PILLAR III DISCLOSURES REPORT

Allfunds Bank International S.A.

2019

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1. GENERAL OVERVIEW

1. GENERAL OVERVIEW[1]

1.1 ABOUT ALLFUNDS BANK INTERNATIONAL S.A.

Allfunds Bank International S.A. (hereafter, the "Bank" or "AFBI") is an entity operating in Luxembourg since 2008, as PSF ("Professional of the Financial Sector") until 2014 and as a Bank after then. It is wholly owned by a single shareholder: Allfunds Bank S.A.U. (hereinafter, the "Group" or "AFB"). The Group is currently one of the leading platforms for the distribution of Undertakings for Collective Investments (hereafter, "UCIs") at an institutional level, and and has a presence on the ground in15 countries worldwide.

The Bank has a branch in Switzerland, Allfunds Bank International, S.A., Luxembourg, Zurich Branch (AFIS), which is duly authorised as a branch of a foreign bank and securities firm and supervised by the Swiss Financial Market Supervisory Authority ("FINMA"). On May 31st 2013, FINMA granted to AFIS the licences required to perform distribution activities. AFIS provides a local-adapted service in Switzerland, where there are specific regulatory limitations to fund distribution.

In accordance with article 19 (1) of the Capital Requirements Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms (hereafter, "CRR"), AFIS is considered excluded from the scope of supervision on a consolidated basis.

The purpose of the Bank shall be the receipt of deposits or other repayable funds from the public and the granting of credits as well as other activities and services which a credit institution may carry out under Luxembourg law including those of an investment firm (investment services and activities as such are defined under Lxuembourg Law of 5 April 1993 on the financial sector, as amended). The Bank may have interests in any form and in any business, undertaking or company having an identical, analogous or related purpose or which are likely to support the development of its business and to facilitate the distribution of its products or services.

The Bank may further guarantee, grant loans or otherwise assist the companies in which it holds a direct or indirect interest or which form part of the same group of companies as the Bank.

In general, the Bank may effect all industrial, commercial and financial operations, movable or immovable, related either directly or indirectly to the corporate purpose described above.

AFB is currently one of the leading platforms for the distribution of investment funds at an institutional level, consolidating open architecture solutions for more than 20 years. It currently offers distribution services comprising 1,720 fund managers and over 90,000 funds, and an extensive network which includes more than 700 contracts with institutional clients, spread over more than 45 countries, including commercial banks, private banking institutions, fund managers, insurance companies and fund supermarkets. Clients generally use funds for one or two purposes: self-investment (pure B2B) or direct distribution (B2B2C). AFBI has no proprietary asset management, insurance, pension or retail (B2C) businesses that could cause any conflict of interests in offering its services to its clients.

The Bank's strategy remains focused on becoming the B2B partner of any financial institution willing to enter into Open Architecture business, becoming their fund platform and main B2B service provider. AFBI is client demand driven, product-agnostic, continuously incorporating new managers and funds according to client demand. AFBI's institutional clients, top financial distributors, ultimately decide the way they want to undertake and implement their business using all the tools and services available at AFB. Through the platform, AFBI is also able to help distributors select the best counterparties in terms of service and information provided. Access to information, service performance and marketing support are now key factors used to select fund providers.

Year 2019 brought several relevant corporate deals: Allfunds and BNP Paribas announced a strategic partnership to create one of the world's leading fund and wealthtech platforms; Credit Suisse InvestLab was acquired marking the largest combination in the platform space to

[1] More information available in our web page https://www.allfundsbank.com/lr/web/public/about-us.

date; Credit Suisse became minority shareholders in Allfunds. Allfunds acquired fundinfo's Zurich-based fund research business, strengthening its data management capabilities by taking advantage of fundinfo as fund data source; the deal with Nordic Fund Market was closed becoming the largest fund distribution network in the region. Allfunds reinforced its digital offering with the launch of three tools to enhance distributor and fund manager experience: Digital On-boarding for Fund Houses, Allfunds Connect and Telemetrics Market Intelligence.

In 2020 Allfunds has continued with the launch of several new and enhanced digital products: through the digital eco-system Connect, Allfunds launches Digital Selector and the Portfolio Optimisation tool to conduct sophisticated analysis and research of funds.

Additionally, Allfunds has continued its global expansion with the opening of new offices in Hong Kong, Paris, Miami and Warsaw. Allfunds has also announced its plans to launch its new subadvisory business and Allfunds Blockchain. In early Q4 Allfunds has successfully closed the transaction with BNP.

In 2019, AFBI experienced an outstanding growth in assets, going from €44.5 Bn by end of 2018 to €64.4 Bn by the end of 2019 representing an annual growth rate of +44.8% (+€19.9 Bn). AFBI has benefited from a growth and diversification in our client base as well as an increase in assets from our existing client base.

1.2 RESULTS

In 2019, the focus remained on the objectives set in previous years:

- To continue to increase the number of investment fund distribution agreements entered into with customers in all the markets in which the Bank operates.
- To extend the range of financial products available to the Bank's customers.
- To continue to enter into agreements with the world's foremost management companies in order to be able to offer customers a wide range of products.
- To make constant improvements in the Bank's platform by investing resources in augmenting the levels of automation and reliability of the services provided to customers.

In 2019, the Bank, according to the annual accounts, obtained a net profit amounting to €7,132 thousand, in line with the previous year's level (€7,337). Fee and commission income was the largest revenue item.

Net fees income increased by 6.8% from €24.7 Mn in 2018 to €26.3 Mn in 2019, as a result of the substantial increase of the volume of assets under intermediation.

Net interest income got negative result passing to €-101.4 thousand in 2019 from €-301.6 thousand in 2018 due to negative interest impact.

1.3 SOLVENCY

Regarding Solvency, and according to the CRR/CRD IV, the Bank shows comfortable levels above the regulatory requirements[2].

The following charts show the change in qualifying own funds, capital requirements and total capital ratio (thousand Euros):

Risk weighted exposure by type of risk

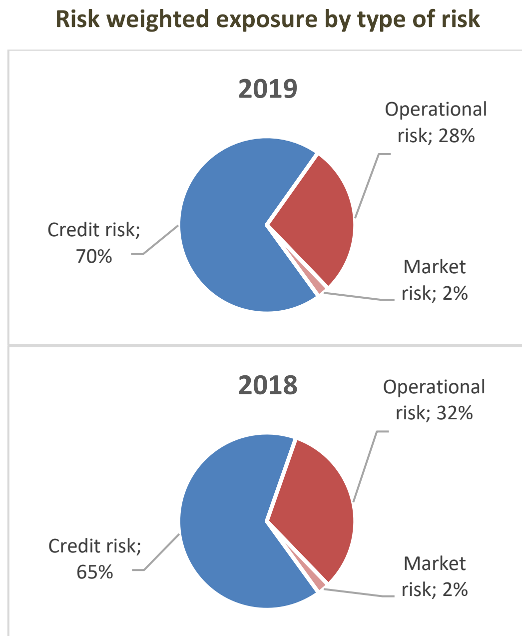


Figure 1: Solvency

[2] By virtue of Art. 92 of the CRR institutions shall apply the following own funds requirements:
a) Common Equity Tier 1 (CET1) capital ratio of 4.5%;
b) Tier 1 capital ratio of 6%;
c) Total capital ratio of 8%.

Additionally, the CRD IV introduced a capital conservation buffer, a countercyclical capital buffer and a systemic risk buffer. Institutions are required to maintain in addition to the previous requirements, a capital conservation buffer of CET1 equal to 2.5 % of their total risk exposure amount by 1st January 2019.

2. INFORMATION ON GENERAL REQUIREMENTS

2. INFORMATION ON GENERAL REQUIREMENTS

2.1 LEGAL FRAMEWORK

In 2010, in the wake of the international financial crisis, the Basel Committee on Banking Supervision (BCBS) approved the reform of the regulatory framework on bank capital adequacy, known as Basel III. Basel III was transposed into EU law by a legislative package, applicable from 1 January 2014, made up of:

- The CRR.
- The Directive 2013/36/UE (CRD IV) of the European Parliament and the Council of 26 June 2013 on access to activities from credit institutions and the prudential supervision of the credit institutions and investment firms, modifying the Directive 202/87/U and abolishing the Directive 2006/48/CE and 2006/49/2006.

The objective of the modifications introduced was to improve the banking sector's capacity to absorb the impacts of economic and financial crisis, reinforce risk management and governance, transparency and disclosure of information. In particular, these improvements translate into greater requirements in the quantity and quality of capital and the introduction of liquidity and leverage measures.

The CRR is directly applicable in Member States from 1 January 2014, and repeals all subordinate acts that entail additional capital requirements.

The CRR provides for a phased-in period that will allow institutions to adapt gradually to the new requirements in the European Union. The capital conservation buffers provided for in CRD IV will also be phased in gradually, started in 2016 and reaching full implementation in 2019.

The Capital regulatory framework (CRR/CRD IV) was reviewed in order to reduce risk in the banking sector, introducing different Basel standards and integrating the loss absorption requirement into the European framework. Thus, on 20th May 2019, the European Commission approved the new CRR II and CRD V incorporating different Basel standards, such as the Fundamental Review of the Trading Book for Market Risk, the Net Stable Funding Ratio (NSFR) for liquidity risk or the SA-CCR for calculation of the Exposure At Default (EAD) by counterparty risk, interest rate risk in the banking book, as well as modifications related to the treatment of central counterparty entities, the Maximum Distributable Amount (MDA), the Pillar II, the leverage ratio and the Pillar III, among others. These reforms address the size, complexity and business profile of the banks. They also include measures that aim to support financing for SMEs and support investment in infrastructure.

In January 2015, the BCBS released a revised version of the Pillar III framework with the aim of addressing those shortcomings in the comparability and consistency of regulatory disclosures that negatively impact the ability of market participants to compare institutions' levels of risk. In particular, the revised framework focuses on improving the transparency surrounding the use of internal models for calculating risk-weighted assets (RWAs) by introducing more granular disclosure requirements under a tabular format (for qualitative information) and a template format (for quantitative information). These Tables and templates are intended to improve the comparability of institutions' disclosures across jurisdictions and over time. The Pillar III disclosure requirements from the Basel framework have been implemented in EU law via Part Eight of the CRR.

In this regard, as is stipulated in Part Eight of the CRR, consolidated financial groups and credit entities not integrated into one of these consolidated groups will publish the information, as soon as possible, at least annually and properly integrated through a single document called "Pillar III Disclosures Report", specifying information about their financial situation and activities which the market and other stakeholders may be interested, in assessing the risks that those groups and organizations face, their market strategy, risk control, internal organization and their situation in order to comply with the minimum capital requirements under solvency regulation.

Under this regulatory context, AFBI has prepared the Pillar III Disclosures Report, in accordance with the final Guidelines EBA/GL/2016/11 of the European Banking Authority (EBA) on disclosure requirements under Part Eight of the CRR, published in December 2016 (applicable since 31 December 2017), providing guidance to financial institutions on how to comply with applicable regulations.

The aim of this report is to promote market discipline, allowing different agents to assess the adequacy of capital of the entities. In order to do so, according to Article 74 of the CRR, entities will be equipped with solid Corporate Governance procedures, including a clear organizational structure with well-defined responsibility lines, transparent, consistent and effective procedures to identify, manage, control and communicate the risks they are exposed to or may be exposed to, adequate internal control mechanisms including proper administrative and accounting procedures as well as policies and practices that are consistent with an adequate an effective risk management and that promote the aforesaid.

In 2017, the Basel Committee on Banking Supervision published the second phase of the document called "Revised Pillar III Disclosure Requirements", which was transposed by the EBA during 2018.

In December 2017, the Basel III revision ended after almost three years of negotiation, when the Basel Committee on Banking Supervision published "Basel III: finalization of post-crisis reform". This document includes the review of the current framework of Basel III, with the dual objective of reducing the excessive variability of risk-weighted assets (RWAs) between financial institutions and facilitating greater comparability between the capital ratios of banks.

The amendments proposed by this reform include:

- Adoption of an aggregate floor calibrated at 72.5% for all risks, subject to a maximum impact cap of 25% on RWAs by institution.
- A review of the standardised approach to calculating capital for credit risk.
- A review of the advanced approaches to calculating capital for credit risk for low default portfolio.
- A new standardised approach to calculating capital for operational risk.
- A review of the credit valuation adjustment (CVA), which eliminates internal models and reviews standardised approaches to bring them in line with the updated framework for market risk.
- The final calibration of the leverage ratio.

During 2019, the most significant legislation issued at national level during the year and legislation/guidelines issued by international bodies that could have an impact on the Company (European Parliament, Financial Stability Board, ESMA, EBA, etc.) have been analysed and implemented.

The following laws and guidelines were considered significant for the entity:

- **MiFID II** (Directive 2014/65/EU of the European Parliament and of the Council of 15th of May 2014 on markets in financial instruments) and its development regulations, highlighting the Delegated Regulation (EU) 2017/565 and Delegated Directive (EU) 2017/593 which came into force on January 3rd 2018. The transposition of this Directive was through the Royal Decree-Law 14/2018, of September 28, which modifies the consolidated text of the Securities Market Law, and Royal Decree 1464/2018, of December 21.

  MiFID II has had a significant effect in the activity of the Company, due to its impact in the investor protection legislation enhancing the MiFID I regulatory framework and its position as intermediary between fund houses and distributors.
- **GDPR** (Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data) came into force on May 25th, 2018. Although all AFBI's clients are institutions, this regulation had an impact on the Company. For this reason, all personal data processing activities have been reviewed, assessed and recorded.
- **4th AMLD** (Directive (EU) 2015/849 of the European Parliament and of the Council of May 20th, 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing) was implem ented in the Luxembourg law on February 13th, 2018. Additionally, on May 30th, 2018, the European Parliament and the Council adopted the Directive (EU) 2018/843 (the so-called 5th AMLD)

amending the Directive (EU) 2015/849 (the 4th MLD) on the prevention of the use of the financial system for the purposes of money laundering and terrorist financing. As indicated, it is not a completely new AML Directive: it only modifies and enhances certain aspects of the existing (4th) ML Directive. Those aspects are mainly the creation of interconnected beneficial owners' registers in all EU member states, and measures in order to control the ML/TF risks linked to virtual currencies, and the creation of a national registers of bank and payments accounts. This Directive is to be implemented into national legislation by January 10th, 2020.

- **Joint ESMA and EBA Guidelines on the assessment of the suitability of members of the management body and key function holders** under Directive 2013/36/EU and Directive 2014/65/EU (EBA/GL/2017/12) of 26 September 2017. The Commission de Surveillance du Secteur Financier (CSSF) has communicated it intends to comply with the standards. The guidelines are applicable from the 30th June 2018 onwards. Their objective is to harmonise and improve suitability assessments within EU financial sectors, and to ensure sound governance arrangements in financial institutions in line with the Capital Requirements Directive (CRD IV) and the Markets in Financial Instruments Directive (MiFID II).

- **EBA Recommendations on outsourcing to cloud service providers.** The Commission de Surveillance du Secteur Financier (CSSF) has communicated the adoption of the mentioned EBA Recommendations. The recommendations, applicable as of the 1st July 2018, establish (among many other things) how to assess the materiality of outsourcing to the cloud; they provide guidelines on the process that institutions must follow to inform the competent authorities of significant outsourcing to the cloud and the content of said information; they give guidelines on the security of data and systems, the processing of data and the locations where they are processed; and guide the institutions on the organizational and contractual agreements that should be established in terms of contingency plans and exit strategies.

- **PRIIPs** (Regulation (Eu) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 and Commission Delegated Regulation (EU) 2017/653 of 8 March of 2017 on key information documents –KID- for packaged retail and insurance-based investment products). Regulation entered into force on January 1st, 2018 and establishes the obligation of producers of packaged investment products destined to retail clients and investment products based on insurance to prepare a standardized information document and deliver it to potential retail clients well in advance of its acquisition. Its objective is to collect clearly and summarized relevant information about the products to facilitate their understanding and comparison with other investment products. The major impact for the entity comes from the need to transfer to clients, mainly insurance companies, the necessary information of the underlying funds of their investments, in order to elaborate the KID of their own products. The measures taken to provide this information have been operating during the year 2018. UCITS funds are also subject to this rule, but the application of the KID PRIIPs for these instruments, originally scheduled for December 31st, 2019 has been delayed to 31st December 2021.

Other regulations analyzed without direct impact on AFBI:

- **PSD2** (Directive (EU) 2015/2366 of the European Parliament and of the Council of 25th of November, 2015 on payment services in the internal market) came into force on January 13th 2018. The transposition of this Directive was through the Royal Decree-Law 19/2018, of November 23. Compliance Department has reviewed this rule on payment services, concluding that, despite its great importance in the financial system, it does not affect AFBI's business since it does not carry out any of the payment activities regulated in the standard.

New coming regulations

- **Sustainable finance**: Making the financial sector a powerful actor in fighting climate change: The European Commission

delivered on the 24th of May 2018 its first concrete actions to enable the EU financial sector to lead the way to a greener and cleaner economy. The proposal confirm Europe's commitment to be the global leader in fighting climate change and to implement the Paris Agreement.

On 4th January 2019, the European Commission published the draft Delegated Regulations on how investment firms and insurance distributors should take sustainability issues into account when advising clients (i) amending Delegated Regulation (EU) 2017/565 –MiFID II- as regards the integration of Environmental, Social and Governance (ESG) considerations and preferences into the investment advice and portfolio management; and (ii) amending Regulation (EU) 2017/2359 –IDD- as regards the integration of Environmental, Social and Governance (ESG) considerations and preferences into the investment advice for insurance-based investment products. The draft Delegated Regulations form part of the European Commission's Action Plan on Financing Sustainable Growth, and amend MiFID II and the Insurance Distribution Directive respectively.

- Compliance Department will monitor the development of these measures given the impact on the activity of the entity. Among other aspects, they involve the categorization of all financial instruments (including investment funds) according to ESG parameters and their inclusion in their pre-contractual documentation.
- **EBA Draft Guidelines on outsourcing arrangements**: on the 25th February 2019 the European Banking Authority has released its draft guidelines on outsourcing arrangements whose purpose is to update the Committee of European Banking Supervisors (CEBS) guidelines on outsourcing that were issued in 2006, which applied exclusively to credit institutions; the aim is to establish a more harmonized framework for all financial institutions that fall within the scope of the EBA's mandate, namely credit institutions and investment firms subject to the CRD, as well as payment and electronic money institutions. The guidelines will enter into force on the 30th of September 2019. The 2006 guidelines on outsourcing and the EBA's recommendation on outsourcing to cloud service providers (mentioned above) will be repealed at the same time.

2.2 SCOPE OF THE REPORT

The report is based on AFBI's figures on a standalone level.

2.3 DISCREPANCIES BETWEEN THE REGULATORY AND THE ACCOUNTING INFORMATION

Regarding the differences between accounting and regulatory scopes of consolidation and the mapping of financial statement categories with regulatory risk categories, template EU LI1 has not been included due to the lack of relevant information that would provide, mainly due to the fact that the only items not subject to capital requirements or subject to deduction from capital are goodwill and other intangible assets (deducted from own funds calculation) and tax assets (not subject to capital requirements).

2.4 APPROVAL AND PUBLICATION OF THE REPORT

The Group has a policy for the verification of information with prudential relevance (Pillar III) to disclose by Allfunds Bank Group updated by the Board of Directors in October 2020. In this sense, the information with prudential relevance have the same degree of verification that is applied to the information of the management report, as part of the financial report. This, in accordance with the guidelines of the EBA on disclosure requirements under Part Eight of the CRR and described in its articles 431 (3) and 434 (1).

The Board of Directors, in its supervisory role, states that:

- The Pillar III Disclosures Report is prepared in accordance with the Policy on disclosure of the information with prudential relevance (Pillar III Disclosures Policy) approved by the Board.
- The published information and the risk management systems implemented are adequate in relation to the Bank's profile and strategy.

The functions of the second line of defence have participated in the review and verification of the information presented, as well as in ensuring that said information complies with the control and/or verification procedures established in the aforementioned Policy.

Prior to the approval of this concise declaration by the governing bodies, the Internal Audit function has reviewed the content of the Pillar III Disclosures Report 2018 and its adaptation to the regulatory requirements, as well as the control structures implemented.

The Board of Directors also agreed to delegate the approval of the Pillar III Disclosures Report by the General Manager, after its verification by the Risk and Audit Committee, responding to the provisions of article 435 (e) (f) of the CRR.

2.5 GOVERNANCE FRAMEWORK

The Entity has a Corporate Governance of Risks appropriate to the nature of the activity it develops and which is adapted to international recommendations and trends, through a structure based on the three lines of defence that ensure the non-existence of conflicts of interest. According to this model:

- The first line of defense is formed by the different business and support departments in charge of the relationship with clients/fund houses and support functions. The first line of defense implements and manages the risk indicators or first level controls in order to identify potential risks and ensure an effective answer to mitigate them. Thus, the role of the first line is to identify and manage risks.
- The second line of defense is formed by the Compliance and Risk Management teams, acting autonomously and independently between them and with respect to the first line of defense. These two units support the first line of defense in defining and monitoring the controls, that is to say, they set and monitor compliance with the rules and limits needed to stay within the risk appetite defined by the Board of Director.
- Finally, the third line of defense is represented by the Internal Audit function, which has the maximum level of independence and objectivity within the entity and ensures the effectiveness of the control systems. At the same time, it carries out an independent review of the first two lines of defense and verifies there is compliance with the model, providing assurance to the Risk and Audit Committee on the effectiveness of risk management.

The general principles of Corporate Governance indicate that the overall direction and management of the Entity is the responsibility of

the Board of Directors, which assigns to the General Management the follow-up and supervision of the Bank's general policies and objectives.

In the field of control, it is the responsibility of the Chief Executive Officer to submit a proposal to the Board of Directors with the definition of the mechanisms and means necessary to supervise management processes and ensure compliance with internal policies.

Therefore, the Board of Directors establishes the Bank's risk strategy, which is led and supervised by the General Management.

The Bank's risk procedures are managed by the Risk Management Department, whose main mission is to control, monitor and manage the risks arising during the Group's activity. This mission is developed as a continuous process that takes into account the size, complexity and typology of the Entity's activity.

Figure 2. Lines of defense - Functions

Source: Own elaboration, 2019

2.6 ORGANIZATION OF THE ENTITY

The Bank has defined the following Organizational Structure:

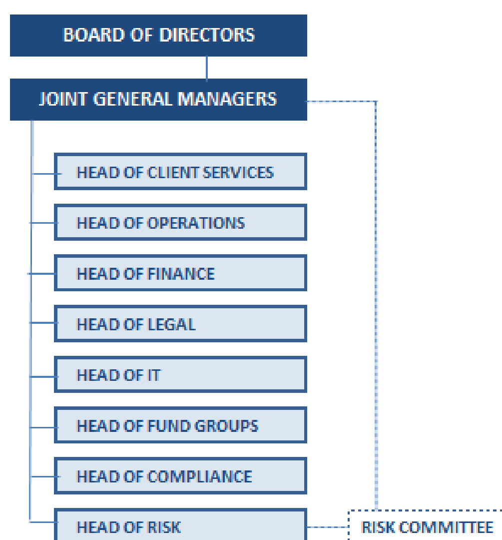


Figure 3. Entity organization

Source: Own elaboration, 2019

The Bank has a Corporate Governance system on risks management process which is appropriate to the nature of the business that it carries out, and which has been adapted to international recommendations and trends.

The general principles on Corporate Governance (within the framework of the agreement signed by the shareholder), indicate that the overall management and direction of the Bank is the responsibility of the Board of Directors, who assign the monitoring and supervision of the policies and objectives of the Bank to the General Management.

In the field of control, it is the responsibility of the General Management to submit to the Board of Directors the definition of the mechanisms and resources necessary to supervise the processes of management and to guarantee compliance with internal policies.

Consequently, it is the Board who establishes the risk strategy of the Bank. The General Manager responsible for the Risk Function, with the support of the Risk and Finance Department of the Group, has been delegated with the following functions:

- Proposing risk policies for the Bank and the level of risk assumed which the Bank considers acceptable.
- Where appropriate, authorizing potential technical overdrafts which may occur on the assigned limits.
- Define the responsibilities and functions of the persons related to risk management function.
- Validate, and therefore authorize, the internal and external reporting in matters of Risk.
- Ensure that the acceptable level of risk is in accordance with the strategic objectives which have been set out.
- Direct and lead the internal risk committee which shall, among other functions, review and approve the structure of the limits which the Bank has to establish for each risk factor.

The risk procedures are managed by the Risk Function of the Bank: this process implies a strong leverage of the methodologies and experience of the Risk Control Unit of AFB. The principal mission of the Risk Function is to control, monitor and manage the risks arising during the business activity of the Bank. This mission is carried on a continuous process which considers the size, the complexity and the typology of the activities which the Bank carries on.

2.7 GENERAL PRINCIPLES OF RISK MANAGEMENT AND CONTROL

Risk management is one of the main pillars of the Bank's strategy. Senior Management acknowledges and supports the proper and efficient definition, assessment, control, and monitoring of risks the Entity assumes during the course of its activities. The key principles are as follows:

- The control function shall be independent from functions that generate risk.
- There shall be a common risk culture, extended and shared throughout the organization.
- Conservative control and assessment criteria shall be defined and applied.
- The risk team shall be qualified and competent.

The Bank has established a monthly Risk Committee, whose main goals are defining, administering, and monitoring compliance with

the Bank's risk management policies. The Committee's functions shall include, among others:

- Discussion of regular reports of key risk topics with the various owners and proposing actions
- Follow-up of agreed actions
- Review of operational incidents once per year
- Monitoring and controlling risk management activities and procedures.

During the year 2019, the Bank's Risk Committee has been held 12 times.

The Global Risk Management Department is responsible for preparing and updating the Internal Risk Manual, which includes quantitative and qualitative procedures for monitoring, controlling and mitigating the potential risk resulting from the Bank's activity. Emphasis is placed on the nature and origin of risks, as well as on the procedures and methodologies governing management and control activities for each risk factor. The Manual also reflects the Entity's Risk Policy, which has been approved by the Board of Directors as part of its responsibilities. The guidelines for implementing defined risk procedures are issued by the Global Risk Management Department together with the General Management. Any local procedure is aligned to the Global one.

2.8 FUNCTIONS OF THE RISK DEPARTMENT

- Defining procedures and methodologies to measure, control and monitor the risks incurred by the Entity.
- Propose the limit structure to be assigned to each counterparty.
- Monitoring the limits usage.
- Preparing periodic risk-related information for local supervisory bodies (CSSF, BCL, etc.).
- Defining and preparing the necessary reports to monitor risk management.
- Preparing and updating the risk management manual as well as calibrating internal procedures.
- Defining the investments required for a better monitoring, control and management of the risks.

2.9 ORGANIZATIONAL STRUCTURE OF THE RISK DEPARTMENT

The Bank has a Chief Risk Officer along with a team designed according to its size, complexity and type of activity.

2.10 RISK MANAGEMENT FRAMEWORK

Prudence applied to risk management constitutes a pillar of the Entity´s activity and in the provision of services to their clients, therefore it is a priority axis in obtaining transparent results and providing added value to their clients and their shareholders.

The general principles which serve as guidelines for the definition, monitoring, and control of risks are those which are listed below:

- The risks assumed must be compatible with the capital of the Entity, in accordance with the objective level of solvency. In this sense, the Entity has a commitment to maintain levels of solvency above 17.5%.
- Intention to maintain a low risk profile, by means of:
  - Stick to the business of distribution avoiding investment and the incorporation of a trading portfolio into the balance sheet which may generate risks that the Entity does not wish to assume.
  - The pursuit of a high degree of diversification in the structural risks, setting up concentration limits on clients, sectors, markets, and/or geographical areas which could put at risk the objectives of solvency, liquidity, and recurrent results.
  - Continuous attention to the identification and monitoring of the risks, providing all the areas with adequate and dynamic systems that generate an optimal management and control on the risk assumed.
- Existence of a procedure for the control and monitoring of all of the risks to which the Entity is exposed in the course of its business.

- Existence of solid mechanisms for the control and mitigation of operational and reputational risks.
- Independence of the risk function from other business areas.
- Involvement of the organization in risk management philosophy.

2.11 RISK APPETITE FRAMEWORK (RAF)

The Risk Appetite Framework is an integral and prospective tool which determines the type and risk thresholds that it is willing to accept in order to achieve the Group's strategic and profitability objectives.

2.11.1 PROCESS OF MANAGEMENT AND GOVERNMENT OF THE RISK APPETITE FRAMEWORK

The Risk Appetite Framework of AFBI is structured according to the following management processes:

- Development and approval of the framework.
- Regular updating.
- Regular follow-up.
- Non-compliance protocol.
- Review.
- Transmission.

The Risk Appetite Framework is used by the Board of Directors as a management tool to:

- Formalize the Entity's declaration of risk appetite;
- Formalize the mechanism for supervision and surveillance of risks, in order to ensure compliance with risk appetite.
- Reinforce the Entity’s risk culture.

Currently, the Board of Directors is responsible for defining risk management guidelines, including the levels of tolerance that the Entity is willing to assume and its governance.

The General Management is responsible for transferring the Board's guidelines through a clear and segregated organizational model, qualitative principles, indicators and thresholds and limits on risks established by the Board of Directors.

2.11.2 DECLARATION OF APPETITE AND MATERIAL RISKS

In order to establish reasonable capital targets for the group, AFBI identifies the risks to which it is exposed and assesses the control measures used.

The main objective of the declaration of appetite is to obtain recurring and stable results over time, maintaining a low level of global risk by:

- Maintaining the distribution activity, avoiding the incorporation of positions on the balance sheet held on its own account that generate risks that the Bank is not willing to assume.
- The search for a high degree of diversification of structural risks, establishing limits to concentrations by customers, sectors, markets and / or geographies that may imply a threat to the solvency, liquidity and recurrence of results objectives.
- Continuous attention to the tasks of identification and monitoring of risks, so as to provide all areas with adequate and dynamic systems that result in an optimal management and control of the risks assumed.

The review of the RAF includes both the risks identified as material in the capital and liquidity assessment processes (ICAAP/ILAAP) and the risks considered relevant for management purposes to which the Entity is exposed in the exercise of its activity.

Table 1. Material risks

Risk Type	Material/Non-material
Credit Risk	Material
Concentration Risk	Material
Operational Risk	Material
Market Risk	Non-Material
Interest Risk	Non-Material
Liquidity Risk	Material
Business Risk	Material

Given the type of activity of the Entity, the main risks to which it is subject are operational risk and technological risk.

In order to measure the level of risk and contrast it with the levels of tolerance and capacity, a

series of indicators are established, which are subject to periodic monitoring in order to ensure that the levels reached are acceptable to the Entity, and if exceeded, define an action plan.

Allfunds Bank Group has established a monthly process to monitor the indicators and thresholds in order to assess the coherence and representativeness with the Entity's activity and business. They will also be reviewed in the event that a relevant event is identified, either by assessing new business opportunities or by continuously exceeding a threshold.

In this context, the Entity has defined indicators related to: credit, liquidity, solvency/capital, concentration, markets, operational, settlement and business.

2.12 RISK PROFILE

Allfunds Bank Group has established a series of principles under which the entity's risk management is based, and where the procedures for assessing the materiality of the risks and the risk profile of the Entity are established:

- Independent and global risk function, which ensures adequate information for decision making at all levels.
- Objectivity in decision-making, incorporating all the relevant Risk factors (both quantitative and qualitative).
- Active management of the entire life of the Risk, from the analysis prior to approval until the risk is extinguished.
- Clear processes and procedures, periodically revised according to the new needs, and with well-defined lines of responsibility.
- Integrated management of all risks through their identification and quantification, and homogeneous management.
- Inclusion of the variable risk in business decisions in all areas, strategic, tactical and operational.
- Alignment of the objectives of the risk function and of the individuals that compose it with those of the Entity, in order to maximize the creation of value.
- Establish a taxonomy for all risks to which the Entity is exposed.
- Have a Risk Appetite Declaration approved by the Group Board that includes all material risks for monitoring and management.

Allfunds Bank Group makes a periodic assessment of the materiality of risks and identification of their profile. The risk relationship covered by the ICAAP/ILAAP Guide is complemented by a series of additional risks, previously not considered and included in the Guidelines on common procedures and methodologies for the supervisory review and evaluation process (SREP) (EBA/GL/2014/13).

2.13 INTERNAL AUDIT

The internal audit function of AFBI is outsourced to the Parent company. Allfunds Internal Audit (AIA) is a Group function based in Madrid (Spain) and is responsible for all internal audit activities across Allfunds Group. AIA has an internal auditor based is Luxembourg who is responsible for audit work in AFBI.

2.13.1 OBJECTIVES AND FUNCTIONS ASSIGNED TO THE INTERNAL AUDIT DEPARTMENT

The objective of AIA is to provide independent, reliable, valued, insightful and timely assurance to the Board and Executive Management over the effectiveness of governance, risk management and control over current and evolving risks.

As a global function, AIA is responsible for the management of internal audit across the Group.

The Global Head of Internal Audit and staff of AIA are authorized to:

- Have unrestricted access to all information, functions, records, property and staff anywhere within the Group, relevant to their role.
- Have uninhibited right of access to the Board of Directors, the Chief Executive Officer and the appointed external auditors.
- Allocate resources, set frequencies, select subjects, determine scopes of work, assess audit need and coverage and apply the techniques required to accomplish audit objectives.
- Obtain the necessary assistance of staff in Allfunds Bank S.A.U. as well as other specialized services from within or outside.

2.13.2 INTERNAL AUDIT DEPARTMENT RESOURCES

The internal audit team for the Entity is a global function. The Global Head of Internal Audit reports functionally to the Chairman of the Risk and Audit Committee and administratively to the Chief Executive Officer.

AIA has an approved headcount of five employees and though the global team is located in Madrid (Spain), since November 2017 it counts with a member based in Luxembourg to ensure constant local representation and alignment with local regulation. The team currently includes a Head of Internal Audit, an Audit Manager and three Audit Seniors.

Members of the Internal Audit team have a diverse background in financial services with relevant international experience in internal and external audit, in financial institutions covering retail, corporate and private banking, asset management and technology.

Regarding the tools used by AIA, the following are used on a day to day basis:

- Audit work is stored in a database management tool (AutoAudit) which allows the team to manage audit work more efficiently.
- AIA uses Arbutus Analytics to perform tests over large sets of data which are extracted by the IT team. This testing approach, also known as Computer Aided Audit Tools & Techniques (CAATTs), allows AIA to increase significantly the level of assurance it provides.
- AIA has read-only access to the Dealing platform, Daily Fund & Account Requests (DaFAR) tool, SWIFT messages and the external web sites used by clients to obtain information on funds distributed by the Entity.

2.14 COMPLIANCE DEPARTMENT

The Compliance Department reports to the Bank's General Management and has a team designed according to its size, complexity and type of activity.

The purpose of Allfunds' Compliance function has been defined following the supervisors' guidelines. So, the mission of Allfunds' Compliance function will be to identify, advise, supervise and report on compliance risks, carrying out their tasks independently, adopting a proactive approach and close to the rest of the organisation, as part of its culture, anticipating changes in the regulatory context, in order to incorporate them into the Compliance Programme and mitigate regulatory and reputational risks while promoting ethical and responsible behaviour.

2.14.1 COMPLIANCE DEPARTMENT RESOURCES

Allfunds' Compliance function is carried out by the Compliance Department, which is responsible for guaranteeing the correct management of compliance risks according to the principle of independence with respect to the areas or units that carry out Allfunds' activities, making use of the appropriate resources in that regard. Allfunds' Compliance Department is made up of the AML/CFT Unit and the Regulatory Compliance Unit, as well as of the local Compliance Officers of each subsidiary and branch. It acts under the premises of independence, authority, objectivity, integrity, effectiveness and confidentiality.

The Compliance Department of Allfunds Bank Group is made of two separate units both under the direction of the Global Head of Compliance:

- the Regulatory Compliance Unit, focused on Compliance matters, and
- the AML/CTF Unit specialized in Anti-Money Laundering and Countering Financing of Terrorism matters;

as well as of the local Compliance Officers of each subsidiary and branch. It acts under the premises of independence, authority, objectivity, integrity, effectiveness and confidentiality.

At the end of 2019, globally the team is formed by 15 professionals with a background of at least 10 years of experience in Compliance duties. This team is based in different locations covering every delegation of Allfunds Group: Spain, Italy, Luxembourg, Switzerland and Singapore. The Compliance Department depends hierarchically on the CEO of the Group and reports at least on a quarterly basis to the Board Risk and Audit Committee and on an annual basis to the Board of Directors.

2.14.2 OBJECTIVES AND FUNCTIONS ASSIGNED TO COMPLIANCE DEPARTMENT

On a general basis, the activities of the Regulatory Compliance Unit consist in:

- Establishing a structured and well-defined Compliance Monitoring Programme based on the risk assessment process, that allows to regularly identify and assess the indicators and/or risk compliance controls in the different business areas.
- Controlling the implementation, development and compliance of Allfunds' Corporate Defence Model, as well as the subsequent monitoring, supervision and management of potential breaches.
- Advising the first line of defense in matters related to the compliance of the applicable regulations.
- Drawing up policies or preparing procedure manuals for the different business areas, as well as communications and training actions necessary for an adequate knowledge and awareness among employees, promoting a compliance culture and an ethical and responsible behaviour.
- Advising and assisting both the Board of Directors and the Senior Management in relation to regulatory compliance matters, especially in the potential impact related to the developments in legislation.

The Anti-Money Laundering and Countering the Financing of Terrorism Unit (AML/CFT Unit) is a technical team which is responsible for the direction and coordination of the systems and procedures to prevent money-laundering and terrorist financing and to review and investigate suspicious transactions reports. The proper management of risks relating to money laundering and financing of terrorism requires the identification and analysis of risks relating to money laundering and the financing of terrorism to which Allfunds Bank is exposed, and the design and effective application of the policies and procedures that are proportionate to the risks identified. This risk analysis must take into account the type of customer, product and service offered, the distribution channels of the products and services, and the jurisdictions in which the customers of Allfunds conduct their business. The goal of Allfunds in developing its AML&CFT programme is:

1. To protect the reputation of Allfunds preventing it from being used for the illicit laundering of assets or movement of funds to support and/or finance terrorism; and
2. To help preserve the integrity of the financial system, as well as the supervision of the authorities in order to prevent money laundering, corruption and to combat the financing of terrorism.

The Local Compliance Officers provide support to both units for the effective implementation of the global policies and procedures, within their unit and area of responsibility, ensuring compliance with local regulations. The Compliance function of Allfunds Group has established the action lines, coordination and standardisation of the Compliance functions of branches and subsidiaries (Local Compliance Officers), who maintain direct functional reporting channels with the Compliance function of the Group, to guarantee their independence, notwhitstanding the jurisdiction in which they are located and their local reporting channels.

The Compliance Department reports on a regular basis to Allfunds Senior Management mainly through its participation in the Risk Committee and the Internal Compliance Committee.

Finally, the Compliance Department reports to the Risk and Audit Board Committee through its quarterly reports and on an annual basis directly to the Board of Directors based on the results of the work performed and the associated risks, together with the proposals for mitigating measures that are considered adequate. Likewise, it will immediately inform the Board of Directors of any regulatory breach, incident or anomaly with special relevance.

3. CAPITAL

3. CAPITAL

CAPITAL MANAGEMENT AND ADEQUACY

The objective in managing the bank's capital is to maintain appropriate levels of capital to support its business strategy, cover all the risks to which the Bank is or might be exposed and meet regulatory and stress-test related requirements.

PILLAR I REGULATORY CAPITAL

INFORMATION ON OWN FUNDS

In Title I of the Second Part of the CRR, the different levels of capital that will constitute the Entity's own funds under the solvency regulations are defined, as well as those items that comprise them.

Regulation 2016/445 of the European Central Bank establishes the options and powers that, in relation to the prudential requirements of credit institutions, the supervisor exercises, specifying among other measures the schedules of progressive application to be used at the time of compute certain items as own funds.

There are no impediments to the rapid transfer of own funds between the parent company and its subsidiaries, having into account that such transfers shall be approved by the BoD.

Table 2. Qualifying own funds

Amounts (Thousand Euros)	31.12.18	31.12.19
CET1	34,482	29,783
Tier 1 additional	-	-
TIER 1	34,482	29,783
TIER 2	-	-
CAPITAL TOTAL	34,482	29,783
RWA	116,584	135,282
CET1 ratio	29.58%	22.02%
Tier 1 ratio	29.58%	22.02%
Total Capital ratio	29.58%	22.02%
Leverage ratio	12.17%	6.35%

Source: AFBI, 2019

Table 3. Details - Qualifying own funds

Amounts (Thousand Euros)	31.12.18	31.12.19
CET1 Instruments	**34,963**	**30,301**
Shareholders' equity	34,963	30,301
Capital	15,000	15,000
Profit	18,467	11,323
Reserves and others	1,496	3,977
Minority interests and unrealised gains/losses	-	-
Adjustments of comput. of minority int. and unrealised g/l	-	-
Other adjustments	-	-
Deductions from CET1	**(481)**	**(518)**
Intangible assets	(56)	(22)
Financial investments	-	-
Deferred tax assets	-	-
Other CET1 deductions[3]	(425)	(496)
CET 1	**34,482**	**29,783**
AT1 Instruments	-	-
TIER 1	**34,482**	**29,783**
T2 instruments	**-**	**-**
Financing of subordinated issues	-	-
Generic provisions and excess of provisions IRB	-	-
T2 deductions	**-**	**-**
TIER 2	**-**	**-**
TOTAL CAPITAL	**34,482**	**29,783**

Source: AFBI, 2019

[3] Free deliveries, in accordance with Art. 379(3) of the CRR.

INFORMATION ON CAPITAL REQUIREMENTS

Title II of the Second Part of the CRR defines the capital requirements for credit risk, Title III refers to the requirements of own funds for operational risk and Title IV to the requirements of equity for market risk. In the following Titles the requirements of own funds for settlement risk and for credit adjustment risk are specified.

The minimum amount of capital the supervisory authority requires the entity to hold to safeguard its solvency, based on the amount of risk assumed, in terms of credit, market and operational risk.

Table 4. Overview of RWAs (EBA Template OV1)

Amounts (Thousand Euros)	RWA		Minimum capital requirements as of 31.12.19
	31.12.18	31.12.19	
Credit risk (excluding counterparty credit risk)	**76,215**	**94,777**	**7,582**
Standardised Approach (SA)	76,215	94,777	7,582
Internal Rating-Based (IRB) Approach	-	-	-
Counterparty credit risk	-	-	-
Standardised Approach for counterparty credit risk (SA-CCR)	-	-	-
Internal Model Method (IMM)	-	-	-
Equity positions in banking book under market-based approach	-	-	-
Simple risk-weight approach	-	-	-
Internal Model approach	-	-	-
Equity investments in funds – look-through approach	-	-	-
Equity investments in funds – mandate-based approach	-	-	-
Equity investments in funds – fall-back approach	-	-	-
Settlement risk	-	-	-
Securitisation exposures in banking book	-	-	-
Market risk	**2,602**	**2,738**	**219**
Standardised Approach (SA)	2,602	2,738	219
Internal Model Approaches (IMM)	-	-	-
Operational risk	**37,767**	**37,767**	**3,021**
Basic Indicator Approach	37,767	37,767	3,021
Standardised Approach	-	-	-
Advanced Measurement Approach	-	-	-
Amounts below the thresholds for deduction (subject to 250% risk weight)	-	-	-
Floor adjustment	-	-	-
Total (1)	**116,584**	**135,282**	**10,823**

(1) Capital requirement of Pillar I: 8% RWA

Source: AFBI, 2019

CAPITAL BUFFER

An important innovation of Directive 2013/36/EU is the criterion of capital buffers during a peak phase of the economic cycle, with the objective of creating a more stable banking system that helps softening, instead of amplifying, economic and financial crisis.

These buffers may be used to absorb losses in difficult economic or stressful times. While its use does not involve a breach of the regulation, this could generate restrictions on dividends of the entity or the payment of variable remuneration for its managers.

- The capital conservation buffer (+2.5%) is set in order to provide the entity with

enough ordinary capital to absorb losses in an economic environment of stress. In case of non-compliance, limits on profit distribution or payment of variable remuneration of its executives are imposed.

- A countercyclical capital buffer (0%-2.5%) is a capital requirement in cases of excessive credit growth to avoid the formation of economic bubbles. The buffer will only be constituted in moments in which credit is growing excessively. During periods of normal credit growth, this buffer will be zero. When it is necessary, it will be additional to capital conservation buffer.

According to Law 10/2014, its Eighth Transitional Provision sets that the requirement of capital conservation buffer shall not apply until 1 January 2016. From this date until 31 December 2018, the buffer will be built in terms of ordinary capital of level 1 on total weighted exposures by risk, in accordance with the following schedule:

- From 1st January 2016 to 31st December 2016: 0.625%.
- From 1st January 2017 to 31st December 2017: 1.250%.
- From 1st January 2018 to 31st December 2018: 1.875%

As of 31 December 2019 the countercyclical buffer for AFBI was at 0.246759 % on RWA. Most central banks keep a 0% for the time being and depending on macroeconomic circumstances that are assessed by the national supervisory bodies.

Table 5. Geographical distribution of credit exposures relevant for the calculation of countercyclical capital buffer

Exposures	Specific buffer
Total	**0.246759%**
Andorra	0,000000%
United Arab Emirates	0,000000%
Austria	0,000000%
Bahrain	0,000000%
Bermuda (UK)	0,000000%
Brazil	0,000000%
Switzerland	0,000000%
Chile	0,000000%
Germany	0,000000%
Denmark	**0,000072%**
Estonia	0,000000%
Spain	0,000000%
Finland	0,000000%
France	**0,004720%**
United Kingdom	**0,124441%**
Guernsey (UK)	0,000000%
Hong Kong	**0,000071%**
Ireland	**0,090645%**
Isle of Man (UK)	0,000000%
Iceland	**0,000000%**
Italy	0,000000%
Jersey (UK)	0,000000%
Kuwait	0,000000%
Liechtenstein	0,000000%
Luxembourg	0,000000%
Malta	0,000000%
Mauritius	0,000000%
Netherlands	0,000000%
Norway	**0,024640%**
Oman	0,000000%
Panama	0,000000%
Poland	0,000000%
Portugal	0,000000%
Saudi Arabia	0,000000%
Sweden	**0,002170%**
Singapore	0,000000%
Slovakia	0,000000%
United States of America	0,000000%
Uruguay	0,000000%
South Africa	0,000000%

Source: AFBI, 2019

LEVERAGE RATIO

The Basel III agreement introduced a regulatory financial leverage ratio. In January 2014, the Basel Committee published the definitive calculation of the leverage ratio, together with an obligation to publish certain information to the market, applicable from 1 January 2015. In October 2014, the European Commission modified the CRR (via Delegated Regulation 2015/62) in order to adapt the new form of the calculation. In accordance with Article 451 of the CRR, entities will notify the leverage ratio. The aim of this ratio is to ensure that banks don't circumvent requirements for secure and long-term forms of capital. The leverage ratio is defined as Tier 1 capital divided by a measure of non-risk weighted assets (the leverage exposure).

This exposure is calculated as the sum of the following components:

- Asset value, without derivatives and without elements considered as deduction in Tier 1.
- Off balance sheet accounts (primarily, guarantees, non-used credit limits, letters of credit) weighted by the conversion factors of the standard credit risk method.
- Inclusion of the net value of derivatives (gains and losses against a single counterparty are netted, less collateral - provided criteria are met) plus a surcharge for potential future exposure.
- A surcharge for the potential risk of security financing transactions.
- A surcharge for the risk of credit derivatives (CDS) in the uncovered part.

BCBS revised the definition of the leverage ratio in 2017. In particular, a series of technical adjustments were made to the method for calculating total exposure (the denominator of the leverage ratio), mainly relating to exposure to derivatives and the treatment of offbalance sheet exposure. The final calibration of the leverage ratio was set at 3% for all institutions.

Banks must implement the final definition of the leverage ratio and comply with the new calibration of the ratio (the additional surcharge for G-SIBs) from January 2022.

The leverage ratio as of 31 December 2019 was as follows:

Table 6. Leverage ratio

Indicator	Current level
Leverage Ratio AFBI	6.35%

The following tables show the relevant information as of 31st December 2019 required by the Commission Implementing Regulation (EU) 2016/200 of 15th February 2016.

Table 7. Leverage ratio (Details)

Leverage ratio. Breakdown (Thousand Euros)	CRR leverage ratio exposures 31.12.2018	CRR leverage ratio exposures 31.12.2019
On-balance sheet items	283,598	469,072
- Asset amounts deducted in determining Tier 1 capital	0	0
Derivatives	13	38
Securities Financing Transactions (SFTs)	0	0
Off-balance sheet items	0	0
Leverage ratio		
Tier 1 capital (numerator)	34,482	29,783
Total exposure measure (denominator)	283,365	468,593
Leverage ratio	12.17%	6.35%
Minimum requirement	3.00%	3.00%

Source: AFBI, 2019

Table 8. Leverage ratio pl.

Table LRSpl: Split-up of on balance sheet exposures (exduding derivatíves and SFTs)		
EU-1	**Total on-balance sheet exposures (exduding derivatrves, SFTs, and exempted exposures), of which:**	469,072
EU-2	Trading book exposures	0
EU-3	Banking book exposures, of which:	469,072
EU-4	Covered bonds	0
EU-5	Exposures treated as sovereigns	0
EU-6	Exposures to regional governments, MDB, international organisations and PSE not treated as sovereigns	0
EU-7	Institutions	165,053
EU-8	Secured by mortgages of immovable properties	0
EU-9	Retail exposures	0
EU-10	Corporate	49,595
EU-11	Exposures in default	-
EU-12	Other exposures (eg equity, securitisations, and other non-credit obligation assets)	254,424

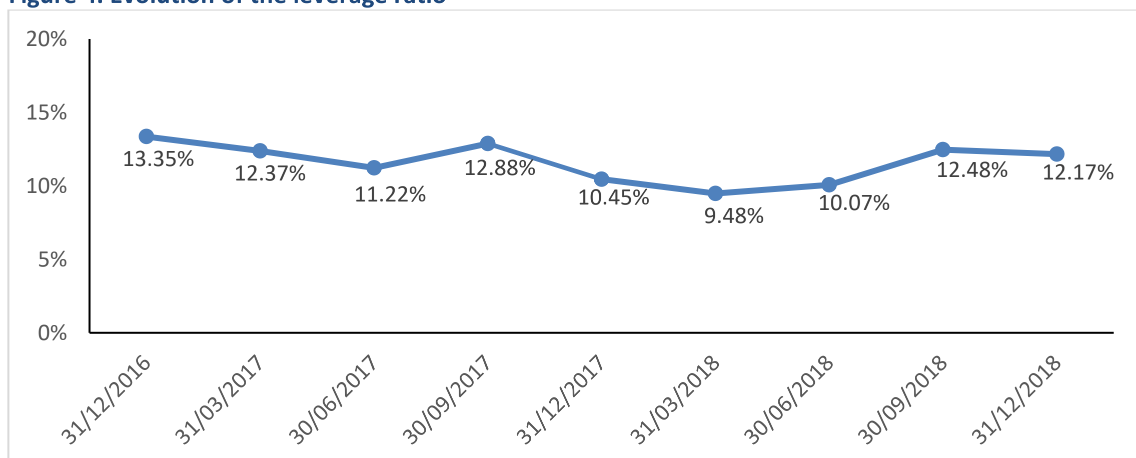
Source: AFB Group, 2019

Table 9. Publication of information on qualitative aspects

Publication of information on qualitative aspects		
1	Description of the processes used to manage the risk of excessive leverage	The leverage ratio is one of the metrics periodically monitored by the Risk department and the management. The monitoring of this ratio is performed within the wider monitoring of the entity's solvency levels and includes an evaluation of the exposure and the Entity's own funds.
2	Description of the factors that had an impact on the leverage ratio during the period to which the disclosed leverage ratio refers	The leverage ratio shows an increase from 10.45% as of year-end 2017 to 12.17% as of year-end 2018. The main reason is the higher increase of the Tier 1 capital (+30%) compared to the increase of the total exposure (+12%).

Source: AFBI, 2018

Figure 4. Evolution of the leverage ratio



Source: AFBI, 2019

PILLAR II ECONOMIC CAPITAL. CAPITAL PLANNING AND STRESS TEST

Economic capital is the capital needed to support all business risks with a certain level of capital adequacy.

The Entity calculates Pillar II capital demand using Economic Capital (EC) on a going concern methodology based on an internal estimate of capital requirements based on its risk profile.

Capital planning

The implemented capital planning process aims at guaranteeing the adequacy of current and future capital, including under very adverse economic scenarios. To accomplish this a three-year solvency projection for the Entity is performed on the basis of the Entity initial status (Financial Statements, capital base and regulatory ratios) plugging in the estimated results.

Stress test

AFBI has stress tests as part of ordinary risk management to assess the impact on capital and profitability of hypothetical stress scenarios. The programme analyses the types of risk collectively assumed by the Entity during its activities and analyses risk factors separately. In particular, based on its materiality, emphasis is set in the Operational risk and liquidity risk.

This programme takes into consideration the relations between different types of risk.

The Stress Tests Programme includes both stress tests based on a disaggregate approach (risk factors are considered independently) and an aggregate approach (scenarios that combine different risk factors are applied).

Lastly, the Programme includes a series of interventions to easily adjust the assumptions. Thus, the definitions of the scenarios are adapted to the complexity of the Entity's operations and include contingency procedures, in accordance with the level and severity of the assumed risks.

RECOVERY AND RESOLUTION PLANS

Recovery and resolution plans for AFBI are handled at Group level.

The Group has prepared a Recovery Plan under simplified obligations In this regard, this Recovery Plan has been reviewed and discussed by the Board Risk and Audit Committee, with the presence of all the members of the Board of Directors subsequently approved by the Board of Directors.

Regarding the Resolution Plan, Allfunds Bank Group has already sent the first information package requested by authorities (Bank of Spain, SRB and FROB) and now is working with them in the final Resolution Plan.Regarding the Resolution Plan, Allfunds Bank Group has already sent the information package requested by the Bank of Spain with the aim of elaborating its Resolution Plan.

4. CREDIT RISK AND COUNTERPARTY CREDIT RISK

4. CREDIT RISK AND COUNTERPARTY CREDIT RISK

4.1 DEFINITION

Credit Risk quantifies the losses derived from the potential breach of financial obligations by the borrowers. Said quantification is performed based on the expected and unexpected loss.

Credit risk arises from the possibility of losses stemming from the failure of customers or counterparties to meet their financial obligations.

4.2 LIMITS AND DIVERSIFICATION

Two types of limits are defined for each client:

- A settlement risk limit, based on the calculation of credit exposure (risk position) applied to each and every client that has executed an intermediation contract with the Entity. The definition of the credit exposure limit is based on the internal rating assigned to the counterparty.
- A credit risk limit, in addition to the previous one, whose purpose is to control the maximum allowed overdraft in a cash account. This limit applies to all clients with a cash account with the Bank and has effective procedures as defined by Allfunds Bank's Department of Operations. For clients settling transactions through "omnibus" accounts the maximum overdraft limit is zero. The overdraft procedures to be applied are analogous to those applied to cash accounts.

The Entity can´t accept as customers those without an acceptable rating, within a scale from Tier 1 (best) to Tier 4 (worst).

4.3 STRUCTURE AND ORGANIZATION OF THE CREDIT RISK

The credit risk management function will be managed within the Entity by the Risk Management department.

The main mission of the Risk Management department is to control, monitor and manage the risks arising from the business activity of the Entity.

4.4 REPORTING, MEASUREMENT AND MITIGATION SYSTEMS

To cope with this risk, the Group has developed an internal credit model to assess a client's probability of default, which may be used to set overdraft limits when needed, but with a strictly controlled risk policy in mind.

The developed system allows the Risk Management department to know at any time the credit limits consumption by counterparty.

Besides, on a daily basis the Risk Management Department performs an accurate report in order to know the liquidity balance held by counterparty, with additional intraday monitoring. In addition, with the aim of preventing risk limit breaches, alert levels by counterparty have been defined.

4.5 STRATEGIES AND MANAGEMENT PROCESSES

Given the typology of the business which the Bank currently carries out, that is to say, the distribution of third party investment funds, the Bank does not maintain, and does not have the objective of maintaining, any activity credit business.

The bank only assumes credit exposures with regulated financial entities.

On the other hand, liquidity generated from its equity (reserves) and from operating flows from their CIIs distribution and intermediation activities, in accordance with the directives marked by BoD subject to a limited risk acceptance framework, is deposited in deposits in central banks, current accounts at sight, "overnight" deposits or long and short term deposits (with no penalty for early cancellation) with entities of high credit quality.

At December 31st 2019 this liquidity was deposited in the following entities:

Table 10. Credit ratings (liquidity deposits)[4]

Entity	Rating
JP Morgan Chase Bank N.A.	A+/Aa2/AA
Citibank N.A.	A+/Aa3/A+
Banque Internationale à Luxembourg	A-/A2/WD
Allfunds Bank	-/-/BBB+

Capital requirements, with the standardized approach, have been calculated according to the CRR, Section 2 Risk Weights.

Source: S&P Capital IQ, Moody's & Fitch Ratings

Exposures to Central Banks have been assigned a 0% risk weight.

The Bank has used credit ratings from nominated ECAIs (S&P and Moody's). Thus, Article 120 (1) (2) and Articule 131 have been applied for exposures to rated institutions.

Article 136 refers to the EBA, EIOPA and ESMA implementing technical standards in order to identify the credit quality steps with the relevant credit assessments of the ECAI ('mapping').

Table 11. Mapping of external rating to credit quality steps

	CQS	S&P	Moody's	Fitch	Maturity < 3 months	Maturity > 3 months
LONG-TERM CREDIT RATING	1	AAA to AA-	Aaa to Aa3	AAA to AA-	20%	20%
	2	A+ to A-	A1 to A3	A+ to A-	20%	50%
	3	BBB+ to BBB-	Baa1 to Baa3	BBB+ to BBB-	20%	50%
	4	BB+ to BB-	Ba1 to Ba3	BB+ to BB-	50%	100%
	5	B+ to B-	B1 to B3	B+ to B-	50%	100%
	6	Lower than B-	Lower than B3	Lower than B-	100%	150%
SHORT-TERM CREDIT RATING	1	A-1+, A-1	P-1	F-1+, F-1	20%	
	2	A-2	P-2	F-2	50%	
	3	A-3	P-3	F-3	100%	
	4	Lower than A-3	NP	Lower than F-3	150%	
	5				150%	
	6				150%	

Source: own elaboration, 2019

[4] Ratings by Standard & Poor's, Moody's and Fitch Ratings, respectively.

4.6 CREDIT RISK ADJUSTMENTS

A financial asset is considered to be impaired[5] when there is objective evidence that events have occurred which:

- In the case of debt instruments (loans and debt securities), give rise to an adverse impact on the future cash flows that were estimated at the transaction date.
- In the case of equity instruments, mean that their carrying amount may not be fully recovered.

As a general rule, the carrying amount of impaired financial instruments is adjusted with a charge to the consolidated income statement for the year in which the impairment becomes evident. The reversal, if any, of previously recognized impairment losses is recognized in the consolidated income statement for the year in which the impairment is reversed or reduced.

Impairment losses on debt instruments classified as loans and receivables are estimated and recognized as set forth in Annex IX of Bank of Spain Circular 4/2017. On 1 January 2018, came into force the Bank of Spain Circular 4/2017, of 27 November. The main purpose of Circular 4/2017 is to adapt the accounting system of Spanish credit institutions to the changes in European accounting legislation stemming from the adoption of two new International Financial Reporting Standards (IFRSs): (i) IFRS 9, which will amend the methods of accounting for financial instruments; and (ii) IFRS 15, which will amend revenue recognition methods.

One the three most noteworthy changes introduced by this Circular that emanate directly from the amendments to IFRS 9 is as follows:

The change in the financial asset impairment model, which ceases to be based on incurred losses and is now based on expected losses. The purpose of this change is to obtain a more appropriate measurement of the assets and an earlier recognition of any impairment losses thereon.

Financial instruments are grouped into three categories based on the impairment method applied, in accordance with the following structure:

- Stage 1 – Normal risk: those transactions the credit risk of which has not significantly increased since initial recognition. Impairment hedging shall be equal to the twelve-month expected credit losses. Interest revenue shall be calculated applying the effective interest rate to the gross carrying amount of the transaction.
- Stage 2 – Normal risk under special surveillance: those transactions the credit risk of which has significantly increased since initial recognition, but without default. Impairment hedging shall be equal to the lifetime expected credit losses of the transaction. Interest revenue shall be calculated applying the effective interest rate to the gross carrying amount of the transaction.
- Stage 3 – Non-performing: credit-impaired transactions, i.e. there has been default. Hedging shall be equal to the expected credit losses. Interest revenue shall be calculated by applying the effective interest rate at amortized cost (i.e. adjusted for an impairment allowance) of the financial instrument.

The measurement of whether or not there has been any significant increase in credit risk must be based on reasonable and supportable information that is available free of charge or disproportionate effort, which shall indicate the credit risk increases since initial recognition and must reflect historical, actual and forward-looking information.

The definitions established to measure the significant credit risk are in keeping with the following criteria:

- Drop in the credit rating given by credit rating agencies.

[5] Therefore, its carrying amount is adjusted to reflect the effect of impairment.

- Drop in the country rating where the counterparty operates.
- Increase in credit default swaps (CDS).
- Public information of results with losses.
- Threat of systemic risk.
- Merger, take-over or consolidation movements.
- Changes in shareholders.
- Significant increase in consumption limits and in customer payment experience.

Whatever the case, Stage 2 is considered with respect to instruments with defaults of over 30 days.

The bank has decided to continue using the practical solutions to calculate its expected portfolio losses in accordance with the requirements set forth in Circular 4/2017.

The measurement process for possible impairment losses for these instruments that involve the risk of insolvency for obligors (credit risk) is done collectively, as there are no significant individual cases that exceed a particular threshold. The aforementioned estimate is done by applying the alternative solutions contained in Appendix IX to Circular 4/2017, calculated on the bases of the parameters established by the Banco de España based on sector information and its accrued experience.

The amount for impairment losses, estimated in accordance with the criteria set forth above, are entered in the headings “Impairment losses or reversals on financial assets not at fair value through profit or loss – Financial assets at amortised cost”.

As a general criterion, the carrying amount allowance for financial instruments due to impairment is entered in the profit and loss account for the reporting year in which the impairment appears. Recoveries of previously entered impairment losses, where appropriate, are reflected in the profit and loss account for the reporting year in which the impairment is eliminated or reduced.

Whenever it is considered that the probability of recovery of any amount entered is remote, this is removed from the balance, without prejudice to the bank and its dependent companies attempting its collection until their rights have definitively lapsed; whether owing to the statutory limitation, having been written off or some other reason.

On the other hand, the methods used for calculating the allowances and provisions for non-performing exposures, and also for performing exposures and for exposures under special monitoring the criteria set forth below:

Allowances and provisions for non-performing exposures

The allowance percentages applied to unsecured transactions, based on the extension of the past-due amounts, are:

- Over 90 days, but not exceeding 6 months: 7,5%.
- Over 6 months, but not exceeding 9 months: 50%.
- Over 9 months, but not exceeding 1 year: 60%.
- Over 1 year, but not exceeding 15 months: 70%.
- Over 15 months, but not exceeding 18 months: 85%.
- Over 18 months, but not exceeding 21 months: 90%.
- Over 21 months: 100%.

Allowances and provisions for performing exposures and exposures under special monitoring

The applicable allowance is calculated in accordance with the following procedure:

The percentages stated below are applicable to the amount of the exposure not covered by the recoverable amount from the effective collateral:

- Normal Risk: 0.5%.
- Standard exposures under special monitoring: 7.5%.

A provisioning percentage of 0% shall be applied to the exposures identified as having negligible risk. As negligible risks shall be considered the following transactions:

- Transactions with central banks.
- Transactions with governments of EU countries, including those from reverse-

repurchase agreements on government debt securities.

- Transactions with general governments of countries classified in group 1 for the purpose of country risk.
- Transactions in the name of deposit guarantee funds and resolution funds, provided their credit quality is such that they are equivalent to those of the European Union.
- Transactions in the name of credit institutions and specialized lending institutions from countries of the European Union and, in general, from countries classified in group 1 for the purpose of country risk.
- Transactions with reciprocal guarantee companies and government agencies or enterprises from other countries classified. in group 1, whose main activity is credit insurance or guarantees.
- Transactions with non-financial corporations considered to belong to the public sector as referred to in rule 66, paragraph 5.
- advances on the following month's pensions or wages, provided the paying entity is a government agency and the wage or pension is direct credited to the institution; and.
- Advances other than loans.

Since January 1st 2018 the bank has adjusted its accounting procedures to Circular 4/2017 regarding IFRS 15 and IFRS 9, entering into force on January 1st 2018. For year end the new regulatory regime had a very limited impact on the bank's financial statements, as the provision for past-due not impaired financial assets amounted to EUR 324 thousand.

4.7 COUNTERPARTY CREDIT RISK

The CRR describes counterparty credit risk as the risk a counterparty to a transaction could default before the final settlement of the transaction's cash flows. It includes the following transaction types: derivative instruments, repurchase agreements, securities or commodities lending, long settlement transactions and margin lending transactions.

Taking into account the definition stated above, counterparty risk is not considered material for the Entity. Capital is not provided.

4.8 CONCENTRATION RISK

Concentration risk is a part of credit risk that includes (i) large (connected) individual exposures and (ii) significant exposures to groups of counterparties whose likelihood of default is driven by common underlying factors, e.g. sector, economy, geographical location, instrument type. Concentration risk can take place in assets, liabilities or in offbalance sheet items, by executing or processing transactions, or through a combination of these wide categories.

Due to their nature, credit risk concentrations are due to common or correlated risk factors, which in times of crisis negatively affect the solvency of each of the counterparties comprising the concentration.

The excess liquidity of the Entity is deposited in current accounts in entities of high credit quality. The only exposure, therefore, is the financial sector, specifically in highly solvent entities. The Entity follows a criterion of reducing the exposure to concentration risk, diversifying the counterparts so as not to incur additional capital needs for this risk. For the grouping and calculation of the concentration indices, the entity is subject to the guidelines established by the EEC under the fourth "large exposures". Non-individual exposures, including all types of credits and variable investments, may not exceed the smallest amount between 100% of regulatory own funds or 150 million.

At 31st December 2018 no exposure was above the previous limit. According to the activity the Bank carries out (fundamentally CIIs distribution and subcustodian services at institutional level), it has not defined additional limits on concentration risks other than the legal requirements mentioned above. In view of this

specific activity in spite of being a bank, the credit risk exposure is focussed exclusively on the financial services sector, although it has to be considered as a highly regulated and supervised sector. In any case, the Bank follows a prudent approach regarding this risk, with continuous monitoring, aiming at a high geographical and sub-sectorial diversification both in its balance sheet and income statement.

5. MARKET RISK

5. MARKET RISK

5.1 DEFINITION

Market risk can be defined as the risk of losses arising from adverse movements in interest rates, FX rates and market prices.

5.2 LIMITS AND DIVERSIFICATION

The Entity has not set limits due to the fact that it does not allow investments and the market risk is practically non-existent and, therefore, aligned with the risk appetite.

5.3 STRUCTURE AND ORGANIZATION OF MARKET RISK

Market risk will be managed within the Risk Management department.

The Board has established an investment policy for which to avoid market risk no financial investments can be made.

5.4 REPORTING, MEASUREMENT AND MITIGATION SYSTEMS

On a daily basis the Risk Management department reports the Finance department about the exposure to foreign currency, requiring measures, if applied, to mitigate the risk. Decisions are adopted by the Finance Department, with notification to the Chief Executive Officer only if exposures are over the limit.

Monitoring and control of the Balance Sheet exposure to currency risk is carried out daily whereby the Entity´s software "Equation" is used which allows monitoring risk levels continuously in order to assure adequate decision-making always before acquiring undesirable risk exposures.

5.5 OWN FUNDS REQUIREMENTS FOR MARKET RISK

There are no positions on- or off-balance impacted by variations in interest rates or prices. As an exception to this principle, the Entity keeps a HQLA portfolio to comply with the Liquidity Coverage Requirements. The Board of Directors approved the acquisition of short-term and liquid sovereign debt for this purpose (keeping this portfolio at maturity). The exposure of this HQLA portfolio to interest rate or market price changes is considered low as they are short-termed, euro denominated and Euro-zone based sovereign references. As of December 31st 2018 no exposure to sovereign debt was kept, all exposures being with central banks.

As a complementary activity to the CIIs intermediation/distribution, foreign currency exchange services are offered to those clients who wish to acquire CIIs shares (subscriptions) or receive the reimbursement product of CIIs shares (redemptions) in a currency distinct to the CII.

In addition, operations of an opposite nature will be closed in pairs of foreign currency and maturity therefore the exchange rate risk is hedged.

The Entity has assets and liabilities on the balance sheet in foreign currency other than the euro, being these positions inherent to its activity. The General Management, as proposed by the Risk department, has established a maximum exposure limit ("short" or "long") to this risk that is renewed annually.

As at 31st December 2019 there were no capital requirements against market risk, in accordance to the CRR.

6. OPERATIONAL RISK

6. OPERATIONAL RISK

6.1 DEFINITION AND OBJECTIVES

AFBI defines operational risk as the "the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events". Operational Risk is inherent to all activities, processes and systems and generated by all business and support areas. For that reason, all employees are responsible for the management and control of operational risks generated in their area. Within this type of risk, at least the following subcategories are identified:

- Conduct Risk: Risk derived from suffering losses due to inadequate delivery of financial services to clients, including cases of inappropriate or negligent behavior.
- Legal and Compliance Risk: Risk associated to the possibility of legal contingencies that affect AFBI's business, as long as they are not related to clients (in which case they would fall within the Conduct Risk).
- ICT Risk: Any risk related to information technology (availability and continuity risks, security risk, change risk, data integrity risk, etc.).
- Outsourcing Risk: Risk derived from a third party or another Group entity (intra-group outsourcing), providing IT systems or related services adversely with impact on AFB's performance and risk management.

Within this risk, AFBI considers not only financial impacts but also regulatory, reputational, on client and business impacts.

The objective of AFBI in the control and management of operational risk is focused on the identification, assessment, monitoring, control, mitigation and communication/reporting of this risk. The priority of AFBI is, therefore, to identify and mitigate sources and root causes of operational risk regardless of whether they have caused losses or not. Integrating the management of this risk within the AFBI's business strategy is a key priority.

During the 2019 exercise, AFBI has promoted the improvement and evolution of the operational risk management model through different initiatives mainly driven by the Corporate Risk Management area.

6.2 OPERATIONAL RISK MANAGEMENT AND CONTROL MODEL

6.2.1 OPERATIONAL RISK MANAGEMENT CYCLE

The different stages of the operational risk management and control model seek:

- To identify the inherent risk to all the AFBI's activities, services, processes and systems.
- To define the target profile and the strategies per unit and time horizon by establishing the operational risk appetite and tolerance, the annual projection of operational risk losses and their follow up.
- To promote the operational risk culture and the involvement of all employees, through appropriate training to all areas and levels throughout the organization.
- To measure and assess the operational risk in an objective, continuous and consistent manner with regulatory standards (Basel, EBA, etc.) and industry.
- To perform a continuous monitoring of operational risk exposures, to implement control procedures, improve the internal control environment and mitigate losses.
- To establish mitigation measures to eliminate or minimize the operational risk.
- To prepare periodic reports on the operational risk exposure and control level to the BoD and Senior Management, as well as Regulatory bodies.
- To define and implement the necessary methodology to estimate the internal capital requirements in terms of expected and unexpected losses.

For each key process previously described, it is necessary:

- To define and implement tools to monitor and control the operational risk exposures, which are integrated into the daily management at AFBI, taking advantage of existing technology and seeking the maximum automation of processes.
- To define and document the policies and procedures for the management and control of operational risk, and implement internal methodologies and tools to

manage this risk according to regulations and best practices.

The operational risk management and control model implemented by AFBI provides the following capabilities:

- It promotes the development of an operational risk culture.
- It allows an integral and effective management of operational risk (identification, evaluation, control /mitigation and information).
- It improves the knowledge about both potential and effective operational risks, and their allocation to the business and support units.
- Operational risk information contributes to the improvement of processes and controls, reducing losses.
- It facilitates the definition of the operational risk appetite limits.

6.2.2 IDENTIFICATION, MEASUREMENT AND RISK ASSESSMENT MODEL

In order to carry out the identification, measurement and evaluation of operational risk, a set of corporate tools /methodologies have been defined within the operational risk framework, both quantitative and qualitative, to be combined in order to make a diagnosis based on risks identified and to get an assessment through the evaluation of every area.

The quantitative analysis is mainly carried out through tools that record and quantify the potential level of losses associated to operational risk events:

- Internal database of operational risk events: its objective is to capture all the operational risk events at AFBI with no exclusions regarding the amount, and it contains both events with economic/financial impact (including positive impacts) and non-economic/non-financial impact. In addition, there is an accounting reconciliation process to guarantee the completeness and quality of the information collected in the database. Most relevant events of AFBI are documented and reviewed.
- Analysis of operational risk scenarios: the objective is the evaluation of the impact of potential events with a very low probability of occurrence but which, in turn, could imply a very high loss at AFBI, using the opinion of business/support areas and other subject matter experts, as well as the risk and control functions. This analysis also identifies additional controls and mitigation measures that could reduce the ocurrence of a high economic impact. In 2019 only punctual scenarios have been carried out exclusively within the Risk Management area.
- Capital requirements calculation for operational risk: AFBI applies the basic indicator method.

The tools defined for qualitative analysis try to evaluate aspects (in terms of coverage/exposure) linked to the risk profile capturing the existing control environment. These tools are fundamentally:

- Risk and Control Self-Assessment (RCSA): this exercise is defined as the qualitative process that allows, through the criteria and experience of a set of experts in each function, to determine the main operational risks in every unit and to assign them to the different functions. The purpose of the RCSA is to identify and evaluate material operational risks that could prevent the business or support areas from achieving their objectives, it means, to evaluate these risks in inherent and residual terms, evaluate the design and performance of controls and define mitigation measures in case the risk levels are not acceptable by the Senior Management.

  The RCSA exercise is new at AFBI and evolves the previous self-assessments campaigns that were mainly focused on completing the ISAE 3402 Report (assurance standard). It was started in July 2016 and it is estimated to be completed during 2019. In addition to comply with *best practices* recommendations in operational risk management, the objective is to establish a continuous process of self-assessment of this risk, so that material risks are evaluated at least once a year. This process combines expert judgment and participation in workshops, in which all interested parties participate, especially the first lines of defense responsible for the risks and controls, as well as the Risk Management area that acts as facilitator

with a neutral and challenging role supporting to get the expected results. Moreover, the Risk Management function is promoting the RCSA exercise within the control areas: second lines of defense (Risk Management and Compliance) and third line of defense (Internal Audit).

- Corporate key risk indicators (KRIs): set of metrics and alerts of different nature which provide information on the risk exposure and the internal control environment. These indicators are reviewed periodically to alert about changes that may be revealing potential threats. During 2017, AFBI has reviewed the existing indicators and, due to the recent organizational changes, has identified the need to define new corporate indicators in all areas and functions, from the first lines of risk management, in order to monitor the main risk sources at AFBI. Those indicators more representative of risk level will be part of the metrics on which the operational risk appetite is defined.
- Regulators and internal audit recommendations: it provides relevant information on inherent risk and allows the identification of weaknesses in controls.
- Client complaints: the follow-up of the claims and, above all, the detection of its root causes will provide relevant information to identify and measure the level of risk at AFBI.

Other specific tools that allow a more detailded analysis of technological risk (e.g. critic incidents and cybersecurity events, etc.) and the evaluation of risks associated to the management processes of technological infrastructure, the acquisition and development of solutions, control on information security and IT governance. During 2017, the Operational Risk function at Group level has defined the *Terms of Reference* with AFB IT Risk to formalize the communication channel between both areas since they are separated, and where the needs/requirements on ICT management are listed within the operational risk framework.

6.2.3 IMPLEMENTATION OF THE OPERATIONAL RISK MODEL AND INITIATIVES

During 2018 AFBI has promoted and improved its approach to operational risk management as part of its transformation process. The objective is, on the one hand, to consolidate the operational risk management framework and, on the other hand, to achieve the best market practices and leverage the monitoring of an integrated and consolidated operational risk profile to direct, proactively, the business strategy and the tactical decisions. The framework has been structured in key work-lines and new initiatives (appetite, RCSA, metrics, etc.) to focus the improvements, which are estimated to be concluded during 2019. For an adequate monitoring of the framework progress, a governance has been established at the highest level of the organization.

The main activities and global iniciatives that have been adopted in order to ensure the effective management of operational risk are:

- Implementation and development of the new operational risk framework, policies and procedures both in the global unit and local units (countries).
- Designation of coordinators responsible for operational risk within the different areas of first line of defense.
- New definition of a set of operational risk taxonomies (risks, controls, root cause) that allow a more granular, complete and homogeneous risk management throughout the whole organization.
- Definition of a new operational risk appetite scheme which allows a greater granularity in the risk tolerance of AFBI's top risks.
- Establishment of an incident escalation process that sets the criteria for the communication and escalation of operational risk events based on their relevance, which is defined according to different internal relevance thresholds depending on the nature of the impact.
- Implementation of a risk culture and training program at all levels.
- With AFB IT Risk area, promotion of mitigation plans on aspects of special relevance (information security, cybersecurity, control of suppliers, etc.), improvements in contingency and business continuity plans and, in general, in crisis management.

AFB continues working on the implementation of an outsourcing model, reinforcing and

homogenizing the activities to be developed throughout the suppliers and third parties management cycle.

6.2.4 OPERATIONAL RISK INFORMATION AND REPORTING

AFBI supports operational risk information through:

- Internal data collection of operational risk events.
- Set of taxonomies (operational risks, root causes and controls).
- Corporate template (risk map) of processes, risks and controls by area currently being updated by the RCSA exercise.
- Set of operational risk appetite indicators and KRIs.
- Policies, procedures and guidelines describing the internal methodology at AFBI.
- Different formats of internal reporting information depending on the destination: BoD, Risk Committee, etc.
- Official external reporting templates (regulatory information).

6.2.5 TRAINING ACTIONS

AFBI promotes the knowledge and awareness of operational risk within the organization at all levels, defining the most appropriate training according to AFBI's needs (online courses, face-to-face courses, specific executive training, etc.). On-line training has been done by all employees.

6.3 EVOLUTION OF OPERATIONAL RISK LOSSES AND RISK APPETITE STATEMENT

Regarding the internal database of operational risk events, the evolution of net losses during the last three years and also during 2019 is reflected as follows:

Figure 5. Historical net losses (figures in thousand EUR)

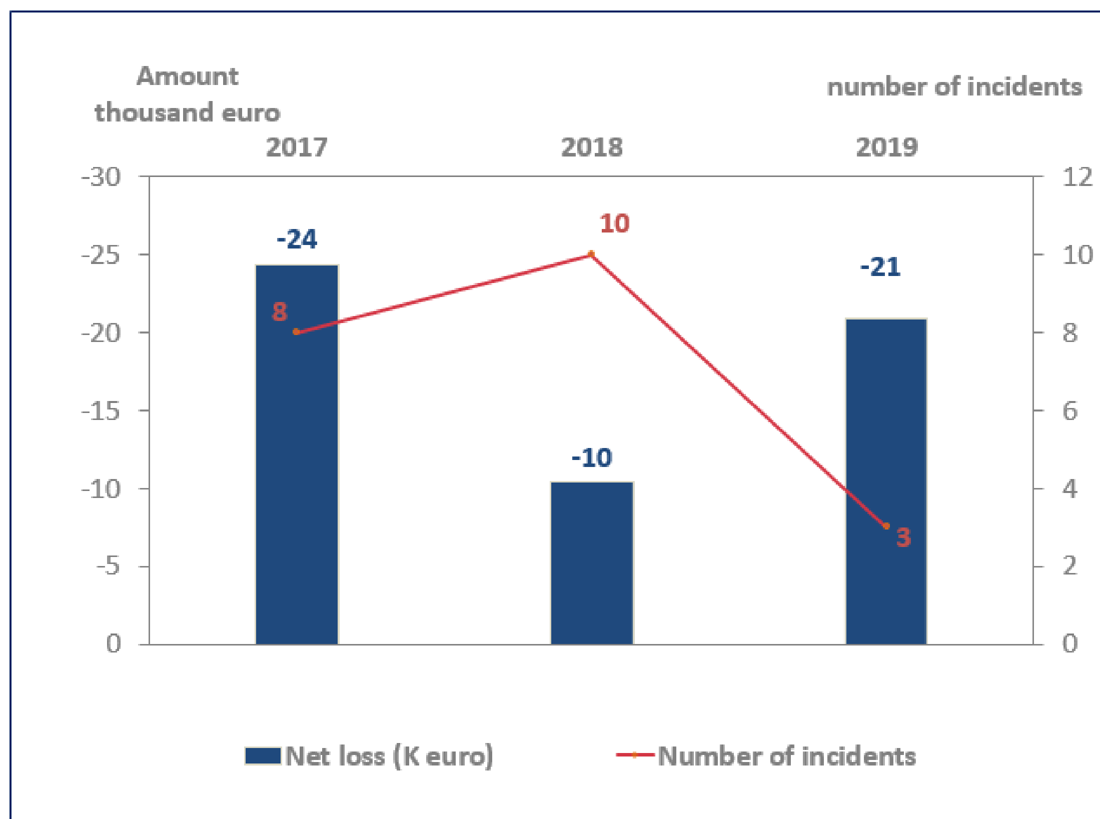
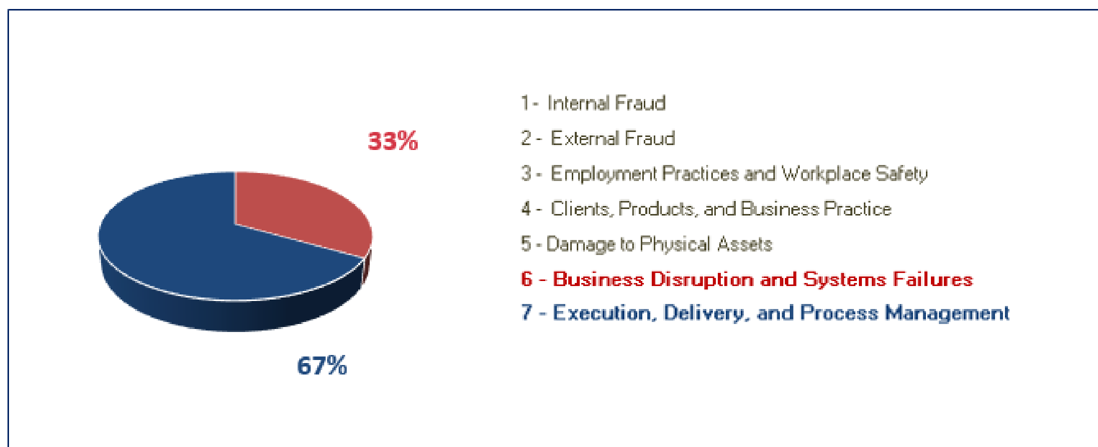


Figure 6. Distribution of incidents (year 2019) by event type

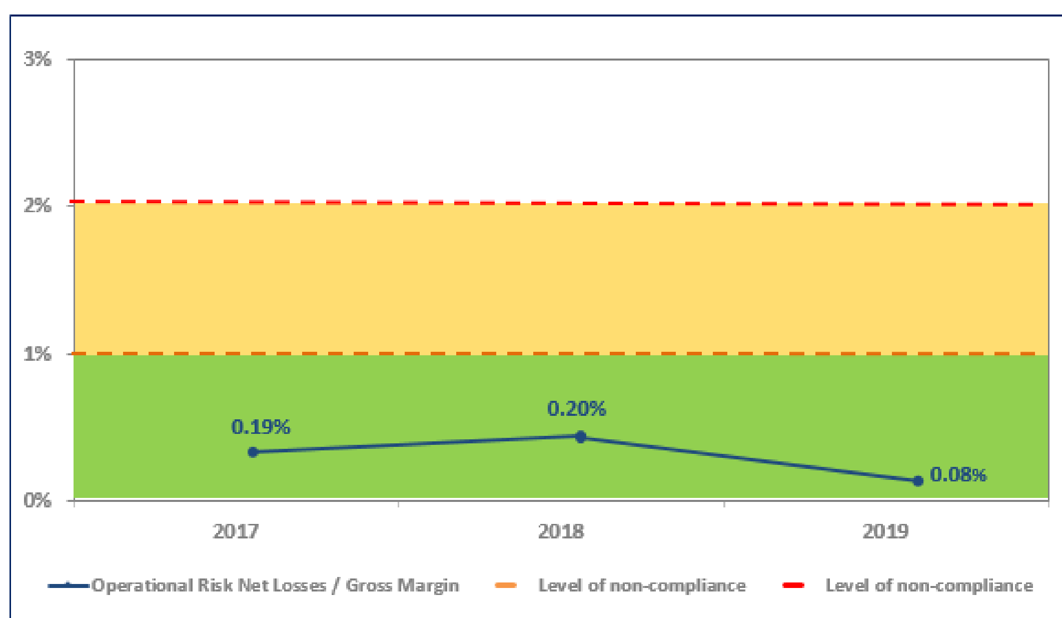


The distribution of losses by type of event shows that all the operational losses are due to failures in processes following the trend of previous years. During 2019, the most relevant event was a loss of € 21 thousand due to a failure in the reconciliation process.

AFBI has analyzed the historical evolution of the number of internal events produced and accounted and has defined a new procedure for communication and escalation of relevant events (not only due to the financial impact but also the client, business, regulatory or reputational impact) that allows a more effective channel of corrective actions. The level of concentration of relevant events over the total number of events has remained at low level.

The evolution of RAS (Risk Appetite Statement) - 'Operational Risk Net Losses to Gross Income' has remained within a very narrow range of low values, supporting AFBI's low risk appetite:

Figure 7. Operational risk net losses/gross margin



6.4 MITIGATION MEASURES AND ACTION PLANS

The operational risk control model assumes that AFB monitors the mitigation measures established in response to the main sources of risk, which have been identified through the analysis of the different tools previously described as well as the organizational model and the preventive implementation of policies and procedures for operational risk management. AFBI's model integrates these mitigation measures into the internal database of operational risk events.

During 2019, the most relevant mitigation measures were focused on immediate corrective actions as well as on the improvement of systems security, the management of external fraud and the continuous improvement of processes and technology for an adequate provision of services.

Specifically, in terms of system security and fraud management, the most relevant measures have been aimed at mitigating the risk of cyber-attacks by starting the Cybersecurity Management Program, that will include measures such as: SOC (Security Opeartion Center) and SIEM (Security Information and Event Management System), DoS protection services, malware protection, DLP (data loss prevention) prevention, third party program, cyber risk surveillance, penetration tests and cybersecurity at Group level. Other measures aimed at fraud prevention refer to the application of specific rules in the tools for monitoring and detecting suspicious transactions in terms of AML. In terms of processes and technology, AFBI has been continuously improving, and subsequently implementing, corporate policies and procedures both in the first lines of defense areas and second line of defense areas, as well as the optimization of processes through the AFB Transformation Office.

At execution level, it has been identified the need to define not only corrective actions but also preventive actions.

6.5 BUSINESS CONTINUITY PLAN

AFBI has a business continuity management system to guarantee the continuity of business processes in the case of a disaster or critical incident. This objective is specified in:

- To minimize the potential damages to people and adverse financial and business impacts for AFBI, arising from a disruption of normal business transactions.
- To reduce the operational effects of a disaster, providing a well predefined and flexible guidelines and procedures for its use in the resumption and recovery of processes.
- To resume business operations and associated support functions, sensitive to time, in order to achieve business continuity, profit stability and continuous planned growth.
- To protect the public image and confidence in AFBI.
- To satisfy AFBI's obligations to its employees, clients, shareholders and other interested third parties.

6.6 OTHER ASPECTS OF CONTROL AND MONITORING OF OPERATIONAL RISK

AFBI considers insurance management as a key element to transfer/mitigate the operational risk. During 2018, coordination between the different Group functions involved in the insurance management cycle that mitigate the operational risk has been strengthened, mainly Legal, Finance, IT Risk and Risk Management areas:

- Identification of all AFB's risks that can be covered by insurance, including new insurance cover for risks already identify in the industry.
- Establishment and implementation of criteria to quantify insurable risk, based on losses and scenarios analysis to determine the level of exposure at AFB.
- Analysis of the coverage available in the insurance industry as well as a preliminary design of the conditions thay best suit the needs previously identified and evaluated.
- Technical assessment of protection provided by the policy, cost and retention levels that AFB will assume in order to decide its hiring.

- Negotiation with suppliers and adjudication, according to the procedures established by AFB.
- Monitoring of incidents declared in the policies as well as those not declared or not recovered due to an incorrect declaration, establishing action protocols and specific follow up meetings.
- Analysis of the adequacy of AFB's policies to the risks covered, taking the appropriate corrective measures to the deficiencies detected.

In 2017 AFB has contracted a cyber risk policy (covering AFBI as well) to respond to potencial consequences derived form cyber-attacks.

6.7 OWN FUNDS REQUIREMENTS FOR OPERATIONAL RISK

The capital requirements for operational risk of AFBI at 31st December 2019 was € 3,021 thousand.

The Bank aims towards maximum automation of CIIs subscription and reimbursement orders management on behalf of its institutional clients. There is an ever-changing and improving environment. Defined alerts are in place which indicate the Bank areas which monitor the operations and the sending and reception of files with orders if these contain the required information and if they are sent on time and with the correct format.

In order to assess if additional capital is required for this risk the Bank performs an estimation of future losses from operational errors with historical data back from 2009. If this amount represents more than 2% of Gross Margin in the Profit and Loss Account, an additional 3% would be added on top of the basic indicator method requirement, to reach a weight of 18% up from the basic 15%.

As mentioned above, at 31st December 2019 the net economic impact amounted to € -20,919 represented 0.08% of Gross Margin, therefore deeming unnecessary the application of additional capital requirements to hedge this risk.

6.8 TECHNOLOGY RISK

Information Technology and Infrastructure are basic elements for all Bank processes, both for business ones as well as for support ones. Thus, technology risk management is highly important within the organization.

For this reason and within Technology's scope, a set of controls are applied to the information systems. These are:

- IT Governance. Creation and monitoring of strategic plans for being aligned with business, legal and regulatory requirements as well as innovation projects due to the digital transformation that the bank is undertaking. Management and monitoring of the necessities of new specific profiles as well as the maintenance of an adequate knowledge management. Performing periodic Committees with the different areas of the department to follow up the objectives fulfillment.
- Software and hardware acquisition. Selection, approval, purchase or outsourcing of third party software and hardware with technological providers. Management and maintenance of contracts and Service Level agreements with them as well as monitoring of the service provided.
- Systems Operation. Controls related to system operation and data management (including administration, data storage, backup management and performance, capacity and availability monitoring). Additionally, management of the technological assets.
- Systems upgrading and substitution management. Controls related to change/updating processes such as migrations, co-existence, decommissioned or partial implementations.
- Information security management. Design, implementation and maintenance of information security policies and procedures. This includes password policies, user management, users and profiles recertifications, security incident management, data protection, media destruction, physical security and IT security awareness plans. On the other hand, periodic risks and vulnerabilities assessments are performed.
- Business Continuity. Definition of Business Continuity Management through crisis management and processes and systems recovery plans. Plans are reviewed annually in order to keep them properly updated in

case of changes in business processes or systems. On an annual basis, business continuity tests are performed evaluating different risk scenarios and, if necessary, corrective measures are applied.

In the case that the critical business transactions and support are supported by a specific software, the controls implementing this software are identified to ensure the integrity, precision and validity of the information generated. The scope covered from a technological point of view for these controls are:

- Integrity: all access records are necessary and the number of processed transactions must be guaranteed as constituting the totality of the population.
- Control of User Access and segregation of functions: transactions are correctly authorised based on profiles, thereby assuring data confidentiality.
- Calculation accuracy: correction of the result of the calculations relies on the software user's responsibility, since the user is familiar with the details and the logic of the operation they are able therefore to identify deceptive reasoning (casuistic) not correctly supported by the software tool.
- Availability: all the information is accessible and available.

6.9 LEGAL RISK

Risk of loss that results from legal proceedings (including claims from providers and clients and bankruptcy) initiated against the Bank or a trade/order not being able to be executed because it is not compliant with the minimum requirements or the applicable regulatory framework. Another legal risk relates to regulatory risk, i.e., that a transaction could conflict with applicable laws and regulation or with a regulator's policy, that services are not provided in accordance with the applicable regulations or, more generally, that legislation might change during the life of a contract under which services are being provided.

AFBI's legal department, with the support of the Group legal department and external legal advice if needed, reviews and analyses the applicable laws and regulations to the services provided and drafts and negotiates all the contracts that the Bank enters into further to such previous legal analysis.

The Senior Management considers several mitigating factors, the most relevant ones being:

- All agreements are based on standard templates which are designed in accordance with applicable laws and regulations from time to time, deviations are only authorised if validated by a senior lawyer and the agreement must have always validation of legal department before being signed.
- All services are designed and rendered in accordance with applicable laws and regulations from time to time.
- The Bank receives the legal support and advisory of external law firms, if necessary.

The Global Head of Legal Department is the Secretary of the Board of Directors and keeps the members of the Board informed about legal concerns.

6.10 MODEL RISK

Model risk is associated to the inappropriate use of information taken from a model.

AFBI does not use internals models to make decisions such as consumer credit score or real-time probability prediction of a fraudulent credit card transaction.

7. INTEREST RATE RISK

7. INTEREST RATE RISK

7.1 DEFINITION

Interest rate risk is the possibility of losses due to the potential impact of changes in interest rates on the entity's profits or on the net value of its assets.

7.2 LIMITS AND DIVERSIFICATION

Due to the low sensitivity to movements in interest rates, no limits have been defined for the interest rate risk. However, in order to comply with the standards issued by the CRR/CRD IV, the impact of the yield curve on net interest income and the equity is calculated and reported every six months.

7.3 OWN FUNDS REQUIREMENTS FOR INTEREST RATE RISK

Most of the assets and liabilities items are positions at sight, with a small presence of financial instruments subject to interest rate risk, which brings the Entity to affirm that there is not relevant exposure to this risk.

All accounts at sight (both assets and liabilities) are referred to a floating interest rate, applying the same reference interest to all accounts in the same currency, establishing a spread by currency among assets and liabilities at sight.

Due to the low remuneration paid on deposits in recent years (especially at sight and short term), the Entity has opted for longer terms in its euro denominated deposit investments. Nonetheless, these deposits can be cancelled at any time without additional costs. Because of short term maturities, increases on interest risks would be positive for the income statement, due to reinvestment at higher rates.

The Entity does not set internal limits to mitigate this risk due to the residual impact on its balance sheet.

On the other hand, the impact of interest rate fluctuations on its income statement (via the net interest income margin) and net equity is very low, mainly because the main source of the Entity's income comes from commissions stemming from the resulting margin between the collection of rebates from the CIIs funds management companies and the payment of part of these rebates to the institutional clients.

As of end of 2019, the following impact (expressed in euro) have been calculated and reported (as per CSSF Circular 08/338 requirements):

Table 14. IRRBB information

Increase of 200 bps	Decrease of 200 bps
65,986	1.125

Source: AFBI, 2019

8. LIQUIDITY AND FUNDING RISK

8. LIQUIDITY AND FUNDING RISK

8.1 DEFINITION

Liquidity risk can be defined as the possibility of incurring losses when there are not sufficient cash or liquid resources to comply with the obligations assumed.

8.2 LIMITS AND DIVERSIFICATION

Due the current business model of the Entity, and the low exposure to liquidity risk, the Entity has decided not to establish limits in order to hedge the potential risks that may arise from operating liquidity (derived from not being able to unwind or close a position in time) as well as liquidity limits orientated towards covering structural liquidity risk that keep a minimum level of liquid assets, so the Entity can assure that there are no maturity gaps between assets and liabilities.

8.3 STRUCTURE AND ORGANIZATION OF THE LIQUIDITY RISK MANAGEMENT FUNCTION

The Entity follows conservative criteria in the management and dilution of losses for this risk. The liquidity risk management procedures and methodologies have been defined and diligently documented in the risk procedures manual. The procedures also provide a full coverage of the liquidity standards required by the regulator.

Operating or short-term cash flow is managed by the "Banking Services Area" integrated in the Bank Operations Department and should be monitored by the Finance Department.

Due to the current business model and the low liquidity risk exposure established by the Chief Executive Officer the probability of incurring losses through not having sufficient liquid resources available to meet the obligations assumed is low.

8.4 REPORTING, MEASUREMENT AND MITIGATION SYSTEMS

Liquidity risk management and monitoring principles assumed by Allfunds Bank Group respond to the guidelines established by the European Banking Authorities and the principles and requirements set up by the CRR through the Liquidity Coverage Ratio. In particular, the main processes implemented by the Bank include the following items:

- Liquidity ratios (LCR, NSFR and ALMM).
- Liquidity stress testing.
- Definition of a minimum level of liquid assets or liquidity buffer.
- Construction of a High Quality Liquid Assets Portfolio.

With the previous mitigation measures in place to face this risk and with the diversified buffer of liquid assets the Bank considers it is well positioned to cover any liquidity needs in a short term liquidity stress. As a result, due to the conservative liquidity management policy established by General Management, the risk of losses from not availability of sufficient cash resources to comply with the assumed obligations is quite limited.

8.5 OWN FUNDS REQUIREMENTS FOR LIQUIDITY RISK

No additional capital is deemed necessary for liquidity risk since current measures are considered adequate to prevent possible losses resulting from adverse liquidity scenarios.

Additionally, in order to face 'extraordinary' stressed scenarios, the Entity keeps a prudential buffer of liquidity in the context of the LCR, having established a target LCR ratio of 40% above the regulatory requirement, mainly allocated to central banks.

8.6 MEASUREMENT OF LIQUIDITY NEEDS

8.6.1 LIQUIDITY AND FINANCING MANAGEMENT FRAMEWORK

Allfunds Bank Group has a governance framework for liquidity and financing management approved by the Board of Directors and aimed at meeting the objectives defined by the Board, using short-term indicators such as the LCR, long in the case of the NSFR and the ALMMs which provide specific related information on the concentration of financing by counterparty, and by product type, prices according to various durations of financing and refinancing, as well as the concentration by issuer and counterparty.

This framework is articulated through an organizational structure with three lines of defense aimed at the adequate admission, monitoring, control and review of liquidity risk; with roles and responsibilities distributed among them, and among each of the different teams and people that make up them, in order to ensure proper risk management and avoid potential conflicts of interest.

In order to ensure the proper supervision of liquidity and financing risk management, the Management Committee of the Entity is established as the delegated body by the Board of Directors of the Entity to supervise risk management on a regular basis.

8.6.2 ROLES AND RESPONSIBILITIES OF THE BOARD OF DIRECTORS

The Board of Directors is responsible, among others, for the following aspects related to the management of the Entity's liquidity and financing, which are scaled up through the General Management:

- Approve the strategy for liquidity and funding management.
- Approve the appetite for liquidity and funding risk.
- Approve the Entity's Liquidity Risk Management and Policy Framework.

8.6.3 LINES OF DEFENCE

Liquidity and financing is managed through an organisational structure with a clear segregation of the roles and responsibilities for each of the lines of defence, with the aim of avoiding conflicts of interest and managing risk in order to comply with the risk appetite approved by the Board of Directors, as shown below:

Table 15. Lines of defence - Liquidity needs

	1ª line of defence	2ª line of defence	3ª line of defence
Main functions	*Execution*	*Identification, measurement and control*	*Assessment, valuation and review*
Areas	**Business**	**Risk**	**Audit**
Roles & Responsibilities	-To assume day-to-day responsibility for the entity's liquidity management Managing the entity's pool of assets and daily liquidity position -To make profitable the excess liquidity of the Entity and find the best option in the market to maintain the amount of liquid assets of high quality, thus maintaining the liquidity ratio in line with risk appetite. -Ensure compliance with the limits and indices in the operation related to the application of funds	-Analysing the liquidity position through indicators used by the Bank -Reporting to the Board of Directors in the event that the established thresholds are exceeded and analysing and advising on action plans related to liquidity and financing -Analysing the mismatches in the flows of the financing structure and the application of funds, which may arise due to their maturities -Control that there are no financing gaps by analysing the maturities of asset and liability flows. -Generate the metrics and statements required by the CSSF	-Review the adequacy and relevance of controls which, inter alia, should ensure the accuracy and completeness of data and information, including the capability of the tools necessary to perform this function. -Lead the periodic review of liquidity and financing management processes in the Entity. -Ensure compliance with the policies, liquidity and financing processes and report on non-compliance with them to the AFBI Risk Committee and the AFB Risk and Internal Risk Committee.

Cross-sectional areas	**IT**	**Accounting**
Roles and Responsibilities	Provide disaggregated information from the source of data (Host) located on the Bank's servers, to the system that generates the accounting information (SIC)	Generate the accounting information required by the CSSF to evaluate liquidity management.

Source: Own elaboration, 2019

8.6.4 FINANCING PLAN AND LIQUIDITY INDICATORS

The Entity has a Liquidity Financing and Management Plan integrated into the Entity's Strategic and Business Plan. The principles defined in particular are the principles of liquidity risk management and monitoring applied by Allfunds Bank Group which comply with the guidelines established by the European banking authorities and the principles and requirements established by the CRR through the calculation of the LCR, NSFR and ALMM.

Liquidity risk management procedures and methodologies have been defined and diligently documented in the liquidity risk procedures manual, providing full coverage of liquidity standards required by the regulator and following conservative criteria in liquidity risk management:

- Allfunds Bank Group does not collect deposits from its customers and does not make funds applications with the customer's balance.
- Excessive liquidity is invested in interbank deposits with institutions of high credit quality, in order to mitigate concentration risk.
- The liquidity that comes from the Entity's equity and from the flows from the Entity's business through the settlement of the subscription and redemption orders received from customers is materialised in overnight demand accounts and interbank deposits.
- In addition, fees income is also generated to funds in relation to the distribution activity, as well as to intermediation services.
- Balances held in customers' current accounts are not intended to be fixed, but to cover the need to underwrite the subscription orders of UCIs units. The Entity is prudentially stable, with maximum overdraft limits allowed in these accounts, thus minimizing the impact on the bank's liquidity risk.
- In addition, there are other balance sheet accounts (accrued and deferred income) arising from the fees receivable and payable for retrocession of the management fees of the aforementioned UCIs. Commissions are charged on a quarterly basis and are payable (liabilities) after the date of collection. Therefore, the liquidity risk arising from this concept is very low. The Bank is well positioned to meet any short-term liquidity needs due to the mitigation techniques used and the diversification of its liquidity buffer.

Due to the Entity's current business model and low exposure to liquidity risk, the Entity has decided not to set limits to cover potential risks arising from operational liquidity (derived from not being able to close or close a position over time), as well as liquidity limits to hedge structural liquidity risk to maintain a minimum level of liquid assets, ensuring that there is no funding gap between the asset and liability flows.

Short-term or operating cash flow is managed by the "Banking Services" area integrated into the Operations Department and monitored by the Finance Department.

8.6.5 LIQUIDITY AND FINANCING POLICIES

The Entity has a Liquidity Risk Manual that allows to:

- Establish the internal rules of the Entity in relation to the functions, responsibilities and committees of the various departments that are directly involved in the management or maintenance of liquidity and financing risk.
- Cover the general criteria for identifying, quantifying, monitoring, reporting and managing liquidity risk to ensure consistency between business activities, stability of methodologies and transparency of risk.
- Define the indicators used by the Bank to monitor liquidity and financing, as well as those required by the regulators.
- Define the entity’s appetite for this risk.
- Establish the principles and criteria that will shape the asset pool management.

8.6.6 MAIN LIQUIDITY INDICATORS

Liquidity risk strategy is integrated into the Entity’s commercial strategy. The main indicators and thresholds defined by the Entity are shown below:

Ratio	Frequency	Value as of 31.12.2019
LCR	Monthly	161.43%
NSFR	Quarterly	42.89%

Source: AFBI, 2019

Liquidity Coverage Ratio (LCR)

The LCR is the basic indicator used for liquidity management which is defined as high quality liquid assets (HQLA) to cover liquidity needs in a liquidity stress scenario of 30 calendar days, the composition at 31st December 2019 being as follows:

Table 16. LCR € thousand

Components	Amount
Liquidity buffer	242,076
L1 excl. EHQCB liquidity buffer (value according to Article 9): unadjusted	242,076
NET LIQUIDTY OUTFLOW	149,955
Total Outflows	301,813
Reduction for Inflows Subject to 75% Cap	151,858
LIQUIDITY COVERAGE RATIO (%)	**161.43%**

Source: AFBI, 2019

The Entity fulfils both the obligation to report the index on a monthly basis and the obligation to maintain a HQLA liquidity buffer, in the form of liquidity at the Banque Centrale du Luxembourg.

Net Stable Funding Ratio (NSFR)

The NSFR is the core indicator used for the management of financing, which is defined as the amount of stable financing available over the amount of stable financing, which as of 31st December 2019 has the following composition:

Table 17. NSFR € thousand

Components	Esposure	Weight	Amount
• Total regulatory capital (excluding Tier 2 instruments with residual maturity of less than one year)	**29,783**	100%	**29,783**
• Other capital instruments and liabilities with effective residual maturity of one year or more	**5,191**	100%	**5,191**
• All other liabilities and equity not included in the above categories, including liabilities without a stated maturity (with a specific treatment for deferred tax liabilities and minority interests)	**438,111**	0%	**0**
• NSFR derivative liabilities net of NSFR derivative assets if NSFR derivative liabilities are greater than NSFR derivative assets	**7**	0%	**0**
TOTAL AVAILABLE STABLE FUNDING	**473,092**		**34,974**
• Coins and banknotes	**0**	0%	**0**
• All central bank reserves	**244,216**	0%	**0**
• All other unencumbered loans to financial institutions with residual maturities of less than six months not included in the above categories	**165,076**	15%	**24,761**
• All other assets not included in the above categories with residual maturity of less than one year, including loans to non-financial corporate clients, loans to retail and small business customers, and loans to sovereigns and PSEs	**4,319**	50%	**2,159**
• Other unencumbered performing loans with risk weights greater than 35% under the standardised approach and residual maturities of one year or more, excluding loans to financial institutions	**2,489**	85%	**2,116**

• NSFR derivative assets net of NSFR derivative liabilities if NSFR derivative assets are greater than NSFR derivative liabilities	**38**	100%	**38**
• All other assets not included in the above categories, including non-performing loans, loans to financial institutions with a residual maturity of one year or more, non-exchange-traded equities, fixed assets, items deducted from regulatory capital, retained interest, insurance assets, subsidiary interests and defaulted securities	**52,467**	100%	**52,467**
TOTAL REQUIRED STABLE FUNDING	**468,605**		**81,542**
NSFR			**42.89%**

Source: AFBI, 2019

The Entity has defined other liquidity metrics to monitor liquidity (ALMM - Additional Liquidity Monitoring Metrics) that are introduced to increase effective liquidity supervision, providing a more complete picture of the Bank's liquidity position, in proportion to the nature, scale and complexity of the institution's activities.

The metrics calculated are the concentration of financing by counterparty and by product type, the prices according to different durations of financing and refinancing, as well as the concentration of countervailing capacity by issuer and counterparty.

8.7 UNENCUMBERED ASSETS

At the end of December 2019, the last available state about the encumbered assests of AFBI was as follows:

Table 18. Unencumbered assets

	Encumbered assests		Unencumbered assests	
Thousand Euros	On-balance sheet amount	Fair value	On-balance sheet amount	Fair value
Assets	362	-	468,243	-
Demand loans	362	-	407,540	-
Equity instruments	-	-	2,489	2,489
Representative values of debt:	-	-	-	-
guaranteed bonds				
asset securitization bonds				
issued by Public Administrations				
issued by financial companies				
issued by non-financial corporations				
Loans and advances other than demand loans:	-	-	5,708	-
mortgage loans	-	-	-	-
Other assets	-	-	54,995	-

Source: own elaboration, 2019

9. OTHER RISKS

9. OTHER RISKS

9.1 REPUTATIONAL RISK

Reputational risk is considered a basic item for action by the Senior Management of the Bank. Before obtaining the General Management's approval, all new services and products must be subject to a comprehensive analysis by different control areas (Risk Management, Compliance, Legal, IT, Operations and the Finance departments).

In the case of new clients, the approval of the Chief Executive Officer is subject to a previous analysis performed by the Compliance and Risk departments of AFB Group, supported by the Sales department. This analysis will determine the potential impact on the reputational and financial risks of the Bank.

Moreover, any particular asset and/or asset management house that the entity considers as sensitive to generate reputational risk will not be incorporated into the product range available to clients. Conversely, if a client requests trading a product of this kind, the Bank requires the signature of a legal agreement whereby the client disclaims all related responsibility resulting from the investment, and therefore the customer assumes and accepts all risks involved in the investments concerned (including a possible default).

9.2 BUSINESS RISK

Business risk is considered a main risk for the bank, for this reason the Entity has integrated this risk into its Risk Appetite the indicator called profitability of the managed assets, which measures the level of commissions according to the volume of assets that are managed. This indicator is the one used by the Entity to know the evolution of the business.

9.3 ENVIRONMENTAL RISK

In view of the business activities carried out, the Bank does not have any environmental liability, expenses, assets, provisions or contingencies that might be material with respect to its equity, financial position or results. Therefore, no specific disclosures relating to environmental issues are included in this report.

9.4 RESIDUAL RISK

The Entity does not apply any credit risk mitigation (CRM) techniques.

10. REMUNERATION POLICIES

10. REMUNERATION POLICIES

This section includes the information with regards to compensation and remuneration policies as required by the Article 450 of the CRR.

10.1 BACKGROUND

AFB emerged as a start-up under the combined umbrella of its former shareholders and AFB itself. As the company evolved, it built its own identity, comprising its own character and culture and developing its personal policies and procedures.

At present, AFB and AFBI are unique companies in constant growth and evolution at all levels, and with a high degree of competitiveness in the market. This means that the policies of the Group must constantly adapt to align human resources to its ambitious long-term goals.

10.2 PRINCIPLES OF THE REMUNERATION POLICY

AFB considers the proper remuneration of its professionals to be a fundamental factor for achieving its goals and, accordingly, for unlocking value for shareholders. In this regard, for AFB it is vital to have a Remuneration Policy that, via the various elements of compensation, enables it to properly remunerate each position within the organization, based on the position's level of responsibility and contribution, and to adequately reward exceptional results and performances, thus, as we have mentioned, allowing the Bank to attract, manage and retain talented professionals.

AFBI adopts this policy and its engagement to apply similar principles as detailed below. In general, AFBI's Remuneration Policy is governed by the following principles:

- Remuneration must foster the adequate and efficient management of risks, and must be aligned with the interests of shareholders, fostering the creation of value in the long term and avoiding conduct aimed at the short term, reducing and curbing excessive risks actions.

- The global remuneration package and its structure should be competitive, making it easier to capture, retain and adequately remunerate employees and directors.

- The remuneration practices derived from this Policy should be in keeping with an effective management of conflicts of interest.

- Remuneration should be in accordance with a base sound and solid capital of the entity.

- Fixed remuneration should represent a significant portion of total compensation.

- Variable remuneration should reward performance, based, among other factors, on achieving the Group's goals, thereby modulating its payment, to avoid overpayment in the event of insufficient performance at AFBI.

- AFB's Remuneration Policy should be highly respectful of the principle of non-discrimination for reasons of gender, age, culture, religion and race.

- The Policy should promote internal fairness between similar levels of responsibility and performance.

- The Company keeps the right to pay, or not, a variable remuneration to the employees.

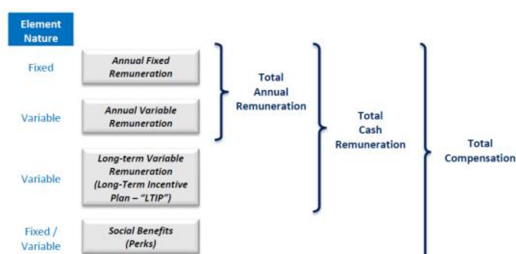
- The allocation of the variable remuneration components within the Bank shall also take into account all types of current and future risks.

- Remuneration packages relating to compensation or buy out from contracts in previous employment must align with the long-term interests of the AFBI as an institution subjected to CRR (according to the updated Law on the Financial Sector (“LFS”), hereafter “CRR Institution”) including retention, deferral, performance and clawback arrangements.

10.3 ELEMENTS OF THE REMUNERATION POLICY

General elements of compensation:

Figure 8. Elements of compensation



Determining the various elements of remuneration of which the Policy is comprised implies being coherent with the degree of responsibility, experience and know-how inherent to each position, and providing incentives for the achievement of the best results at the Company, with the utmost respect for the principles governing it. Furthermore, the remuneration policy is consistent with the principles relating to the protection of clients and investors during services provided.

10.3.1 FIXED REMUNERATION

Fixed Remuneration is the annual gross fixed cash compensation received by each employee, for which purpose the Company uses as a reference in the various markets where it operates (Spain, Italy, United Kingdom, Luxembourg, Switzerland, Latin America, Singapore, UAE, etc.), the principles of both External and Internal Fairness.

Fixed Remuneration fundamentally achieves two goals:

- To remunerate the level of responsibility and complexity of the functions assigned to each position. In relation to this objective the Internal Fairness of remuneration is especially important, establishing and maintaining a fair remuneration structure that is coherent with the relative importance of each post, so that the greater the responsibility and/or complexity the higher the benchmark level of Fixed Remuneration.

- To guarantee enough remuneration so that there is a fair and efficient ratio between the fixed and variable components of total remuneration, enabling variable remuneration to be modulated to the extent that it is even possible to completely remove it in the event of a deficient performance, critical operational risk fault or because of a proven behaviour of not looking for clients' best interests according ESMA regulations.

Additionally, for the Company to be able to attract, retain and motivate talented professionals, Fixed Remuneration, considered in combination with the remaining Elements of Remuneration, must make a competitive package that allows AFB to attract and retain the best professionals in the financial sector, and to be an attractive employer in the market where talented employees want to develop their professional career.

As a result, the Company's intention is that, generally speaking, fixed remuneration should be in market average ranges for a position with a comparable profile (Knowledge's, abilities, attitudes, responsibility, experience and contribution).

Since Fixed Remuneration is established in terms of agreed annual amounts, any increase by law, covenant or agreement will be duly absorbed. The Fixed Remuneration may include benefits.

Salary reviews at AFBI are conducted annually, at the end of the year immediately prior to the year in which the potential review would take effect, or at the beginning of this latter year. The aim of the reviews is that the employees' fixed remuneration is adequately aligned with the market and, internally, with their profile, i.e. level of knowledge, abilities, attitudes, responsibility, experience and contribution.

10.3.2 SHORT-TERM VARIABLE REMUNERATION

A reasonable part of the remuneration of AFB's employees is variable and is aimed primarily at achieving the following goals:

- Providing an incentive to create value for the Company in the short, medium and long term
- Rewarding distinguished performance and achievements
- Motivating people to improve their performance
- Retaining talented professionals in the short, medium and long term

AFBI's Variable Remuneration system was designed to align employees' performance with the shareholders' interests, prudent risk management and the generation of value for the Company in the long term.

AFBI's assessment system shapes the variable remuneration effectively received (bonus payable) by employees. The Bank conducts assessments every year, covering capabilities classified into three blocks of content, measuring the employee's individual performance and their contribution to their department:

- Job performance
- Human Factor
- Competencies.

Generally, the ranges of the Basic Bonus vary and are established for each employee in accordance with their responsibility, so that the economic proposal for the employee must be competitive considering the fixed and variable components of remuneration jointly. Notwithstanding the above, in any event, the Basic Bonus established must always uphold a fair and efficient ratio between the fixed and variable components of the total remuneration.

In no case shall the established Basic Bonus exceed 100% of the fixed component of each employee's total remuneration. In the event that the short-term variable remuneration, itself or once considering all the elements of the variable remuneration (long-term and/or variable benefits, if apply) exceeds 100% of the fixed component of each employee's total remuneration, the Shareholders Meeting approval will be required following the legal procedure established by law (according to Art. 42 of the EBA Guidelines). In this case, the total variable remuneration (short-term, long-term and variable benefits, if applies) will not exceed 200% of the fixed component of each employee's total remuneration.

In no case shall obtaining Variable Remuneration be linked solely to incentives connected with sales and no incentives linked solely to sales of a specific type of financial asset are established, thereby preventing potential conflicts of interest and improper conduct.

10.3.3 LONG-TERM VARIABLE REMUNERATION

At present, the Company does not have any long-term incentive plan in place. Nevertheless, AFBI considers this kind of incentive to be an important element of its remuneration structure, and identifies such plans as an adequate measure to link the interests of its employees and directors with those of the Company in the long term, so it does not rule out implementing an incentive of this kind in the future.

Accordingly, in no case do the variable components of remuneration account for more than 100% (or 200% when applicable) of the fixed component of the total remuneration of each employee.

10.3.4 BENEFITS

When it comes to establishing benefits, as in regard to other items, AFB and AFBI refer to Company policy and market practices. Generally speaking, the most common benefits are:

	Remuneration Nature
Subsidised meals	Fixed
Life insurance	Fixed
Medical insurance	Fixed
Pension Plan (if applicable)	Fixed

Some of the Company's senior executives, in terms of both responsibility and business, are also given a corporate vehicle (fixed Remuneration) in accordance with the applicable Group's policy.

10.3.5 APPROVAL PROCEDURE FOR A HIGHER RATIO AND REPORTING TO COMPETENT AUTHORITIES

In no case do the variable components of remuneration account for more than 100% (or 200% when applicable) of the fixed component of the total remuneration of each employee.

Any approval of a ratio higher than 100% should be notified to the CSSF in accordance with

Circular CSSF 15/622. Any approval of a higher ratio laid down in this point (ii) shall comply with the following procedure steps, among others:

- the shareholders or owners or members of the CRR institution shall act upon a detailed recommendation by the institution giving the reasons for, and the scope of, an approval sought, including the number of staff affected, their functions and the expected impact on the requirement to maintain a sound capital base;
- shareholders or owners or members of the CRR institution shall act by a majority of at least 66% provided that at least 50% of the shares or equivalent ownership rights are represented or, failing that, shall act by a majority of 75% of the ownership rights represented.
- the CRR institution shall, without delay, inform the CSSF of the decisions taken by its shareholders or owners or members, including any approved higher maximum ratio.

10.3.6 CONFIDENTIALITY

The individual remuneration conditions of each employee are STRICTLY CONFIDENTIAL, and must not be divulged under any circumstances to other employees or directors, except for direct supervisors or the Human Resources department.

10.4 APPLICATION OF THE REMUNERATION POLICY TO THE IDENTIFIED STAFF

Current legislation imposes certain requirements on financial institutions in regards to remuneration, in respect of the categories of personnel whose activities significantly impact on the institution's risk profile so can be considered as material risk-takers (“Identified Staff”). There follows a list of Identified Staff at AFBI, and the specifics of application of the Remuneration Policy to members of the Identified Staff based on the requirements pursuant to regulations on remuneration.

To determine the members of its Identified Staff, AFBI has taken into account both (i) qualitative and (ii) quantitative criteria, established under Commission Delegated Regulation (EU) No. 604/2014, supplementing Directive 2013/36/EU of the European Parliament and the Council, with regard to regulatory technical standards with respect to qualitative and appropriate quantitative criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile (the “Regulation”).

The following positions were identified in accordance with the qualitative criteria established pursuant to the Regulation:

1. Members of the “Management Body” in regard to their management duties.
2. Members of the “Management Body” in regard to their supervisory duties.
3. The overall Senior Management.
4. Persons in charge of risk control, compliance and internal auditing, reporting directly to the “Management Body”.
5. Directors of material Business Units.
6. Persons in charge of risk management at material business and employees with management responsibility in the functions of Risk Control, Regulatory Compliance, Internal Audit and material Business Units, and reporting directly to the person in charge of said functions.
7. Employees with management responsibilities in material business units and reporting directly to the director of said unit.
8. Employees responsible for the duties of Legal Counsel, Human Resources, Information Technology, Finance, etc.
9. Employees responsible for or members of a committee in charge of managing any of the risk categories such as securitization, liquidity, concentration, residual, interest rate, etc.

No other personnel to be included in Identified Staff has been identified, in accordance with the quantitative criteria established in the Regulation, in addition to those already included pursuant to the qualitative criteria.

Each person providing service to and belonging to the so-called Identified Staff will be understood to be an “Identified Person”.

Table 19 below includes details of each of the identified positions in accordance with each of the aforementioned criteria.

For the year 2019, the amounts of remuneration, split into fixed and variable remuneration, and the number of beneficiaries is included in the Table 19 below.

10.5 DISCLOSURE

The Remuneration Policy[6] is updated periodically after each modification and validation by the Board and available through the public website of the company (www.allfundsbank.com).

Table 19. Details on Identified staff

N°	QUALITATIVE CRITERIA	POSITION	Malus	Clawback
1	Members of the "Management Body" regarding their management duties	Chairman of the Board of Directors of AFBI, General Manager of AFB	✓	✓
		Member of the Board of Directors of AFBI and Deputy General Manager of AFB	✓	✓
		Member of the Board of Directors of AFBI and Chief Financial Officer of AFB	✓	✓
2	Senior Management	Luxembourg Joint General Managers	✓	✓
3	Persons in charge of risk control, compliance and internal auditing, reporting directly to the "Management Body"	Head of Compliance	✓	✓
		Head of Risk Management	✓	✓
		Global Head of Internal Audit	✓	✓
4	Directors of material Business Units	Switzerland Joint General Managers	✓	✓
5	Employees responsible for the duties of legal counsel, human resources, information technology, finance, etc.	Head of Legal	✓	✓
		Chief People Officer		
		Head of IT Systmes		
		Head of Operations		
		Head of Finance		

[6] Appendix IV of the Remuneration Policy contains aggregate quantitative information on the remunerations, broken down by scope of activity as well as by senior managers and employees, of personnel whose professional activities affect the Entity's risk profile.
It is also pointed out that during the year 2017 there was not in the aforementioned group recipients of remuneration exceeding 1 million euros.

ANNEX 1.

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ANNEX 2.

ACRONYMS

ANNEX 2. ACRONYMS

AIA	Allfunds Internal Audit
ALMM	Additional Liquidity Monitoring Metrics
AML/CTF	Anti-Money Laundering / Countering Financing of Terrorism
BCBS	Basel Committee on Banking Supervision
CET1	Common Equity Tier 1
CIIs	Collective Investment Institutions
CRD IV	Directive 2013/36/UE
CRR	Regulation 575/2013
CSSF	Commission de Surveillance du Secteur Financier
CVA	Credit Valuation Adjustment
EBA	European Banking Authority
ECAI	External Credit Assessment Institutions
G-SIBs	Global Systemically Important Banks
HQLA	High Quality Liquid Assets
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standards
ILAAP	Internal Liquidity Adequacy Assessment Process
IMM	Internal Model Method
IRRBB	Interest Rate Risk in Banking Book
IT	Information Technology
KRIs	Key Risk Indicators
LCR	Liquidity Coverage Ratio
NSFR	Net Stable Funding Ratio
RAF	Risk Appetite Framework
RAS	Risk Appetite Statement
RCSA	Risk and Control Self-Assessment
SA-CCR	Standardised Approach for counterparty credit risk
SFTs	Securities Financing Transactions
SREP	Supervisory Review and Evaluation Process