Principles of risk management

In line with the bank's strategic business orientation, the bank engages in business activities that are exposed to various banking risks such as credit risk, market risk, liquidity risk, operational risk and compliance and legal risks. These risks are assessed and monitored by the management on an ongoing basis. Risk management is aimed at safeguarding the bank's financial strength and reputation in the long term.

Risk management and control falls under the responsibility of the Board of Directors as the bank's senior corporate body. The Board of Directors ensures that a bank-wide internal monitoring system is in place and maintained at all times. For this purpose the Board of Directors issued an Institution-wide risk management framework. Therein, risk management principles, risk tolerance as well as risk limits are determined.

Risk profile and strategic risk approach

Banking risks are measured, managed and limited on a systematic basis in accordance with uniform guidelines and standards, which are periodically checked as to their adequacy. In particular, the standards set out by the Swiss Financial Market Supervisory Authority (FINMA) and the guidelines adopted by the Swiss Bankers Association are taken into account.

The bank's executive bodies are regularly briefed on changes in the bank's net assets, financial position and results of operations.

Default risks

Credit risk management deals with all loan exposures that can lead to a loss if counterparties are not in a position to meet their obligations.

To minimise credit risk, conservative lending limits have been established. As regards the credit standing of issuers, these limits are among other things also based on the ratings published by the major rating agencies. Currency, country and other risks such as diversification and liquidity risks are also taken into account when calculating the value of collateral. Loans are granted on the basis of uniform guidelines and authorisation limits.

Loan applications are assessed by a unit that is independent of the bank's front office. Each individual loan is valued according to a standardised procedure that distinguishes between five risk categories:

Group A	Loans that are fully covered when valued according to the bank's uniform lending standards
Group A–	Loans that are fully covered when valued according to the bank's uniform lending standards, but include diversification risks and thus require particular attention

Group B+	Loans that are fully covered when valued according to the bank's uniform lending standards and where special lending over and beyond standard limits has been permitted
Group B	Loans that require particular attention (e. g. where the value of collateral is exceeded or where attention is requested by the responsible Executive Management member, the Loan department or the relevant account manager) when valued according to the bank's lending standards
Group C	Loans involving a risk of loss and requiring explanation when valued according to the bank's lending standards

Loans are valued and monitored daily. Loans that require particular attention will be reported to the Executive Management immediately and to the Board of Directors at quarterly intervals.

The assets held with banks and the selection of counterparties for the clearing and settlement of banking transactions are subject to strict internal requirements and limits.

Minimum requirements as regards the credit standing of issuers and maximum exposure limits are adhered to when managing financial investments.

Interest rate risks

The emergence of greater interest rate risks is avoided by refinancing loans largely on the basis of matched maturities and currencies. Financial investments are financed through own funds and held to maturity. A limit system restricts the risk of loss resulting from changes in interest rates.
The valuation of interest rate risks resulting from balance sheet and off-balance sheet business is based on the market interest rate method and focuses on the sensitivity of the present value of equity capital. Interest rate risks are calculated with the help of a dedicated asset/liability management software.

Other market risks

Other market risks are restricted by means of an appropriate system of limits. There are no own-account risk exposures in derivatives business. No market liquidity risks exist with respect to foreign currency trading, since no trading is carried out in narrow markets.

The responsibility for risk control at departmental level is strictly separated from that for trading business.

Liquidity risks

Liquidity is monitored and safeguarded in accordance with the statutory banking regulations.

The objective of liquidity risk management is to ensure the bank's solvency on an ongoing basis and at all times. For this purpose, the Board of Directors establishes corresponding guidelines and defines the liquidity risk tolerance. The Executive Management develops a liquidity risk management strategy on this basis and is responsible for its implementation.

Finally, a contingency funding plan is in place that defines concrete measures to be taken under liquidity stress scenarios in order to ensure that the bank is able to meet its payment obligations at all times. The most important aspects of the contingency funding plan are set out in the overall crisis management plan at Group level.

Liquidity management in day-to-day operating business is performed by the Execution Desk. The tasks of this Desk comprise managing payments, planning the expected cash flows and ensuring liquidity in daily business operations. Liquidity and the key liquidity ratios are monitored by the Finance department, which is also in charge of carrying out stress tests.

Operational risks

The term operational risk refers to the risk of a potential or actual occurrence of losses or loss of profit (including any legal and regulatory risks, i. e. compliance risks) arising from the inadequacy or failure of internal processes or systems, individual members of staff, contractual arrangements, documentation, technologies, infrastructure downtimes, catastrophes, external events, or client relationships or relationships with other persons. Operational risks do not include business risks, strategic risks or reputation risks. Operational risks are limited by means of internal regulations and instructions relating to organisation and monitoring.

The appropriateness of these regulations and adherence to them is reviewed by the Risk Control department and the Internal Audit function at regular intervals.

The objectives of operational risk management, aimed at avoiding high operational losses that might endanger the bank's existence, are the following:

- continuous enhancement of the operational control framework in order to enable the bank to manage and minimise operational risks effectively;
- promoting high risk awareness throughout the organisation and all its hierarchical levels;
- ensuring smooth business operations, in particular in cases of infrastructural failures, disasters and catastrophes (business continuity management);
- ensuring that all risk-relevant aspects are checked prior to the introduction of new products or the entry into new markets (new products process).

Compliance and legal risks

Compliance risk refers to the risk of suffering a financial or other loss or damages due to a violation of applicable law and regulations or non-adherence to internal or external codes of conduct or customary market practices. In this case, the loss or damages can take the form of (regulatory) fines or other measures such as a limitation of business activities or the obligation to introduce corrective measures.

Legal and compliance risks are mitigated among other things by raising employees' awareness with respect to relevant situations and risks via trainings and internal instructions as well as by means of monitoring compliance with legal and regulatory provisions and regulations.

To avoid conflicts of interest, Legal & Compliance is a staff department that reports directly to the Executive Management. The department ensures that the bank conducts its business in line with the prevailing regulatory provisions and the obligation to exercise due care and diligence. Legal & Compliance is responsible for checking that the requirements of the regulatory authorities, the legislator and other organisations are met, and for keeping track of developments at these bodies.

The Board of Directors is informed of the legal and compliance risks at regular intervals. In line with changing legal and compliance requirements within the financial industry, the bank has been investing in human and technological resources on an ongoing basis in order to ensure adequate compliance coverage.

Reputation risk

Reputation risk is defined as the risk emanating from events that could potentially impair the bank's reputation. Reputation risk is often a related risk deriving from the risk categories set out above.

The achievement of the bank's strategic and financial targets hinges on its good reputation. In all activities in which it engages, the bank therefore pays close attention to whether the activities may potentially lead to impairment of its reputation. Business relationships with an elevated degree of risk, such as those with politically exposed persons (PEPs), for example, may only be entered into or continued following a very careful examination of the overall circumstances. The initiation or continuance of such business relationships is furthermore subject to approval by the Executive Management.

Outsourcing

The bank has outsourced the following services:

– Operation and maintenance of the core banking system (ASP), New Access SA
– IT managed services, EveryWare AG

All outsourced functions are integrated into the bank's internal control system. All major risks associated with outsourcing are monitored on a systematic basis. In addition, the bank's dedicated Outsourcing Officer is responsible for oversight and monitoring of the service providers.