



GATEHOUSE  
BANK

# PILLAR 3 DISCLOSURES

31 May 2016

Approved by the Board on 12 October 2016



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## 1. SCOPE OF PILLAR 3 APPLICATION

### Purpose

This document comprises Gatehouse Bank plc's ("Gatehouse", "Gatehouse Bank" or the "Bank") Pillar 3 disclosures on capital and risk management at 31 May 2016. It has two principal purposes:

- To meet the regulatory disclosure requirements under CRD IV, Part 8 – Disclosure by Institutions, and the rules the United Kingdom ("UK") Prudential Regulation Authority ("PRA") set out in the PRA Rulebook, Part B – Public Disclosure, and as the PRA has otherwise directed, including Remuneration Code disclosures;
- To provide further useful information on the capital and risk management of Gatehouse.

Additional relevant information may be found in the Bank's Annual Report and Financial Statements 2015.

### Business Profile

Gatehouse Bank is a fully Shariah compliant investment bank based in the City of London, authorised by the Prudential Regulation Authority and regulated by the Prudential Regulation Authority and the Financial Conduct Authority ("FCA"). Incorporated in May 2007, the Bank was authorised by the Financial Services Authority ("FSA") in April 2008. The Shariah compliant nature of the business encourages a simpler business model and conservative risk appetite. The philosophy of Shariah in relation to finance does not seek to prohibit or restrict economic activity, but rather direct it towards responsible behaviour and strongly encourages that financial resources should be put to good use.

The main business lines of the Bank are currently Shariah compliant Real Estate Finance, Real Estate Investment Advisory, Wealth Management and Treasury. Key sources of funding for the Bank are shareholder funding and client deposits. Also as part of GHB's continuing strategy to diversify funding sources, March 2015 saw the launch of a new retail internet based deposit product for longer term funding ("Milestone Savings"). Effective risk management is central to Gatehouse and in accordance with the disclosure requirements under CRD IV Basel III (as defined below), this document provides an overview of how the Bank's risk management framework operates and describes the key risks which the Bank faces.

### Overview

The European Union ("EU") Capital Requirements Directive ("Basel II") came into force from 1<sup>st</sup> January 2007 and applies to all United Kingdom ("U.K.") based banks. Basel II implemented improvements on the original Basel Accord, agreed in 1988 by the Basel Committee on Banking Supervision, and aims to make the capital requirements framework more risk sensitive and representative of modern banks' risk management practices. The Directive was updated by the CRD IV Basel III requirements which became effective from 1 January 2014.

The Basel framework consists of three pillars:

- **Pillar 1:** defines the minimum capital requirements that banks are required to hold for credit, market and operational risk.
- **Pillar 2:** builds on Pillar 1 and incorporates the Bank's own assessment of additional capital resources needed in order to cover specific risks faced by the Bank that are not covered by the minimum regulatory capital resources requirement set out under Pillar 1. The amount of any additional capital requirement is also assessed by the PRA during its Supervisory Review and Evaluation Process ("SREP") and is used to determine the overall capital resources required by the Bank.
- **Pillar 3:** requires banks to publish information on their principal risks, capital structure and risk management.

The Directives are enforced in the U.K. by the PRA. The Pillar 3 disclosure requirements are contained in Articles 431 – 455 of the Capital Requirements Regulation ("CRR"). Gatehouse adopts the Standardised Approach to credit risk and market risk and the Basic Indicator Approach ("BIA") to operational risk. This document outlines the capital required for Pillar 1 and, in accordance with Pillar 3, details specific risks which the Bank faces and how these risks are managed.

## Frequency

The Board of Directors (the “Board”), after due consideration of the size and complexity of the Bank, do not feel it is necessary to produce Pillar 3 disclosures any more frequently than annually unless there is a material change in the business plan or permissions from the Regulator. The Board believes that the separate publication of these disclosures on the Bank’s website is more appropriate than including them in the Bank’s annual report and accounts and considers the dynamics between the two reports to be different due to the differing requirements.

The disclosures will therefore be made annually on Gatehouse’s website ([www.gatehousebank.com](http://www.gatehousebank.com)) as soon as practicable after the approval of the annual report and accounts of the Bank.

Unless otherwise stated, the disclosures in this document are based on the financial position as at 31 May 2016. The quantitative disclosures in this document in respect of the current risk management policies and procedures of the Bank are a function of the balance sheet and the asset portfolio of the Bank as at 31 May 2016.

## Scope

Gatehouse Bank is not part of a UK consolidation sub-group and as such the Pillar 3 disclosures as at 31 May 2016 have been prepared on an individual basis.

## Verification

The disclosures included in this document are not subject to audit. These disclosures explain how the Board has calculated certain capital requirements and information about risk management generally. They do not constitute financial statements.

This document, being the Pillar 3 disclosures at 31 May 2016, was approved at the Audit, Risk & Compliance Committee on 12 October 2016 and by the Board on the 12 October 2016.

## Enquiries

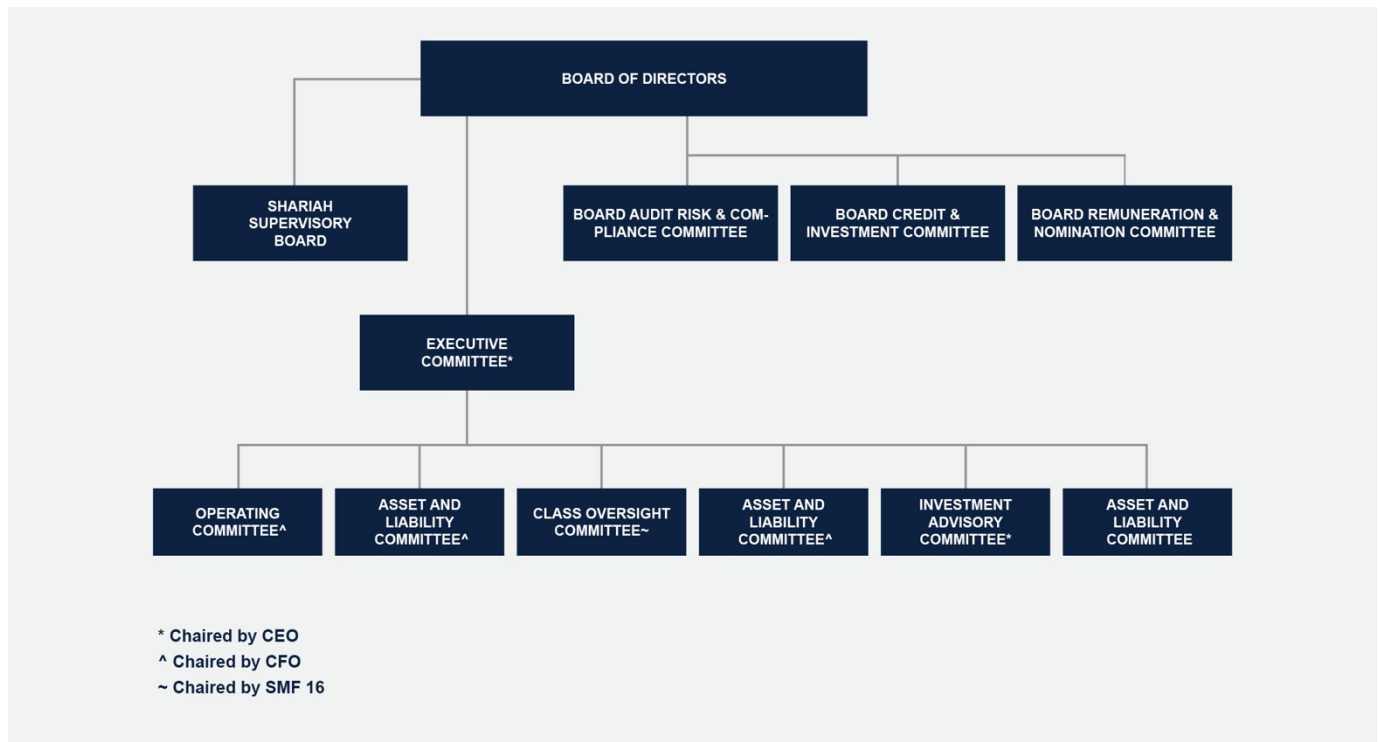
Enquiries on any disclosures related to Pillar 3 should be directed to the CFO.

## 2. CORPORATE GOVERNANCE FRAMEWORK

The Bank is committed to the ongoing sustainability of its business lines and has established a comprehensive corporate governance and risk management framework to ensure that the risks faced by the Bank are managed prudently.

The risk control and governance framework is governed and managed on a day-to-day basis by the Board, its Committees and the Executive Committees.

The Gatehouse Corporate Governance Framework



### The Board of Directors

The Board is the primary governing body and has ultimate responsibility for setting the Bank’s strategy, corporate objectives and risk appetite. The strategy and risk appetite take into consideration the interests of depositors, customers and shareholders.

The Board approves the level of risk through the Risk Appetite Statement (“RAS”) which the Bank is willing to accept and is responsible for maintaining a sufficiently controlled environment to manage principal risks. The Board is also responsible for ensuring that capital and liquidity resources are adequate to support the Bank’s business plans without taking undue risk. The Board maintains close oversight of current and future activities, through a combination of Board reports including financial results, operational reports, budgets and forecasts and reviews of the main risks set out in the Internal Capital Adequacy Assessment Process (“ICAAP”) and Internal Liquidity Adequacy Assessment Processes (“ILAAP”).

The Board is comprised of non-executive directors and executive directors. The Board meets formally at least four times a year.

### The Shariah Supervisory Board (“SSB”)

The SSB comprises three individual Shariah scholars that specialise in Islamic commercial jurisprudence and is responsible for ensuring that the Banks activities are in compliance with the requirements of Shariah.

In this regard the SSB reviews contracts, new deal structures and legal documentation and confirms whether or not a transaction is in compliance with Shariah principles. The SSB works closely with the internal Head of Shariah who reports quarterly to the Bank’s Board. The SSB meets periodically with the Bank’s representatives and on an annual basis it reports to the Shareholders via the inclusion of a Shariah Audit Report in the annual accounts. The SSB is appointed by the Bank’s Board.

### **Board Audit, Risk and Compliance Committee (“ARCC”)**

The Board has delegated responsibility for reviewing the effectiveness of the Bank’s internal controls to the ARCC. The ARCC is required to meet at least quarterly and monitors and considers the internal control environment focusing on operational risks, internal and external audits and compliance matters.

The ARCC is chaired by an Independent Non-Executive Director, and comprises a further two Non-Executive Directors, with invitees as required from the Bank’s Executive Management Team. This usually includes the Head of Compliance, the Head of Risk, Treasurer, the Chief Executive Officer and the Chief Financial Officer.

The Internal Audit function reports directly to the ARCC under the terms of reference for the committee. The ARCC approves the term of appointment of external auditors and receives reports from the external auditors independently from the Board. Both the internal and external auditors attend ARCC meetings.

### **Board Remuneration and Nominations Committee (“RNC”)**

The RNC reviews remuneration matters, employee benefits and performance related pay structures for the Bank. It is also responsible for considering and determining the Bank’s remuneration policy, reviewing its adequacy and effectiveness and ensuring that the remuneration policy and process complies with the FCA Remuneration Code.

In addition, the RNC is also responsible for reviewing the structure, size and composition of the Board and arranging the Board’s annual performance review alongside formulating plans for succession for both non-executive and executive directors and reviewing Board committee memberships.

The RNC comprises four Non-Executive Directors, meets at least twice a year, with the Chief Executive Officer, Chief Financial Officer and HR Manager usually in attendance.

### **Board Credit and Investment Committee (“BCIC”)**

The BCIC takes decisions on issues pertaining to transactions that fall outside the delegated authority given to management committees. For this purpose, the BCIC meets on an ad-hoc basis when business needs dictate. Every transaction to be reviewed by the BCIC must have been considered and recommended for approval by the management committee from which it is escalated. The BCIC will not consider any individual transaction except in cases where they exceed the authority delegated to management committees.

The Chairperson of the BCIC reports to the Board on a quarterly basis.

### **Executive Committee (“EXCO”)**

The EXCO takes day-to-day responsibility for the running of the business. The EXCO implements the strategy which is approved by the Board and ensures the performance of the business is conducted in accordance with the Board’s instructions.

The EXCO meets monthly and reviews all aspects of business performance, including reviewing the financial performance, allocation of resources and management of principal risks. The EXCO implements the framework for risk management assisted by its various sub-committees.

### **Asset & Liability Committee (“ALCO”)**

The EXCO has delegated responsibility for managing and overseeing the Bank’s exposure to liquidity, profit rate and market risk to ALCO.

The ALCO meets monthly and ensures that the Bank adheres to the market risk, balance sheet management and liquidity policies and objectives set out by the Board. It also has responsibility for ensuring that the policies are adequate to meet prudential and regulatory targets. The ALCO oversees the effective management of the Bank’s balance sheet and the impact on capital and liquidity of future business activity and management actions.

### **Operating Committee (“OPCO”)**

The OPCO meets monthly and is the operational management forum responsible for delivery of the Gatehouse operating plan. The OPCO duties include ensuring there is effective implementation of appropriate policies and governance arrangements across the lines of business and functions, efficiencies are identified and implemented and projects are managed according to relevant standards and within timescales and budgets.

### **Investment Advisory Committee (“IAC”)**

The IAC is the forum for approval of real estate investment advisory proposals. It meets as required and its duties include approval of proposals to originate, sponsor or secure advisory mandates in respect of investment transactions; client fundraising related decisions to ensure alignment between a given investment opportunity and the client base; and any advice or recommendations to be given by the Bank to investment advisory clients.

### **Risk Committee (“RISKCO”)**

The RISKCO is responsible to oversee the credit, market, operational, regulatory, conduct and legal risk inherent in the business strategy of Gatehouse. It is also responsible for the review of credits and large exposures and the other concentration limits for the Board of Directors’ approval. The RISKCO also has responsibility for reviewing and, where appropriate, making recommendations for changes to the Bank’s provisioning, financing and watchlist policies and monitoring the health of the overall credit portfolio.

### **Management Credit and Investment Committee (“MCIC”)**

The MCIC considers all requests for credit or investments from the business lines of the Bank. In addition, MCIC is also responsible for annual and any ad hoc reviews of credit and investment exposures. The MCIC is responsible for approving transactions within its delegated approval authority from the Board.

Exposures in excess of the agreed limits are considered by the MCIC who then make a recommendation to the BCIC. All proposals or topics for discussion must be vetted by the Risk Department. Where possible, the Head of Risk and the Heads of Business Units co-operate and resolve all outstanding issues prior to bringing the proposal to the MCIC. If not, queries are discussed at the MCIC.

### **CASS Committee (“CASSCO”)**

The CASSCO is responsible for ensuring that appropriate systems and controls are in place to ensure compliance with the CASS rules. The CASSCO has two key roles; to ensure that the appropriate systems and controls are in place for the Bank to discharge its requirements under the U.K regulations, and ensure that all changes to systems, process and new business propositions are mindful of the needs for good client money management. The CASSCO also ensures that any breaches are reported to the Financial Conduct Authority (“FCA”).

This Committee reports into EXCO monthly and annually into the ARCC.



### 3. RISK MANAGEMENT FRAMEWORK

#### Risk Management Philosophy at Gatehouse

Risk management is at the core of Gatehouse's financing philosophy and plays a vital role in the prudent growth of the Bank's business. Gatehouse's risk appetite is for exposure against defined target clients of sound financial strength and integrity, as well as a core competency, and the Bank offers a focused range of products designed to meet its clients' needs. Gatehouse only engages in activities where it possesses the expertise to identify, quantify and manage the risks inherent to the underlying transaction.

Gatehouse complies rigorously with U.K regulatory directives and Basel III recommendations. The Bank's Shariah-compliant model with low geared products and services is a cautious one. That said, all areas of banking business involve an element of risk and Islamic finance is no exception. An often made criticism of Islamic finance is that it has few risk management tools at its disposal; for example, there are only limited Shariah compliant derivatives to facilitate the hedging of currency and interest rate risks in what are still small markets. However, new Shariah-compliant structures are being developed for managing these risks. The other key concern has been liquidity management, but new qualifying Islamic notes are being issued and used more frequently as the Islamic banking industry and the wider understanding of Islamic finance advances.

Gatehouse regularly reviews the processes and procedures within the risk management function to ensure that they remain effective and appropriate for the current and future activities of the Bank.

#### Overview of Risk Management Framework

Gatehouse's Risk Management function is divided into three key areas: Real Estate Risk, Credit & Market risk and Operational risk. These three areas are delegated responsibility for the day-to-day monitoring of individual risks by the Risk Committee (RISKCO). The purpose is to ensure that risks are managed within the risk appetite parameters set by the Board. The RISKCO is responsible for providing an oversight function that considers all risks on a consolidated basis. The Risk Management Function is managed by the Head of Risk and reports to the Chief Financial Officer and the Chairman of the ARCC.

Gatehouse adopts the Standardised approach to calculate credit and market risk. For operational risk, the Bank operates under the Basic indicator approach.

Another inherent risk in managing the Bank's balance sheet is liquidity risk. Liquidity risk is the risk that the Bank will be unable to meet its payment obligations when they fall due. Liquidity risk management is the responsibility of ALCO. To limit this risk the Bank maintains an adequate portfolio of liquid assets which consists of cash (Nostro balances), short-term bank deposits and investment grade sukuk and listed equities. Liquidity adequacy is monitored on a daily basis by the Finance Department who circulates reports to relevant members of senior management and the Board. Liquidity adequacy is discussed at monthly ALCO meetings with key issues being escalated to EXCO. The ILAAP and supporting liquidity stress test scenarios are reported on a regular basis to ARCC.

The section below describes the Bank's policies and processes which identify, manage and control the above risks. These essentially cover all transactions, including those which do not utilise the Bank's balance sheet. A full risk analysis is completed for each transaction and presented to the relevant committees for approval. In addition, a risk analysis of the Bank's overall portfolio is presented to the monthly ALCO and at least three times per year to the ARCC.

#### Internal Audit

Internal audit is responsible for reviewing all business lines and support functions. The function is outsourced (currently to KPMG LLP), however, Gatehouse retains overall oversight and accountability. Internal audit provides executive management and the ARCC with independent assurance that the Bank's policies and procedures have been implemented effectively. Internal audit also ensures that there are adequate controls in place to mitigate significant risks so that the exposure is within acceptable tolerance levels. The internal auditors report directly to the Chairman of the ARCC with a reporting line to the CFO (SMF2).

The Bank's Internal Audit function provides the following:

- risk-based internal audit reviews and concentrates on key risk areas;
- special investigations on behalf of the ARCC;
- monitoring of management implementation of audit recommendations; and
- advice to management regarding systems, controls and procedures.

The audit plan is risk-based and formulated and agreed by the ARCC. The ARCC also monitors the adequacy of the work and sets out the process for the timely follow-up of reported issues. The Internal Audit department ensures that business activities are conducted in a controlled and efficient manner and achieve results consistent with planned objectives and goals. It also makes sure that information used for measuring performance and managing risks as well as preparing financial statements is reliable and has integrity, that compliance requirements are adhered to, and that the decisions made by those authorised are based on adequate and sound information. Other key roles performed by Internal Audit include ensuring that transactions, income, expenditure, liabilities and assets are completely and accurately recorded, that assets are safeguarded, and that operational activities and the use of resources are efficient and effective. Internal Audit has the responsibility to provide management with independent assurance of the Bank's internal audit function and report to management any breakdowns, failures or weaknesses with appropriate recommendations for remedial action.

## 4. REMUNERATION

The members of Remuneration and Nominations Committee are selected non-executive Directors. Regular attendees include the CEO, CFO and the HR Manager. Meetings are held at least twice a year and written terms of reference as approved by the Board include:

- consideration and periodic recommendation to the Board of the remuneration policy (including incentives linked to the Company’s performance measured, amongst other things, by financial results adjusted for risks) relating to the executive directors and other senior executive managers that it is designated to consider and ensuring that such policy attracts and retains high calibre directors and senior executive management whilst ensuring this is consistent with sound risk management; and
- the review of performance related pay schemes and incentive plans and to consider and make recommendations in respect of their rationale, structure and aggregate cost.

### Remuneration Policy (the “Policy”)

Gatehouse’s Remuneration Policy advises of operating a total reward package comprising:

- Fixed Pay (Salary);
- Variable Pay (Bonus and LTIP Awards);
- Benefits;
- Non-financial rewards.

The policy provides for the deferral of a significant portion of higher value bonus awards to provide an effective means of risk management, discourages short termism and encourages the longer term retention of high performing employees.

### Material Risk Takers

The schedule of Material Risk Takers (“All staff who have a material impact on the firm’s risk profile, including a person who performs a significant influence function for a firm, a senior manager and risk takers”) is approved by the RNC on an annual basis.

### 2015 Aggregate Remuneration in respect of Material Risk Takers

<b>Average number of Material Risk Takers</b>	<b>12</b>
Fixed Remuneration <sup>1</sup>	£1,849,319
Variable Remuneration	£117,500
<b>Total Remuneration</b>	<b><u>£1,966,819</u></b>

Total remuneration due to material risk takers relates to senior management of the Bank. There were no other material risk takers in 2015.

<sup>1</sup>Fixed remuneration consists of base salary.

## 5. CAPITAL RESOURCES

### AS AT 31 May 2016

<b>Core Tier 1 Capital</b>	£
Share capital	150,049,301
Retained losses	(27,458,002)
YTD Loss	(526,807)
Other Reserves - AFS	(2,781,864)
Other Reserves – EIP	180,752
<b>Total CET 1 Capital</b>	<u>119,463,380</u>
<b>Deductions from CET1 due to Prudential Filters</b>	
Intangible assets <sup>1</sup>	(472,592)
Goodwill <sup>2</sup>	(8,147,189)
<b>Subtotal</b>	<u>110,843,599</u>
<b>Deductions from CET1 Capital</b>	
Significant Investments (Associate Investment in GC)	(19,150,584)
<b>Total regulatory capital</b>	<u>91,693,015</u>

<sup>1</sup> Intangible assets represent software costs and IT licences to the extent these are not amortised.

There is no additional CET1 capital held.

<sup>2</sup> The goodwill relates to the Bank's direct equity interest of 35.6% in Gatehouse Capital and accounted in conjunction with a financing to GFGL. The latter is treated as a connected funding of capital nature ("CFCN") for the purpose of owning the entire 100% of Gatehouse Capital.

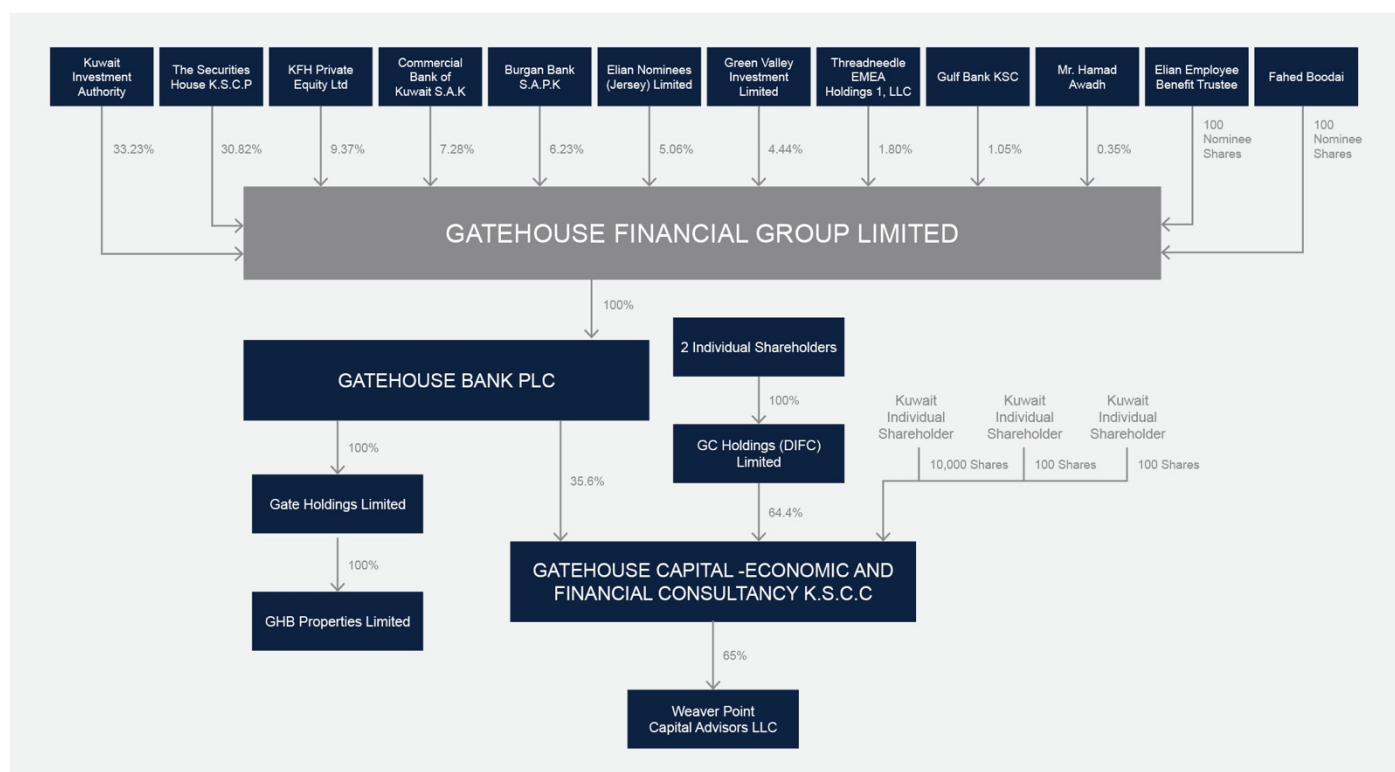
## 6. CAPITAL AND LIQUIDITY ADEQUACY

### Capital Position

Gatehouse was incorporated in May 2007 with an authorised capital of £200 million. This was increased to £225 million in March 2008. Start-up capital of £10 million was injected by The Securities House K.S.C.C. in 2007. Paid-up capital was increased to £50 million in April 2008 as part of the FSA authorisation.

On 28 July 2011, Gatehouse bank successfully raised an additional £100 million capital through a rights issue resulting in paid-up capital being increased to £150 million.

### Gatehouse Bank plc ownership structure as at 31 May 2016



### Capital Resources

Capital resources as at 31 May 2016 amounted to £91,693k. Pillar I requirements as at 31 May 2016 amounted to £26,794k. Pillar 1 and Pillar 2 capital requirements are explained in further details below.

The capital adequacy of the Bank is calculated on a daily basis and circulated to the executive management of the Bank. The capital adequacy is also formally reviewed and approved once a month through the Bank's monthly management accounts.

On an annual basis, the Bank produces a 12 month Budget incorporating the income statement, balance sheet and capital requirements. This is presented to and approved by the Board. The 12 month forecast is monitored on a monthly basis and reported in the management accounts of the Bank.

The 12 month forecast prepared for the year-ended 31 December 2016 shows that the Bank will operate comfortably within its current and planned capital resources.

### Pillar 1 - Compliance with CRD IV capital requirements

The current Basel III requirements have not changed the minimum capital requirements ratio of 8% for Pillar 1 purposes. The significant changes are related to calculation of Risk Weighted Assets ("RWA") where the calculation is now based on a more sophisticated approach to measuring the risk exposures of the Bank.

Credit and Operational risks comprise over 94% of the Bank’s capital requirement; and they are also the two key risk types to which the Bank is exposed, in addition to liquidity risk. The Bank has no material exposure to market risk as it is not the nature of a Shariah compliant bank to engage in speculative and derivative-based market trading.

As a UK regulated bank, the minimum capital requirement of Gatehouse for Pillar 1 purposes is the base capital resources requirement of €5,000,000.

The table below shows the approach currently used by Gatehouse to comply with Basel III regulations for the calculation of Pillar 1 capital requirements:

<b>Type of Risk</b>	<b>Approach</b>
Credit Risk	Standardised approach
Operational Risk	Basic indicator approach
Market Risk	Standardised approach

### **Pillar 2 - Internal Capital Adequacy Assessment Process**

The UK regulator has prescribed obligations under Pillar 2 of the Capital Requirements Directive (“CRD”) which require all firms within the scope of CRD to have an Internal Capital Adequacy Assessment Process.

Not all material risks can be mitigated by capital but where capital is appropriate, the Bank has adopted a “Pillar 1 plus” approach to determine the level of capital that needs to be held in accordance with the Individual Capital Guidance. This method takes the Pillar 1 capital formula calculations (for credit, market and operational risk) as a starting point and then provides for additional capital in Pillar II.

The current ICAAP was approved by the Board on 8 June 2015.

### **Liquidity Risk – Internal Liquidity Adequacy Assessment Processes**

The Bank also approves a formal ILAAP annually as per BIPRU 12 guidelines. The key function of the Internal Liquidity Adequacy Assessment Process (“ILAAP”) is to inform senior management and the Board on an ongoing basis of the risks affecting the Bank’s available liquid resources and of the need to implement any pre-agreed contingency plans to deal with risks should they materialise.

The key liquidity risks the bank models are:

- Franchise viability risk;
- Non-marketable assets risk; and
- Funding concentration risk.

The ILAAP was last approved by the ARCC on 17 May 2016.

### **Recovery plan and Resolution Pack (“RRP”)**

The Board regards the RRP as a key component of the Bank’s risk management framework as it enables the Board to understand and monitor the indicators and events that have the potential to cause the Bank to fail due to a lack of capital and/ or liquidity.

The development of the RRP identified a range of metrics (referred to as Early Warning Indicators and Invocation Trigger Points) that may impact the Bank’s available liquidity and / or capital, and various recovery options. Performance relative to Early Warning Indicators is monitored daily and reported monthly to ALCO and regularly to the ARCC.

### **Contingency Funding Plan (“CFP”)**

The CFP sets out the strategies, policies and actions that senior management and the Board have identified as being necessary to improve and enhance the Bank’s liquidity in crisis situations and periods of market stress. In line with regulatory expectations each CFP action establishes a clear allocation of roles and clear lines of management responsibility, and is aligned and integrated into the liquidity component of the Bank’s RRP.

### **Capital Adequacy and Liquidity Assessment Process**

Gatehouse considers ICAAP and ILAAP to be working documents that are continually being updated to reflect current business activities. The ICAAP and ILAAP are standing items on the monthly ALCO meeting agenda and are discussed at quarterly ARCC meetings. The ICAAP and ILAAP are presented formally to the Board for approval once a year.

Through the ICAAP and ILAAP, Gatehouse completes an annual assessment of the key risks to capital and liquidity, based on scenario analysis as well as sensitivity and reverse stress testing.

The key sources of risk to capital and liquidity that the Bank assesses are:

- Credit Risk
- Market Risk
- Operational Risk
- Liquidity Risk
- Concentration Risk
- IRRBB Risk
- Group Risk
- Strategic Risk

## 7. CREDIT RISK

Credit risk is the risk of suffering financial loss in the event that one of Gatehouse's clients or market counterparties fails to fulfil their contractual obligations. Credit risk may also arise where the downgrading of an entity's credit rating causes the fair value of the Bank's investment in that entity's financial instruments to fall. The credit risk that Gatehouse faces arises mainly from Treasury activities, real estate finance and legacy real estate investment.

Gatehouse's Credit Risk functions covers three key areas:

- The overall management and implementation of the risk management framework and risk appetite as determined by the Board; determining mandate and scale limits as set by the Board;
- Assessment of investment and financing activities via the provision of comprehensive credit risk assessments and recommendations for appropriate decision making forums. This includes monitoring of portfolio composition; and
- The monitoring of exposures to ensure compliance with approved limits and to ensure that the credit quality of the counterparty or collateral has not deteriorated or circumstances changed. Monitoring provides a picture of the portfolio as a whole and its inherent risks, including concentrations and capital allocation.

A comprehensive control framework is in place. This incorporates:

- maximum credit guidelines relating to exposure to an individual counterparty or transaction and where appropriate, the minimum level of collateral;
- country specific limits to avoid excessive concentration of credit risk in individual countries; and
- industry specific limits to avoid excessive concentration of credit risk in individual economic sectors.

A range of analysis methodologies are used to determine the credit quality of a counterparty, such as quantitative analysis, qualitative analysis, external rating agency research, industry specific research and for wholesale assets, market information such as credit spreads.

As at 31 May 2016, credit risk capital requirements arose on treasury assets, available for sale investments (Sukuks and Equities) and non-trading financial assets.

### ProMS

The Bank has introduced a new rating system as part of its credit assessment and review process for real estate transactions. This uses Monte-Carlo simulation techniques and is currently being calibrated. Once calibrated, this model will provide the bank with a probability of default and loss given default evaluation for secured real estate finance transactions, and will assign a transaction rating on a scale equating to that used by the major rating agencies.

Calibration is targeted for completion by the end of the year.

### Treasury Assets

The Bank has exposures to a range of banks and financial institutions in its portfolio of mainly short-term treasury placements. These exposures arise mainly due to the placement of surplus capital in the market. Current exposures are to counterparties ranging from unrated institutions to those rated AA- by Standard & Poor's. Exposure sanctioning authorities are agreed by the Board. Counterparty exposures are monitored against limits by the Credit and Market Risk and Treasury departments on a daily basis and by the ALCO on a monthly basis.

### Available for sale investments (Sukuk and Equities):

The Bank has a portfolio of listed equities and Sukuk. The aim of the Listed Equities Portfolio is to generate sustainable, low risk income for the Bank, with positions and trades made in a prudent manner. The Shariah Advisory team have approved a list of Shariah compliant investment grade rated stocks that can be traded and Treasury monitors the portfolio on a daily basis. Maximum limits per stock and stop loss limits are in place. Sukuk yields offer attractive returns relative to money market deposits. Maximum limits per Sukuk and stop loss limits are in place.

### Non-trading financial assets

Gatehouse Bank maintains a non-trading (or banking) book of investments in Shariah-compliant investment vehicles and bilateral financing transactions. These take the form of secured or unsecured financing and are usually funded by external treasury liabilities in the same currency to minimise any foreign exchange risk.



Treasury assets, available for sale investments and non-trading financial assets are monitored by Treasury on a daily basis in respect of capital requirements, liquidity mismatch and large exposures.

### Exposure

The table below shows the maximum exposure to credit risk for financial assets on the balance sheet at 31 May 2016:

	<b>2016</b>
	<b>£</b>
Cash and balances with banks	11,564,545
Due from financial institutions	43,453,350
Financing arrangements	133,458,358
Available-for-sale investments	86,084,777
Investments in Subsidiary	5,338,200
Investment in Associate	11,307,937
	<b>291,207,167</b>

### Analysis of Balance Sheet Assets

The Bank's exposures are distributed in the following geographical regions as at 31 May 2016:

	<b>£</b>
GCC countries	60,975,113
Kuwait	39,864,578
Saudi Arabia	11,647,345
UAE	7,394,556
Qatar	2,068,634
Jersey	57,546,756
Cayman Islands	30,739,084
Europe	134,044,159
USA	4,425,087
Asia	3,476,968
	<b>291,207,167</b>

Exposures by counterparty type as at 31 May 2016:

Counterparty Type	Institution £	Corporate £	MDB £	Sovereign £	Total £
<b>Assets</b>					
Cash and balances with banks	11,564,545	-	-	-	11,564,545
Due from financial institution	43,453,350	-	-	-	43,453,350
Financing arrangements	-	133,458,358	-	-	133,458,358
Available for sale investments	3,645,331	57,975,229	11,647,345	12,816,872	86,084,777
Investments in Subsidiary	-	5,338,200	-	-	5,338,200
Investment in associates	11,307,937	-	-	-	11,307,937
<b>Total Assets</b>	<b>69,747,586</b>	<b>196,771,787</b>	<b>11,647,345</b>	<b>12,816,872</b>	<b>291,207,167</b>

The residual maturity breakdown of exposures as at 31 May 2016:

	Less than 1 month £	1-3 months £	3-12 months £	1-2 years £	2-5 years £	5 years+ £	Total £
<b>Assets</b>							
Fixed rate items	17,390,816	7,166,264	29,369,170	32,884,863	108,391,817	1,462,128	196,665,058
Non rate sensitive items	11,564,545	-	-	-	82,977,564	-	94,542,109
<b>Total assets</b>	<b>28,955,361</b>	<b>7,166,264</b>	<b>29,369,170</b>	<b>32,884,863</b>	<b>191,369,381</b>	<b>1,462,128</b>	<b>291,207,167</b>

### Credit quality

The table below shows the credit quality of financial assets on the balance sheet at 31 May 2016, based on the Bank's credit policies:

	Investment grade £	Non-investment grade £	Non-rated £	Total £
<b>Assets</b>				
Cash and balances with banks	11,465,441	-	99,104	11,564,545
Due from financial institution	9,277,110	-	34,176,240	43,453,350
Financing arrangements	-	-	133,458,358	133,458,358
Available for sale investments	34,221,382	245,306	51,618,089	86,084,777
Investments in Subsidiary	-	-	5,338,200	5,338,200
Investment in Associates	-	-	11,307,937	11,307,937
<b>Total assets</b>	<b>54,963,933</b>	<b>245,306</b>	<b>235,997,928</b>	<b>291,207,167</b>

The Bank has adopted the standardised approach to credit risk and it follows the standard mapping of credit quality steps to ratings provided by external credit assessment institutions such as Standard & Poor's.

Whilst the Bank uses credit risk mitigation techniques where suitable, these are not used in the calculation of the Pillar 1 capital requirements. Hence, the exposure values and exposure values after credit risk mitigation are the same.

### Exposures to corporates:

Credit quality step	Risk weight	Exposure (£)	Exposure after credit risk mitigation
1	20%	-	-
1	100%	777,730	777,730
2	50%	-	-
2	100%	3,454,286	3,454,286
3	100%	1,879,818	1,879,818
4	100%	245,306	245,306
5	150%	-	-
NR	50%	-	-
NR	100%	110,433,485	110,433,485
NR	150%	79,981,162	79,981,162
<b>Total</b>		<b>196,771,787</b>	<b>196,771,787</b>

**Exposures to institutions with effective original maturity of 3 months or less**

Credit quality step	Risk weight	Exposure (£)	Exposure after credit risk mitigation
1	20%	6,357,621	6,357,621
2	20%	3,386,273	3,386,273
2	50%	287,246	287,246
3	20%	10,709,405	10,709,405
3	100%	2,007	2,007
NR	20%	6,964,395	6,964,395
NR	100%	13,175	13,175

## 8. MARKET RISK

Market risk is a measure of potential change in the value of a portfolio of instruments as a result of changes in market factors (such as interest rates, equity indices, bond prices, commodity markets, exchange rates and volatilities) during a specified time horizon. Gatehouse is exposed to market risk in both the management of the balance sheet (i.e. banking book) and via trading operations (i.e. trading book). The role of the Risk Management function is to identify, quantify and manage the potential effects of those potential changes on the value of the portfolio.

The ARCC reviews market risk limits on a quarterly basis and delegates responsibility for monitoring adherence to market risk limits to the Risk Management team and the ALCO.

The Risk Management function implements a limit framework within the context of the approved market risk appetite. A daily market risk report summarises market risk exposures against agreed limits. This daily report is available to all the senior executive members of the Bank.

Day-to-day responsibility for market risk lies with the Head of Risk. A detailed market risk presentation is produced monthly and discussed at the ALCO. Gatehouse Treasury manages treasury market risk.

### Market Risk Measurement

Market risk is measured using a combination of whole portfolio measures such as Value at Risk (“VaR”) and maximum loss, and product specific factors such as maturity mismatch for money market funding, VaR for FX, DV01 for Sukuk, and Beta for Equities.

Although the Bank only trades in Shariah compliant products, the carrying value of financial instruments held by the Bank is sensitive to movement in interest rates. If interest rates had been 200 basis points higher/lower and all other variables were held constant, the Bank’s profit for the year ended 31 May 2016 would decrease/increase by £5.9m (2015: £6.7m).

In order to meet internal and client demand, Gatehouse maintains access to market liquidity by using all reasonable endeavours to quote bid and offer prices with other market makers and carries an inventory of approved capital market and treasury instruments, including a range of cash, securities and treasury products. These include Commodity Murabaha, Wakala and Islamic FX forwards, Exchange of Deposits or a combination of these instruments.

### Profit Rate Risk (equivalent to Interest Rate Risk)

The varying profit share features and maturities of products, together with the use of Treasury products create profit rate risk exposures due to the imperfect matching of margins and maturity differences between assets and liabilities.

Gatehouse manages profit rate risk by matching as far as possible the maturity profile of assets and liabilities, Gatehouse has not to date used derivatives to hedge profit rate risk.

VaR and maximum loss are used to monitor the risk arising from open profit rate positions.

As at 31 May 2016, the market value of net nominal positions generating profit rate risk was £36,653,065 which generated profit rate VaR and maximum loss estimates of:

£	95% VaR	Maximum Loss
<b>One day</b>	(33,161)	(78,457)
<b>One week</b>	(81,929)	(192,385)

### Foreign Exchange Risk

A proportion of treasury funding and investment activity is undertaken in foreign currencies, mainly US dollars, Euros and Kuwaiti dinar. Foreign currency exposure is hedged on the balance sheet to reduce currency exposures to acceptable levels. VaR and maximum loss are used to monitor the risk arising from open foreign currency positions. The Group’s Pillar 1 minimum capital requirement allows for foreign exchange risk through the foreign exchange risk requirement PRR.

As at 31 May 2016, the market value of net nominal foreign exchange exposure was £3,088,175 which generated Foreign Exchange VaR and maximum loss estimates of:

£	95% VaR	Maximum Loss
<b>One day</b>	(13,326)	(31,020)
<b>One week</b>	(64,393)	(105,824)

#### Sukuk Portfolio Risk

Gatehouse Treasury invests in selected Sukuk. As at 31 May 2016, the Bank has not used derivatives to hedge Sukuk investments.

VaR and maximum loss are used to monitor the risk arising from the available for sale Sukuk investment portfolio.

As at 31 May 2016, the market value of nominal AFS Sukuk investment exposure was £22,586,906 which generated estimated Price Risk VaR and maximum loss of:

£	95% VaR	Maximum Loss
<b>One day</b>	(13,008)	(31,745)
<b>One week</b>	(30,460)	(73,221)

#### Equity Portfolio Risk

Gatehouse Treasury invests in selected Listed Equities. As at 31 May 2016, the Bank has not used derivatives to hedge Listed Equity investments.

VaR and maximum loss are used to monitor the risk arising from the Listed Equities portfolio.

As at 31 May 2016, the market value of Listed Equities investment exposure was £9,606,355 which generated estimated Price Risk VaR and maximum loss of:

£	95% VaR	Maximum Loss
<b>One day</b>	(92,428)	(208,653)
<b>One week</b>	(270,129)	(585,942)

#### Capital Resource Requirement for Market Risk

During the period ended 31 May 2016, the Bank entered into FX derivative transactions in order to hedge its exposures to exchange rates. A Pillar 1 charge arises from its notional foreign currency position risk requirement and its counterparty credit risk component.

Pillar 1 capital resources requirements for each of the market risks below as at 31 May 2016 were:

Market risk type	Trading Book (£)	All activities (£)
Interest rate PRR	-	-
Equity position PRR	-	-
Option PRR	-	-
Collective investment schemes PRR	-	-
Counterparty risk capital component	-	14,448
Concentration risk capital component	-	-
Foreign currency PRR	-	1,151,688
Commodity PRR	-	-

## 9. OPERATIONAL RISK

Operational risk is the risk of losses resulting from human factors, inadequate or failed internal processes and systems or from external events. Operational risks are inherent in the Bank's business activities and are typical of any financial enterprise. It is not cost effective to attempt to eliminate all operational risks and in any event it would not be possible to do so. Those of material significance are rare and the Bank seeks to reduce the likelihood of these in accordance with its risk appetite.

Major sources of operational risk include: operational process reliability, IT security, outsourcing of operations, dependence on key suppliers, implementation of strategic change, integration of acquisitions, fraud, error, customer service quality, regulatory compliance, recruitment, training and retention of staff, and social and environmental impacts.

Operational risk oversight is the responsibility of the Head of Risk, who reports directly to the Chief Financial Officer and the Chairman of the ARCC. They are also a member of both OPCO, RISKCO and EXCO.

The role of the Head Risk in this capacity is to analyse the operational (enterprise) risks faced by the bank. Ongoing assessment of operational risks is recorded in a dashboard that is prepared and presented monthly to the Risk Committee and regularly to the ARCC. The dashboard captures and rates the significance of key operational risks, along with an analysis of mitigating controls in place. The role also involves input into outsourcing arrangements and reviewing of any new products.

Each functional area is required to report key indicators and the core risks facing their business. These are maintained in conjunction with the Head of Risk, who provides challenge and oversight.

The business line risks are also considered as part of the Bank's risk register / dashboard. The Bank risk register / dashboard is maintained by Operational Risk and owned by EXCO.

The Bank risk register / dashboard is published to RISKCO and is formally reviewed by EXCO and the ARCC on a quarterly basis.

The Bank has put aside £2 million capital to cover Operational Risk events.

## 10. CREDIT RISK MITIGATION

The Bank's business model means that a significant portion of its credit and country risks fall within the upper range of its grading system. In order to mitigate its credit and country risks, the Bank employs a number of risk mitigants:

- As set out in Section 7, the Bank has a framework of concentration limits and guidelines to diversify the risk of excessive exposure concentrations
- limits are established for individual countries and counterparties based on their gradings
- These limits govern quantum, nature and tenor of exposure.
- Typically the Bank does not enter into transactions in excess of one year other than in its real estate activity or for counterparties of appropriate credit quality such as the liquid assets buffer;
- The majority of Gatehouse exposures are secured by tangible credit risk mitigants with an aim to decrease the credit risk associated with the exposure. This can take the form of property, quoted (listed) stocks and shares and other tangible or intangible assets, all of which must be Shariah compliant.
- Those liquidity buffers are only used to purchase the securities of highly rated sovereigns; and
- Other surplus liquidity is primarily placed with highly rated financial institutions.
- The Bank uses a credit grading system to facilitate the monitoring of the portfolio and individual exposures.
- Risk mitigation forms an important part of the credit assessment of a potential business proposal.
- It is Gatehouse's policy to ensure that credit risk mitigants are valued at the time a facility is approved. This is documented in the credit application. Once a transaction is drawn down the credit risk mitigant is revalued or viewed as part of the annual review process to take into account current market conditions.



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