portfolio with the volatilities and correlations of those factors which is based on historical observed levels.

Stress testing is undertaken to complement VaR to assess the impact of the move beyond the 99% confidence level on the capital adequacy ratio of the Branch.

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments. The interest rate risk on the trading book is captured as part of the above described process under the market risk section. Interest rate risk represents the Branch's exposure to adverse movements in interest rates with regard to its non-trading exposures (Banking Book). Interest rate risk is measured by doing a gap analysis as well as factor sensitivity analysis. Business-specific assumptions underlying these measurements, e.g., tenor bucket used for demand deposits, are documented and models used to measure interest rate risk are independently reviewed. Interest rate gap analysis utilizes the maturity or repricing schedules of balance sheet items to determine the differences between maturing or repricing items within given tenor buckets. The interest rate risk in the banking book is also measured and monitored through PV01 limits. The Branch follows a prudent policy on managing its assets and liabilities so as to ensure that exposure to fluctuations in interest rates are kept within acceptable limits.

Foreign currency risk

Foreign currency risk is the risk of exchange rate fluctuations that may result in the receipt of reduced interest and a loss of principal when converted to the investor's local currency.

Exchange controls imposed by the relevant authorities may also adversely affect the exchange rate and result in the receipt of reduced interest or principal.

Foreign currency liabilities generally consist of foreign currency deposits in the Branch's FCBU account or which are generated from remittances to the country by Srilankan expatriates and overseas Srilankan workers who retain for their own benefit or for the benefit of a third party, foreign currency deposit accounts with the Branch and foreign currency denominated borrowings appearing in the regular books of the Bank.

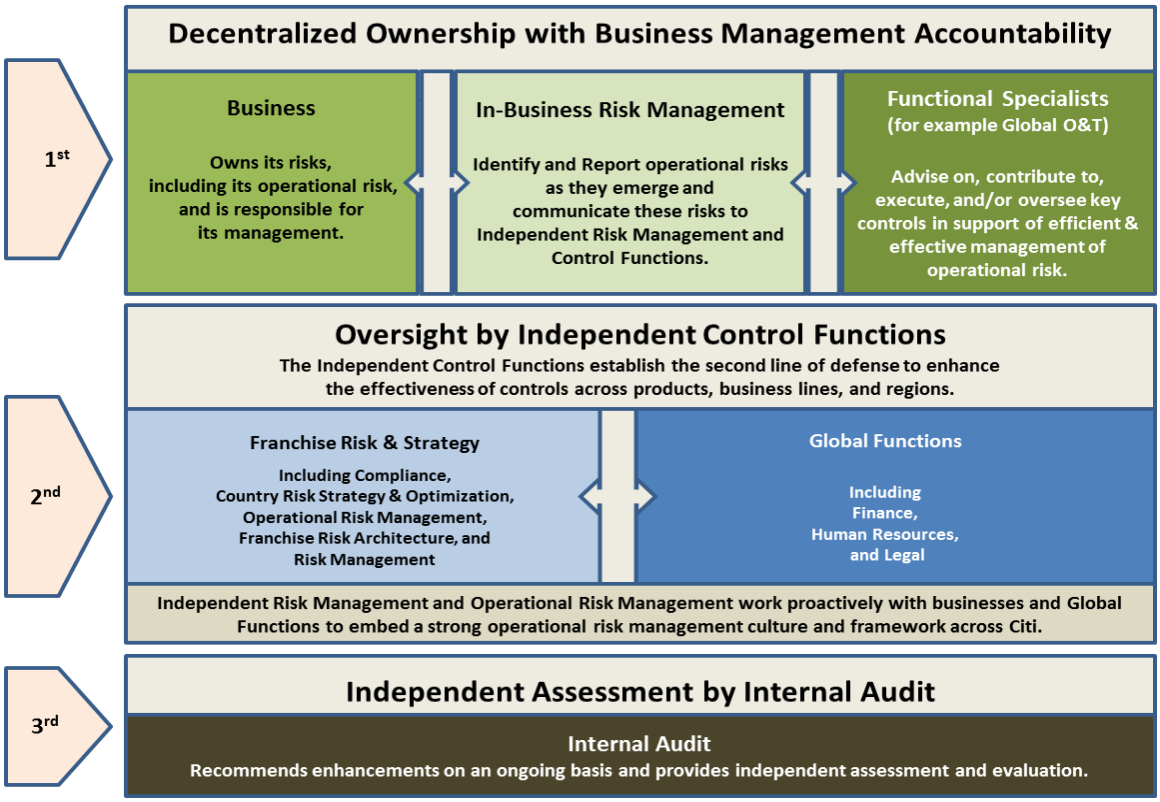
Foreign currency deposits are generally used to fund the Branch' foreign currency denominated loans and receivables and investment portfolio in the FCBU. Banks are required by the Central Bank of Sri Lanka to match the foreign currency liabilities with the foreign currency assets held through FCBUs.

The Branch determined that the functional currency of the FCBU is USD. Consequently, the FCBU is not exposed to fluctuations of its USD-denominated financial assets and liabilities.

4. Operational Risk

Operational Risk is the risk of a loss resulting from an inadequacy or a failure ascribable to people, processes, technology or external events. Currently the Branch is reporting operational risk capital charge under Basic Indicator Approach (BIA).

The Branch's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Branch's reputation with overall cost effectiveness and to avoid control procedures that restrict initiative and creativity. As such the Branch adopts the three lines of defences as below:



The primary responsibility for the development and implementation of controls to address operational risk is assigned to senior management within each business unit. This responsibility is supported by the development of overall Branch's standards for the management of operational risk in the following areas:

- requirements for appropriate segregation of duties, including the independent authorization of transactions
- requirements for the reconciliation and monitoring of the transaction
- compliance with regulatory and other legal requirements
- documentation of controls and procedures
- requirements for the periodic assessment of operational risk faced, and the adequacy of controls and procedures to address the risks identified
- requirements for the reporting of operational losses and proposed remedial action
- development of contingency plans
- training and professional development
- ethical and business standard, and
- risk mitigation, including insurance where this is effective.

Compliance with Branch's standards is supported by periodic audits undertaken by Internal Audit.

The results of these audits are discussed with the stakeholders to which they relate. These audit reports are submitted to the senior management of the Branch.

Use of insurance for the purpose of mitigating operational risk

Citi Group has the following Corporate Reimbursement Programs (CRP) that provides protection to Citibank Sri Lanka:

1. CRP for all Risk Property for physical loss or damage, including Flood, Earthquake, and Business Interruption coverage. This program provides protection for Real and Personal property including owned / leased Buildings, Tenant Improvements / Installations, Furniture and Electronic /IT Equipment on a Replacement Cost basis.
2. CRP which provides protection for its subsidiaries against physical loss or damage to securities, cash and other valuables in Citi's legal care, custody or control on premises and in transit anywhere in the world. The program applied to loss from burglary, robbery, theft, employee dishonesty, forgery, counterfeiting, computer system fraud and similar offenses. The limit provided by the program is reasonable and customary for financial institution exposures.
3. CRP for third party / public liability coverage for third party bodily injury and third party property damage, including broad form contractual liability and products / completed operations coverage.

Outsourced activities together with parties and basis for payment for such services;

Citibank Sri Lanka has outsourced several activities in accordance with its Outsourcing policy and have duly informed the Central Bank of Sri Lanka (CBSL) of all such outsourced activities.

Investment in appropriate information technology and other risk mitigation techniques taken during the reporting period;

Citi Sri Lanka has invested appropriately on IT technology. The Citigroup as a whole uses globally developed IT software for which significant investments have been made.

Due diligence tests of third party service providers;

Citi Sri Lanka conducts due diligence tests annually for outsourced service providers, in accordance with the Asia Pacific Outsourcing Governance Procedure Manual.

Contingency plan to handle failure situations

A detailed Continuance of Business policy document is in place which is tested periodically by a dedicated unit within Sri Lanka operations. A full disaster recover drill is conducted annually for Denial of Access scenario in compliance with Citi Policy and regulatory guidelines. As recommended by regulator a semi-annual drill is also conducted for core banking functions and payment & settlement related functions and results are communicated to CBSL with an action plan for improvements where necessary. Throughout the year respective business units participate for hosting data center tests for the applications used by the respective units.