



Game Changer

Hatton National Bank PLC
Annual Report 2016



Game Changer

In a fast paced world, the ability to perform brilliantly within a rapidly changing business environment is fundamental to real success. Technological deftness and customer awareness become second nature when you're delivering peak performance, every single day.

At HNB, we're very much at ease with the changing landscapes of banking and finance. We're engaging with today's realities by continuously evolving to deliver our promise of New World Banking: smart device-led banking technologies supported by 'Beyond Banking Transactions' - our focus on building lasting relationships.

This report describes another excellent financial performance that will surely please our many investors. Yet we have also accelerated our overall business leadership by unleashing the talent of our extraordinary team to apply creative thinking and intelligent strategies to disrupt the norms of technological and business processes, industry-wide.

We're leaving it upto you, our stakeholder to decide: are you with us? And will you join us on this exciting journey of positive transformation? For we have pledged an outstanding value experience to our customers, investors and other partners. Every year we will renew that promise with confidence, integrity and the game-changing products, people and technologies we now own.

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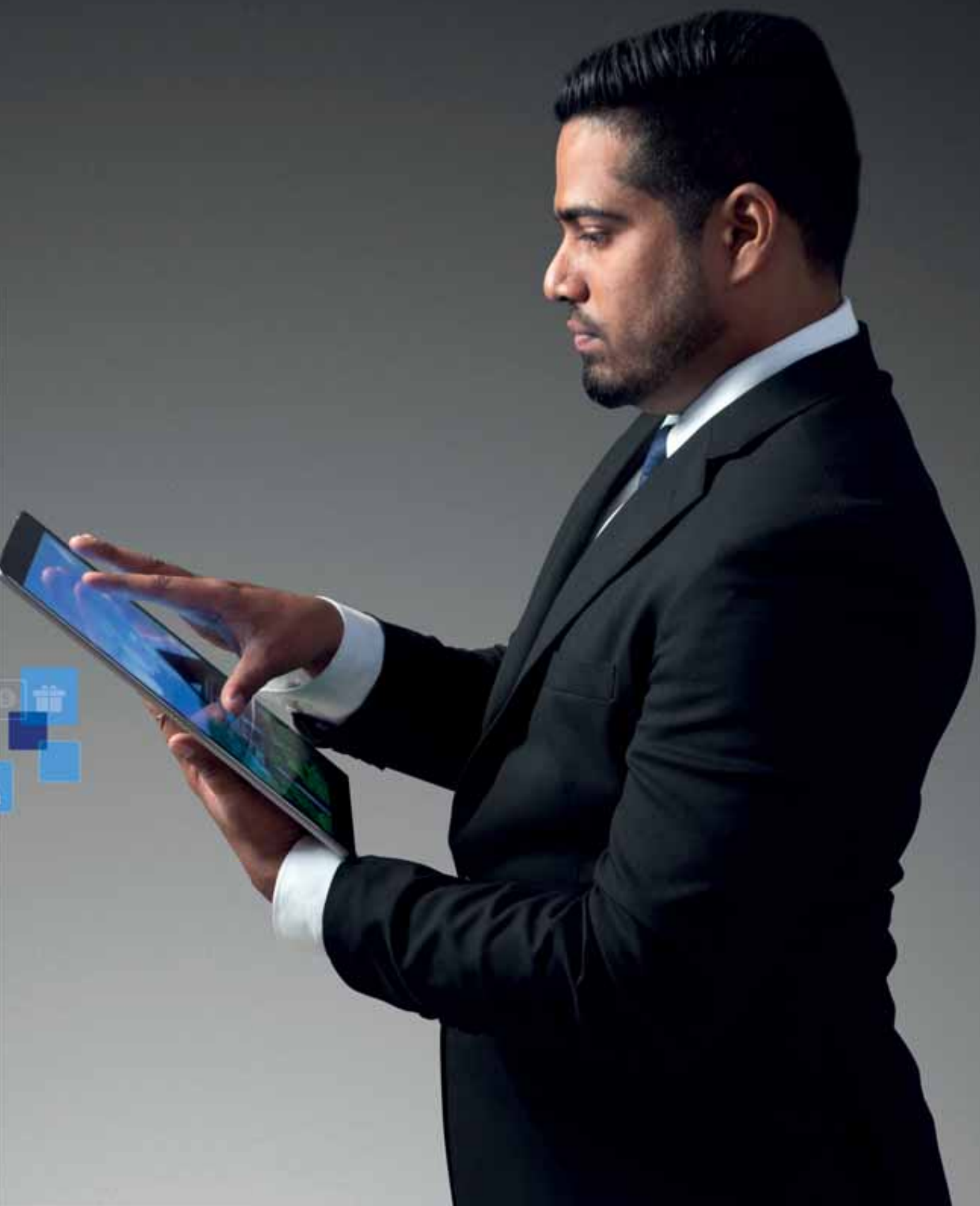


Read the report online at



Applying creative thinking and intelligent strategies...





Continuously evolving
to deliver
our promise...





**We have pledged an outstanding
value experience to
our customers, investors
and other partners.**







**We're redefining the norms
of technology and
business processes,
industrywide....**



Welcome to our Annual Report 2016

Our annual report (hereinafter referred to as the 'report'), consists of financial and non-financial reporting disclosures related to our strategies, management approach and performance for the year 2016. We view integrated reporting based on IIRC framework as our ultimate goal, and commenced working towards integration of the reporting of financial and non-financial information in 2015. Our annual report 2016 is presented in as integrated a manner as possible especially the section dealing with our business model and our strategy based on our understanding of the International Integrated Reporting Council (IIRC) guidelines. We no longer have a separate non-financial / sustainability report or section as the sustainability policy constitutes an integral part of our Bank's strategy. We have incorporated this information instead into the description of our business model and strategy. To ensure continuity in our non-financial reporting over time, we continue to be influenced by the Global Reporting Initiative (GRI) guidelines, where relevant i.e. this report includes disclosures from GRI G4 'In accordance' – Core option of reporting based on identified material aspects for HNB business for the year 2016. We have also reported on key GRI indicators that we have been historically reporting.

This report covers the operations of the Bank during the financial year which ended 31 December 2016. The most recent previous report was for the year 2015. The financial performance of all subsidiary and joint venture companies where the Bank holds a 50% or more stake are included in the consolidated financial statements.

The Bank's performance in the wider context of sustainability, providing an insight into the Bank's contribution towards the enhancement of economic, environmental and social conditions within which it operates are also presented in this report.

It should be noted that this report is primarily about the performance of the Bank and does not cover in detail the sustainability related performance of its joint venture companies/ subsidiaries. These companies either prepare their own sustainability reports.

Complete and comprehensive measurement is not practicable at present. We expect to consolidate all performance by the year 2021.

Sustainability reporting affords the Bank a means to communicate and engage with its stakeholders. Reporting is therefore focused on indicators that reflect on the Bank's performance against defined core areas such as economic, environmental and social impacts that would influence the assessment and decisions of its stakeholders. Given the disparate nature (and interests) of various stakeholders, the Bank has strategically defined its' key stakeholder audience to ensure materiality in engagement and reporting. This report therefore, focuses on indicators that reflect the Bank's significant economic, environmental and social impacts or that would influence the assessment and decisions of its stakeholders.

There have been no significant restatements to the non-financial information provided in previous reports or to the scope and aspect boundaries. In the event of such changes, these have been captured and reported in the relevant sections.

There were no significant changes regarding the Bank's size, structure, ownership, or its supply chain, including changes in the location of, or changes in, operations, changes in the share capital structure and other capital formation; maintenance and alteration operations changes and in the location of suppliers, the structure of the supply chain, or in relationships with suppliers, including selection and termination.

The Bank recognises the critical role of stakeholder feedback in further enhancing its sustainability reporting frameworks. To facilitate better engagement and formal feedback, an investor/stakeholder feedback form is attached to this report. In addition, all questions regarding the report or its contents could also be directly addressed to the Assistant General Manager - Finance.

Whilst the Bank is governed by all applicable legal and regulatory frameworks and charters, we also follow, endorse and / or subscribe to the following externally developed charters and principles - Sri

Lanka Accounting Standards (commonly referred as "SLFRS" / "LKAS") laid down by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka); Laws and regulation of the Companies Act No. 7 of 2007; Listing Rules of the Colombo Stock Exchange (CSE); The Banking Act No. 30 of 1988 and amendments there to; the Code of Best Practice on Corporate Governance jointly issued by the Securities and Exchange Commission of Sri Lanka and the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka); Principles stipulated by "International Convergence of Capital measurement and Capital standards" widely known as Basel II, which provides a framework to foster integrated Risk Management in the Bank; International Finance Corporation (IFC) guidelines and performance standards; Sri Lanka Banks Association - Sustainable Finance Principles and the Global Reporting Initiatives for Sustainability Reporting (GRI).

Independent assurance is a widely accepted norm within the process of reporting sustainability performance. The Bank recognises that independent assurance enhances the transparency and credibility of its reporting process through the delivery of superior value to the Bank, users of the report and broader stakeholder groups and individuals.

M/s Ernst & Young have provided independent assurance reports on the Bank's financial and non-financial performance. The auditors review engagement was carried out in accordance with the International Standard on Assurance Engagements (ISAE 3000).

In addition, the Bank engaged the services of M/s DNV GL Business Assurance Lanka Pvt Ltd. to provide an independent assurance of the non-financial disclosures reported in this report which are prepared based on the requirements of GRI G4 and IIRC framework as applicable. In doing so we have applied the principles of reporting sustainability context, materiality, stakeholder inclusiveness and completeness.

Who We Are

Vision

To be the acknowledged leader
and chosen partner in providing financial
solutions through inspired people

Mission

Combining entrepreneurial spirit with empowered people and
leading edge technology to constantly exceed stakeholder
expectations

Our Values

- Treasure professional and personal integrity at all times
- Demonstrate mutual respect in all our interactions
- Passionate about everything we do
- Committed to being customer centric
- Courage to change, challenge and be different
- Demonstrate unity in diversity



Financial Highlights & Financial Goals / Performance

Our performance in 2016

The Bank surpassed its excellent performance of the preceding year to record another exceptional performance.

20.1 Billion  33.9%

Profit Before Tax



Cost / Income

42.5%

595 Billion  16.9%

Total Gross Loans



Gross NPA

1.8%

623 Billion  18.3%

Total Deposits



ROE

19.9%



ROA

1.8%

	Bank			Group		
	2016 Rs Mn	2015 Rs Mn	% Change	2016 Rs Mn	2015 Rs Mn	% Change
Results For the Year						
Income	84,351	61,153	37.9	95,991	70,027	37.1
Net profit before income tax	20,146	15,050	33.9	22,499	16,160	39.2
Income tax on profits	6,002	4,601	30.5	6,834	5,064	34.9
Net profit after taxation	14,143	10,449	35.4	15,665	11,096	41.2
Gross dividends	3,517	3,451	1.9	3,517	3,451	1.9
At the Year End						
Shareholders' funds (Capital and Reserves)	77,017	65,051	18.4	91,291	75,564	20.8
Deposits from customers	623,495	527,126	18.3	635,371	536,133	18.5
Gross loans and receivables to customers	595,514	509,525	16.9	608,966	518,586	17.4
Total assets	858,874	725,208	18.4	901,451	757,585	19.0
Information per ordinary share						
Earnings (Rs)	34.25	25.41	34.8	35.73	25.67	39.2
Dividends (Rs)	8.50	8.50	-	-	-	-
Dividend yield (%) - Voting	3.78	4.04	(6.4)	-	-	-
Dividend yield (%) - Non Voting	4.47	4.78	(6.4)	-	-	-
Net asset value (Rs)	186.11	160.29	16.1	220.61	186.20	18.5
Market value (Rs) - Voting	225.00	210.60	6.8	-	-	-
Market value (Rs) - Non voting	190.00	177.90	6.8	-	-	-
Ratios						
Return on average shareholders' funds (%)	19.91	16.59		17.69	14.71	
Price earning (Times) - Voting	6.57	8.29		6.30	8.21	
Price earning (Times) - Non Voting	5.55	7.00		5.32	6.93	
Dividend cover (Times)	4.02	3.03		4.45	3.22	
Capital Adequacy Ratios						
Tier 1 (%) (Statutory minimum ratio required is 5%)	11.22	10.53		11.51	10.99	
Total capital (%) (Statutory minimum ratio required is 10%)	15.27	12.70		15.37	13.11	

Note: Information are based on LKASs/SLFRSs.

	2012	2013	2014	2015	2016	Medium Term Goals
Key Performance Indicators						
Return on Average Assets (%)	1.8	1.5	1.7	1.6	1.8	Over 1.8
Return on Average Shareholders' Funds (%)	17.8	14.3	16.0	16.6	19.9	Over 20.0
Cost / Net Income Ratio (Excl Financial VAT) (%)	53.0	46.0	47.4	45.9	42.5	Below 40.0
Dividend per Share (Rs)	8.50	8.50	8.50	8.50	8.50	Payout of 30%
Capital Adequacy (Bank)						
Tier 1 Capital Ratio (%) (Statutory Minimum Ratio Required is 5%)	13.9	13.0	12.2	10.5	11.2	11.0
Total Capital Ratio (%) (Statutory Minimum Ratio Required is 10%)	16.6	16.5	14.8	12.7	15.3	15.5

Delivering peak performance every single day

Chairman's Message



I take pleasure in welcoming you to the forty eighth annual general meeting of Hatton National Bank PLC and in presenting to you the annual report and audited financial statements for the year ended 31st December, 2016.

The Bank surpassed its excellent performance of the preceding year to record another exceptional performance, which is discussed in detail in the ensuing MD's Review and the Management Discussion and Analysis (MD&A). Let me present a few highlights of the performance and an overview of the economic landscape which formed the backdrop to the industry's performance.

Backdrop to Performance

The Group's Profit Before Tax grew by 39.2% to reach Rs 22.5 Bn whilst Profits After Tax reached Rs 15.7 Bn during the year as it reaped the dividends of its multipronged strategy which sought to enhance its topline whilst managing the middle line.

Sri Lanka's economic activity began to gather momentum as the year 2016 left behind some of the policy uncertainties that characterized the preceding year of elections and transitions. The Bank's excellent results were well supported by the rise in interest rates which began in late 2015 and continued into 2016, facilitating higher interest income and interest margins for the banking industry. Simultaneously, the Bank benefited from strong credit growth during the year. However credit growth is likely to slow down marginally in the next few months in response to the tightening of monetary policy during the year.

The government's budget proposals for 2017, focused on reining in the ballooned budget deficit and on preventing an overheating of the economy. This augurs well for stronger macroeconomic fundamentals into the future, albeit posing some challenges to the profitability of the banking sector due to the proposed increase in levies.

June 2016 saw Sri Lanka reach an agreement with the IMF for an Extended

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Fund Facility (EFF). This was an important milestone during the year, not only to boost the country's foreign reserves but also to boost investor confidence and provide a sustainable fiscal and monetary policy framework.

Sri Lanka's enhanced image amongst the international community, supported by the new government's commitment to good governance, also complemented HNB's capacity to attract high calibre global investors; and this bodes well for more investments from other multilateral agencies which have partnered HNB in the past.

The global political environment sprung two significant surprises during the year, in the form of Brexit and the United States' election of Donald Trump as its president. Both these events, in a general sense, appear to imply a worldwide trend of rising nationalism and protectionism. However, whilst the global markets were in turmoil in the immediate aftermath of these events, they soon reverted to their previous status quo. HNB has aptly recognized the importance of factoring in such scenarios which may be considered least likely, into its strategic planning. The Bank's strong risk management framework considers multiple scenarios in incorporating international events for the forecasting and management of risks relating to its strategic investments, currency exposures and interest rates.

The political changes in the United States point to a loosening of fiscal policy which is likely to prompt the Federal Reserve to adopt a much tighter monetary policy in 2018. This in turn necessitates that we factor in the likely implications on domestic interest rates and capital flows. The renegotiation of trade arrangements, due to factors such as Brexit and the policy changes in the United States leading to the latter's

exit from trade arrangements in South Asia, could see China play a more dominant role in order to fill in the vacuum thus created. These developments in turn could present new opportunities for the region.

Dividend

I am happy to announce that your Board has proposed a final dividend of Rs 7.00 per share for both voting and non-voting shares consisting of a cash dividend of Rs 3.50 per share and a scrip dividend of Rs 3.50 per share in addition to the interim dividend of Rs 1.50 per share paid in December 2016. Accordingly, the total dividend payment for the year amounts to Rs 3.5 Bn.

Governance

A cornerstone of HNB's sustained success and its reputation that spans over a century, as a safe, strong and stable Bank has been its adherence to the highest standards in governance.

The Board sets the tone at the top by promoting professional standards and corporate values that cascade down to senior managers and all other employees of the Bank. Its Board which constitutes members from diverse professional backgrounds who bring a wealth of experience, has established independent committees to ensure the highest standards in transparency, compliance and the efficacy of business and risk management strategies in order to oversee the discharge of stewardship.

In addition to the compliance with the mandatory requirements, HNB has established its own set of benchmarks, structures and processes to meet accepted best practices in governance.

Chairman's Message

Our Sustainable Approach

HNB's journey of growth and leadership which spans over 128 years, is testimony to its sustainable and long term approach in enterprise. Since its inception in Hatton, in 1888, to support the burgeoning tea industry, the Bank has funded a countless number of entrepreneurial initiatives across different industries, geographical, social and ethnic divides; growing with our clients and the nation itself, understanding that each other's success is a win-win. HNB is today the leader in micro and SME funding in the country and will continue to focus on supporting this sector to facilitate economic and social inclusivity and for the sustainable development of Sri Lanka.

The Bank's sustainable approach to business also means that we adopt an approach of partnership with customers, driven by the Bank's tagline - to "partner in progress". The Bank also strives to ensure that its team of employees lives the Bank's values and practices the highest ethical standards expected of them and work within the Bank's ethos via policies, procedures and processes established across the organisation.

Reflecting our Triple Bottom Line focus, the Group will continue to integrate social and environmental value creation into business strategy whilst also looking to uplift communities and the environment through its CSR agenda. Environmental protection is an urgent imperative today. The Bank's solar energy and paper saving initiatives during the year typify a double Bottom Line impact of achieving cost reduction whilst reducing our carbon footprint.

The Future

HNB has been at the forefront of technology in the banking sector and technology will continue to be a key strategic route for sustained profitability and leadership in the future where digital banking would see a rapid proliferation. The Bank's electronic and mobile banking channels augment its extensive brick and mortar channel and the year under review saw the Bank continue to enhance its digital banking proposition to continue its position of leadership in

Rs 22.5 Billion
Group Profit Before Tax

Rs 901 Billion
Group Assets

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this space. The Bank's rebranding initiative launched recently, and currently in progress, has also placed technology at its centre; reflecting the strategic priority of driving banking in the digital space.

The process of formulating strategy at HNB incorporates emerging trends in the socio-economic and political landscape and recognises the importance of pre-empting changing consumer needs. This has been a key factor in the Bank's ability to not only meet changing needs but in fact Change the Game and sustain profitability for over a century.

It is expected that the next 5 - 10 years will see a greater concentration of post millennials in Sri Lanka's workforce, thus requiring that the Bank's employee environment, ethos and HR practices be aligned with the aspirations and needs of this generation of employees. HNB's HR strategies have hence begun to gear itself towards this end; in the development of its employee brand, by empowering its younger workforce and by expanding the channels of communication and the use of social media.

We also foresee a great opportunity for consolidation in the Banking industry as narrowing margins will be an impetus to increase efficiency and productivity with economies of scale being the key to remaining profitable. HNB, as one of the largest players in Sri Lanka's Banking industry sees this as opportunity to enhance the value we create for all our stakeholders.

Whilst we look to the future with much optimism, we are also mindful of the possible challenges of narrower margins, the entry of non-bank players such as telecommunication companies into the banking space and market volatility caused by global events, international conflicts, global terrorism, cyber threats and environmental challenges.

We are confident that the new political landscape will pave the way for political and economic stability, and be a launch pad to create a quantum change for the people of our country. However, I would like to reiterate the need for an unwavering commitment by the government to ensure consistency in its policies and the effective

implementation of them, in order to harness the tremendous growth potential of the country.

Whilst the private sector must be the engine of growth, neither sector can single handedly shoulder the responsibility of development. I would hence like to highlight the importance of Public Private Partnerships (PPP) in driving the nation forward. Entering into effective PPP's with banks and other private enterprises will be vital to ensure the success of key projects. Furthermore, a vibrant export sector is vital for sustainable growth of Sri Lanka's economy. Hence is the need for the government to take leadership in reviving the nation's export sector which continues to underperform.

The Government's commitment to "Good Governance" had become an urgent imperative, and which, as I have alluded to above, has paved the way for better international relations and new trade opportunities. More effort however is needed in the gigantic task of weeding out corruption which has become institutionalised and entrenched and in addressing the inefficiencies it has created. The Government thus stands to benefit by adopting best practices from the private sector and the Banks in particular, to establish controls and enhance governance and independence in the public sector.

In Conclusion

One of HNB's key strengths has been its brand image - with attributes of trust, stability and strength and a proud heritage that spans over a century as Sri Lanka's oldest private commercial bank. Moreover, its substantive footprint, represented by 251 branches and 485 ATMs and a rapidly

Our strengths and key differentiating factors will continue to propel us forward in our journey towards becoming the benchmark in the commercial banking sector in Sri Lanka. Towards this end, the Bank will seek suitable lending and investment opportunities in regional markets and continue to grow its banking business among the SME, Micro, Retail and Corporate segments of Sri Lanka. We will seek to be unparalleled in our customer service offering in terms of customer experience as well as convenience and comprehensiveness of the digital banking solutions to spearhead the industry in technology led banking.

growing digital channel network, has also been a significant strength.

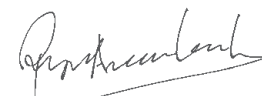
The dedication and unstinted commitment of the entire team that makes up HNB to look at things anew and do things differently have driven the successful implementation of the Bank's multipronged business strategy. HNB's people have thus proved to be the most significant differentiating factor in its success, inspiring it to strive to become Sri Lanka's premier employer.

Our strengths and key differentiating factors will continue to propel us forward in our journey towards becoming the benchmark in the commercial banking sector in Sri Lanka. Towards this end, the Bank will seek suitable lending and investment opportunities in regional markets and continue to grow its banking business among the SME, Micro, Retail and Corporate segments of Sri Lanka. We will seek to be unparalleled in our customer service offering in terms of customer experience as well as convenience and comprehensiveness of digital banking

solutions to spearhead the industry in technology led banking.

I would like to convey my sincere appreciation to my colleagues on the Board for their valuable support and guidance and to the entire team of employees led by the Managing Director, it is their talents, unreserved effort and commitment that propel the Bank to keep expanding its horizons.

I also wish to extend my sincere gratitude to the shareholders and all other stakeholders for their support and the confidence placed in us to be the Partner in Progress for several generations.



Rienzie Arseculeratne
Chairman

Colombo, Sri Lanka
23rd February 2017

Engaging with today's realities

Managing Director's Review



Dear Stakeholder,

It gives me great pleasure to share with you an extraordinary performance by your Bank, with many of the key performance indicators surpassing previous highs to establish new milestones in the industry.

Performance

The Group's Operating Profit Before VAT and Tax grew by a record 41.3% to Rs 27.1 Bn whilst Group Profit After Tax grew by 41.2%, to Rs 15.7 Bn during the year. The Profit Before Tax for the Bank recorded an impressive growth of 33.9% to reach Rs 20.1Bn while the Bank's Profit After Tax improved by 35.4% to Rs 14.1Bn.

Bank's loan portfolio grew by 17.3% during the year, in an environment of rising interest rates, which saw rates increasing by nearly 400 basis points by year end. The higher interest rates contributed to an improvement in interest margins with loans being re-priced. However, it also spurred a movement of funds from capital savings to Fixed Deposits. Despite intense competition in the industry to attract deposits the Bank's deposit base grew by 18.3% year on year. HNB's Minor Savings, proposition 'Singithi' also contributed significantly towards this growth in deposits, with an impressive growth which included mobilisation of a record breaking Rs 900 Mn in minor savings during the national Savings month of October alone.

The Bank's ROA improved to an outstanding 1.8% while the ROE improved to nearly 20% for the year 2016.

Following the Bank's strategic focus on increasing fee income to reduce the dependency on interest income, it continued to enhance fee income by 22.0% during the year under review; mainly supported by trade finance, cards business and guarantee commissions, as well as the offer of new value added services and products which were facilitated by the Bank's technological advancements.

HNB's Asset Quality improved once again, recording its lowest NPL ratio ever, to close at 1.8% as at year end. The improvements to credit screening and evaluation helped

improve approval and monitoring across the branch network. Credit quality was also enhanced by maintaining stringent limits on risk concentration and diversifying our portfolio across the Corporate, SME, Micro Finance and Personal Banking segments. During the year, we also implemented significant enhancements to the Bank's Risk dashboards and initiated improvements in skill levels through appropriate training. Furthermore, our persistent efforts into recovering overdue loans also enabled this outstanding improvement. Asset quality will continue to be a key focus area and the measures we have undertaken would further augment our Risk management framework and processes to continue enhancing the Bank's asset quality.

A Digitally driven journey

HNB continues to drive technology led banking and will provide industry leadership in the digital banking space. The electronic banking upgrade completed during the year, enabled the launch of a state of the art payment and Cash Management solution - a trail blazer in the industry; a distributor and supplier financing solution amongst other value added features and benefits offered to retail customers. HNB also initiated the launch of its digital branches - the first of which will be opened during the first quarter of next year, becoming another first in the industry. HNB also continued to increase the number of cash recyclers and cash deposit machines across the network.

Moreover, it is most heartening to see that the micro and small scale sectors of the economy have begun to adopt technology, with many in the sector starting to use Debit and Credit cards and POS machines to conduct micro finance transactions. Even more significantly, micro entrepreneurial

Game Changer Digital

- Launching Digital Branches
- Appointment of a Chief Digital Officer to drive the digital transformation
- Payment and Cash Management
- Distributor Financing

Game Changer

Group

PBT
Rs **22.5 Bn**

PAT
Rs **15.7 Bn**

Bank

ROA **1.8%** ROE **19.9%**

Cost to Income **42.5%** NPA **1.8%**

artisans and farmers have begun to reach export markets through many web portals, with local handmade sarees now being purchased in Europe via the internet and vegetables being ordered through the web.

Globally, the trend amongst most organisations is towards convergence of their digital strategy with their corporate strategy. In this evolving environment and in line with the Bank's strategic plan and vision to be the most future ready bank in Sri Lanka, we created a new vertical during the year, with the appointment of a " Chief Digital Officer" (CDO) to drive the digital transformation across our entire value chain. Digitalisation as we know is breaking down boundaries and becoming the foundation for entirely new ways of doing business as well as creating new business.

Customers

Whilst HNB pursues a digital banking led strategy to enhance value creation and convenience to customers, we are always mindful that the raison d'etre of any business is satisfying customer needs, and as articulated by our mission, " to constantly exceed stakeholder expectations" . Sustaining a competitive advantage in banking at HNB has been about " banking beyond transactions" , about long term

Managing Director's Review

relationships and “partnering people's progress”.

Reflecting our strategic focus on customer service, the year under review saw the Bank recruit a Customer Experience Officer to give leadership to enhance customer experience, to meet the highest standards and set new industry benchmarks. This new role will also enable us to incorporate customers perspectives and experience to every aspect of our business, such as at each stage of product development, launch and delivery.

Following a market research study commissioned by us, the Bank re-launched its new proposition for high net worth customers re-branded as “Priority Circle” replacing HNB's Crystal Circle. The new proposition aims to meet changing customer needs and intensifying competition with the offer of an exclusive service and a plethora of benefits to our loyal high net worth customers.

Game Changer
Customer

- Recruitment of a Customer Experience Officer
- First to market innovative products such as MoMo, WallyE
- Re-launching the Priority Circle proposition

Enhancing productivity and efficiency

Our commitment to look at things anew and do things differently for win-win impacts has enabled us to keep innovating the ways in which we play the Game.

As I enumerated last year, following an in-depth analysis of the internal processes and operations, the Bank launched a reengineering of its business processes in 2013. To drive initiatives for the Bank's sustained leadership in evolving market conditions, we established a dedicated change management unit, the only local bank to have a fully dedicated and

Game Changer
Productivity & Efficiency

- Centralisation of Retail credit
- Regionalisation of SME credit
- Creating a culture of continuous improvement through six sigma

empowered team to initiate and implement change. These BPR initiatives in 2013-2016 have created new pathways for our Game Changing journey, and contributed tremendously to the excellent results of the past two years. The initiatives include the establishment of centres of operational excellence, automation and streamlining of processes which have yielded significant improvements to the Bank's Cost to Income ratio, to 42.5% as at the year end; whilst helping grow the topline through service excellence and enhanced value creation for all our stakeholders. The lean management initiatives have enabled our Profits per employee to increase to Rs 3.4 Mn in 2016 compared with Rs 2.4 Mn in 2015. During the year under review, we focused on expanding these initiatives to other aspects, as well as on ensuring that a culture of continuous innovation and reengineering is embraced by the different departments in order to sustain the competitive advantages thus harnessed. Towards this end the Bank introduced training in tools such as Six Sigma Yellow belt, Lean Management and 5 S.

Our People

The talents, passion and commitment of our people have been at the heart of our strategy - in adding new perspectives and in the passionate drive to re-engineer our business processes; in being nimble enough to adapt and drive change in our business model to adopting a mindset of continuous improvement and rising up to the challenges of greater responsibilities and for nurturing win-win partnerships with our stakeholders. It is thus most heartening that our HR efforts have been recognized during the year by several international accolades. These include the award for “Best HR Strategy in Line with Business” by the Asia

Best Employer Brand; overall award for Best Results Based Training at the Asia's Training & Development Excellence Awards 2016.

The Bank's strategic initiatives to harness technology, streamline operations and establish centres of excellence have energised and empowered our people by relieving them of mundane responsibilities to engage in more value adding activities. This has yielded the anticipated dividends in terms of improved productivity, and has also been win-win in driving sales whilst also enabling greater focus on building relationships with our existing clients and attracting new ones. In addition, flexible hiring is being introduced to support the Bank's strategic objectives and to cater to a future workforce which would largely be made up of Generation Z. Aligning our HR Management practices with the Bank's strategic objectives of driving sales and marketing, the Bank increased the rewards for achievement of targets and introduced a performance based variable pay to support a sales and marketing driven culture.

A focus on “Experience” is a growing trend in the market. Whilst many companies the world over have verticals dedicated to Customer experience, a few have also begun to focus on enriching the Employee Experience. Hence, appreciating that service must begin at home, HNB became the first bank in Sri Lanka to create the position of Chief Employee Experience Officer – to serve as a single point of contact for the entire HATNA family, for all experience related matters which could range from a need for resources or information or two way communication, a breaking down of barriers and silos to share ideas, opinions and criticisms to improve the work place.

The Bank's Talent Development Model introduced in 2014, is a key platform for future growth and was further expanded during this year with the management development programme designed for branch managers in collaboration with the Post Graduate Institute of Management.

In line with the Bank's strategy of a digital transformation, our HR efforts will also focus on recruiting as well as developing and

nurturing a tech savvy workforce. During the year we increased our investments into virtual learning. Reflecting a lean and technologically driven model, the future employees of the HATNA family will also be groomed to be members of cross functional teams who are provided opportunities to enrich and enlarge their job roles.

Game Changer People

- Appointment of Employee Experience Officer to drive a happy organisation
- Performance related pay

A Sustainable Approach

The role we play in the nation's development agenda is one we hold high and which is intrinsic to our triple bottom line approach in business. HNB's involvement with the SME and Micro Finance sectors of the country dates back to the Bank's origins in the small hillside town of Hatton. Our engagement with the SME sector has since then expanded across the length and breadth of the country from the rural hinterlands to the big cities. Our Micro Finance programme "Gami Pubuduwa" - the first ever micro finance initiative in the country by a Bank, is in its 28th year and continues to enrich diverse communities across rural Sri Lanka.

During the year, the Bank expanded its value addition to the SME sector via the launch of Distributor Financing, to benefit small scale distributors of large corporates.

In line with our triple bottom line objectives, the Bank invested over Rs 350 Mn on Solar energy systems for 69 of its branches during the year. These have enabled us to reduce our dependence on the national grid for electricity and hence reduce energy bills whilst contributing to green energy. Furthermore, our green focus also prompted us to encourage green initiatives by our employees, by introducing a concessionary loan scheme to purchase solar energy systems for their homes.

In addition to our business integrated social and environmental sustainability initiatives, the Bank also continued its on-going initiatives under the categories of children and education, health and environment.

Looking ahead

We anticipate that the moderate growth in GDP experienced in the past two years will pick up to a faster pace, as the economy regains the vibrancy that better reflects its potential. We expect new development projects, planned infrastructure projects and new investments to begin in the year ahead.

E-Commerce is likely to continue to see exponential growth going forward. With HNB's game changing presence in the digital space, it stands well poised to grow in this business space and harness the opportunities that would arise from the proliferation of E-Commerce.

Following our strategic planning exercise involving the top 100 of the Bank's executives, a number of priorities for the year ahead have been established and we will take initiatives to achieve them in 2017. Amongst them is a need to drive low cost deposits important for sustainable balance sheet growth.

The Bank will continue to expand its centralisation initiatives (which began with the centralisation of credit processing in 2015) in 2017, by centralising the disbursement of credit, thus minimizing risks and enhancing customer service. Moreover, we also plan to centralise the repository of all security documentation, thereby enhancing protection, consistency and accuracy of documentation and efficiency of retrieval.

The past two years has seen us harness the unique opportunities and advantages of utilising technology across the board. We foresee boundless possibilities ahead of us, and we look to serve generations more with added vigour, continuing on our trail blazing journey - to develop new propositions and products, to adopt new business models and attract new customers and reduce costs, whilst standing firm on a sound platform of

a strong brand promise - of "Safety, Stability and Strength", which spans over a century.

Appreciation

I would like to convey my sincere appreciation to our Chairman and my colleagues on the Board for their guidance, constant support and the confidence placed in me. My gratitude also to the Governor of the Central Bank of Sri Lanka and other regulatory bodies for the vital role they play and their contributions to the industry; and to all our stakeholders and customers for their loyalty and inspiration and the opportunity to be a "partner in their progress".

My heartfelt thanks to my corporate and senior management teams who provide leadership and their boundless energy to drive our strategies for growth and business excellence and each and every member of our team that make up HNB, who continue to be the ambassadors of a legacy and bolster the Bank's stature whilst staying nimble and energized enough, to not merely respond to changing market environments but to *keep Changing the Game*.



Jonathan Alles
Managing Director /CEO

Colombo, Sri Lanka
23rd February 2017

The Board of Directors



01 Rienzie Arseculeratne
Chairman

02 Jonathan Alles
Managing Director/Chief Executive Officer

03 Rose Cooray
Director

04 Rohan Karunaratne
Director

05 Damien Fernando
Director

06 Sujeewa Mudalige
Director

07 Sanjivani Jayawardena
Director

08 Rusi Captain
Director

09 Amal Cabraal
Director



10 Palitha Pelpola
Director

11 Duliksha Soosaipillai
Director

12 Nilanth de Silva
Director

13 Thushari Ranaweera
Company Secretary

The Board of Directors

Rienzie Arseculeratne Chairman

LL.B (Ceylon), LL.M (Commercial Law) Bristol, President's Counsel, Solicitor – England, Barrister – Australian Capital Territory (ACT)
(Non-Executive Director) H N

Appointed Director in April 2015 and Chairman in May 2015. Mr Rienzie Arseculeratne is an Attorney-at-Law and a Member of Unofficial Bar practicing Criminal Law and Public Law. He was appointed a President's Counsel in 1998.

He holds a Law Degree from the University of Ceylon (LL.B) and a Master's Degree (LL.M) from the University of Bristol, U.K. in commercial law. He has been admitted as a Solicitor of the Supreme Court of England and as a Barrister of the Australian Capital Territory (ACT).

Mr Arseculeratne was the former Director General of the Commission to Investigate Allegations of Bribery or Corruption. He was also a State Counsel, Senior State Counsel, Deputy Solicitor General and Additional Solicitor General from 1975 – 2003 and he was the Head of the Criminal section of the Attorney General's Department until his retirement in 2003. Mr. Arseculeratne was also the Legal Advisor to the Ministry of Fisheries from 1989 to 1993 and served as an Examiner at Sri Lanka Law College.

Mr Arseculeratne is a Member of the Board of Governors of the Office of National Unity and Reconciliation.

Jonathan Alles Managing Director/Chief Executive Officer

M.B.A. Finance (Stirling), A.I.B. Sri Lanka
(Executive Director) R

Appointed an Executive Director on 1st May 2013 and Managing Director/Chief Executive Officer on 1st July 2013.

Mr Jonathan Alles holds a MBA from the University of Stirling, U.K. and is an Associate Member of the Institute of Bankers, Sri Lanka. He counts 30 years of banking experience having served at International Banks and HSBC, Sri Lanka and also at Hatton National Bank during the period September 2002 to June 2005. Having returned to Sri Lanka from the UAE in September 2010, Mr Alles re-joined Hatton National Bank in the capacity of Chief Operating Officer.

Mr Alles is the Chairman of Lanka Financial Services Bureau Ltd, Lanka Ventures PLC, LVL Energy Fund and HNB Grameen Finance Ltd. He serves as a Director of Acuity Partners (Pvt) Ltd.

Mr Alles is a Member of Sri Lanka Institute of Directors & also serves as a Member of the Advisory Committee of Sri Lanka Business & Biodiversity Platform.

Rose Cooray (Mrs) Director

B.A. (Hons) (University of Ceylon, Peradeniya, Sri Lanka), M.Sc (Strathclyde University, U.K.)
(Non-Executive Director) N R

Appointed Director in February 2010 and was the Senior Independent Director till the 30th of October 2014. Mrs Rose Cooray having served the Central Bank of Sri Lanka for 35 years retired as a Deputy

Governor and counts over 40 years of experience in the financial sector. She is the Chairperson of HNB Assurance PLC, H N B General Insurance Limited, Sithma Development (Private) Limited, Ceylon Guardian Investment Trust PLC and Ceylon Investments PLC. She is also a Director of HNB Grameen Finance Limited and Guardian Capital Partners PLC.

On release from the Central Bank, she served the Ministry of Finance in the capacity of Director General Fiscal Policy and Economic Affairs Department for nearly 6 years, represented the Government on the Boards of DFCC Bank, Sri Lanka Institute of Information Technology, Sri Lanka Telecom, Ceylon Electricity Board, De La Rue Currency and Security Print (Pvt) Ltd, Export Development Board, National Housing and Development Authority and represented the Monetary Board on West Coast Power (Pvt) Ltd.

She has functioned as the Vice Chairperson of the Institute of Bankers of Sri Lanka for 5 years and has served on a number of Committees at national level covering a variety of subjects representing the Ministry of Finance and the Central Bank. She has represented the Central Bank and the Ministry of Finance at various international meetings and been a resource person at a number of local and international seminars.

Mrs Cooray has been involved extensively in policy making and implementing projects and programmes especially in the area of regional development and microfinance. She has wide experience in negotiating loans with multilateral and other donors as well as bilateral trade agreements on behalf of the Government. Her articles/papers have been published in professional journals.

Rohan Karunaratne**Director**

*B.E (India),
T.Eng (CEI),
MIE (Lon),
MBA (U.K.),
Ph.D (U.K.),
FIIM (HK),
FCIOB (Ceylon)*

(Non-Executive Director) 

Appointed Director in October 2011, Dr Rohan Karunaratne, a Consultant Engineer, is the incumbent President of the Ceylon Institute of Builders (CIOB), engaged in developing the construction industry and construction builders in Sri Lanka. He is the Chairman of A.K.K Engineers (Pvt) Ltd, an engineering company specializing in building construction, civil engineering, water supply and waste water, construction of swimming pools and now in road construction too. He is also in the advisory council of megapolis development in Sri Lanka and Export Development Board. He is the Chairman of Associated Motor Finance Co Ltd, Hybrid Airports (Pvt) Ltd, Master Builders International (Pvt) Ltd, Pinthaliya Holiday Resorts & Spa and is also the Deputy Chairman of the International Institute of Management.

He has over 30 years of experience in civil Engineering Consultancy, Construction Training, lecturing in civil Construction, Designing & Planning. He was the Past Chairman of the National Construction Association of Sri Lanka and was the first Chairman of Human Resources Development (Pvt) Ltd and Advance Construction Training Academy. He is also a Director of Arpico Finance PLC, Sino Lanka Hotels & Spa (Pvt) Ltd and Canwill Holdings (Pvt) Ltd.

Dr Karunaratne holds a PhD in Management and a MBA from the Sussex University (UK). He is an Engineering Graduate in Civil Engineering and an advanced Diploma holder in HIET (Chennai, India).

He is a Fellow of the International Institute of Management (HK) and a fellow of the Ceylon Institute of Builders.

Damien Fernando**Director**

*MBA (Sri J),
FCMA (U.K.)*

(Non-Executive Director)  

Appointed Director in April 2012. Mr Damien Fernando was the former Executive Director of Sri Lanka Insurance Corporation Limited. He has also served on the Boards of Distilleries Company of Sri Lanka PLC, Pelwate Sugar Industries PLC, The Lanka Hospitals Corporation PLC, Melstacorp Limited, Lanka Bell Limited, National Asset Management Limited, Continental Insurance Lanka Limited and on the Boards of several other Companies.

He is a Fellow of the Chartered Institute of Management Accountants UK. He has been awarded a Master's degree in Business Administration by the Postgraduate Institute of Management of the University of Sri Jaywardenepura.

Sujeewa Mudalige**Director**

*FCA (Sri Lanka),
FCMA (UK),
FCCA (UK),
FCPA (Australia)*

(Non-Executive Director)  

Appointed Director in April 2012. Mr. Sujeewa Mudalige is a past President of the Institute of Chartered Accountants of Sri Lanka (CA – Sri Lanka) and is the Chairman of the Sri Lanka Accounting Standards Committee. Mr Mudalige has more than 25 years of experience in public accounting practice and in industry. He was a Member of the Securities and Exchange Commission of Sri Lanka (SEC) and chaired its audit committee. He has served as a

Board Member of the Sri Lanka Accounting and Auditing Standards Monitoring Board (SLAASMB) and Financial Systems Stability Consultative Committee (FSSCC) of the Central Bank of Sri Lanka.

Mr Mudalige is also a past President of the Confederation of Asian and Pacific Accountants (CAPA), the largest regional body of accountants. The confederation includes the professional accountancy bodies of Asian and Pacific nations.

He is a Fellow of the Institute of Chartered Accountants of Sri Lanka (CA-SL), Fellow of the Chartered Institute of Management Accountants (CIMA-UK), Fellow of the Association of Chartered Certified Accountants (ACCA -UK) and Fellow of the Certified Public Accountants (CPA-Australia).

Sanjivani Jayawardena (Ms)**Director**

*B.A. Monash University, Australia,
Certified Auditor (DNV-Norway),
CIM – London,
MCIM (U.K), Chartered Marketer*

(Non-Executive Director) 

Appointed Director in April 2012. Ms D S C Jayawardena is a Director of Stassen Exports (Pvt) Ltd, Milford Exports (Ceylon) (Pvt) Ltd, Stassen International (Pvt) Ltd, Stassen Natural Foods (Pvt) Ltd, Ceylon Garden Coir (Pvt) Ltd, Milford Developers (Pvt) Ltd, Stassen Foods (Pvt) Ltd, C B D Exports (Pvt) Ltd, Lanka Milk Foods (CWE) Plc., Lanka Dairies (Pvt) Ltd, Ambewela Livestock Company Ltd, Pattipola Livestock Company Ltd, Ambewela Products (Pvt) Ltd and Indo Lanka Exports (Pvt) Ltd. She worked as an Intern for the Clinton Foundation in 2008.

Ms Jayawardena holds a B.A. (Commercial Law, Criminology, Sociology) from Monash University, Australia, Professional Certificate in Marketing (CIM), Diploma in Marketing

The Board of Directors

(CIM) and a Professional Postgraduate Diploma in Marketing (CIM). She is also a Certified Auditor (DNV-Norway), a Member of the Chartered Institute of Marketing (UK) (MCIM) and a Chartered Marketer.

Rusi Captain

Director

University of Miami, Florida

(Non-Executive Director) N

Appointed Director in April 2012. Mr R S Captain is a Director of Polypak Secco Ltd, Paints & General Industries Ltd, Paints & General Industries (Exports) Ltd, Polytex Garments Ltd, CIC Holdings PLC, Propertex Development Ltd, Austin Gloves (Ceylon) Ltd, CEI Plastics Ltd, Ranweli Ltd, Agriland Ltd, Forest Creek Park Ltd, Body Bar (Pvt) Ltd, Horahena Investments Ltd, Palmland Ltd, Parkland Ltd, Cisco Specialty Packaging (Pvt) Ltd and Randiya Farms Ltd.

Mr Captain has had his primary education at Royal College Colombo and secondary education (O/L & A/L) at Millfield, U.K. and the University of Miami, Florida

Amal Cabraal

Director

Chartered Marketer – FCIM (U.K.),
MBA – University of Colombo,
Alumnus – INSEAD - France

(Non-Executive Director) H A

Appointed Director in April 2014.

Mr Amal Cabraal is the former Chairman and CEO of Unilever Sri Lanka. He has over 3 decades of business experience in general management, marketing and sales in Sri Lanka and overseas. He is an alumnus of INSEAD-France and holds a MBA from the University of Colombo. A Chartered Marketer by profession and a Fellow of the

Chartered Institute of Marketing, UK. He is presently the Non-Executive Chairman of the CIC Feeds Group of companies and serves as an independent non-executive Director of John Keells Holdings PLC, Ceylon Beverage Holdings PLC, Lion Brewery (Ceylon) PLC, Silvermill Investment Holdings (Pvt) Ltd and the Supervisory Board of Associated Motorways Ltd. He is a committee member of the Ceylon Chamber of Commerce and serves on the Management Committee of the Mercantile Services Provident Society.

Palitha Pelpola

Director

Institute of Cost & Management Accountants
Part III

(Non-Executive Director) N

Appointed Director in April 2015. Mr Palitha Pelpola is currently the Presidential Coordinating Secretary at the Ministry of Defense while being Chairman of Ceybank Asset Management Limited. He also served as Private Secretary to His Excellency the President from January 2015 to November 2015.

Mr Pelpola has also served the Government of Sri Lanka in the capacities of the Private Secretary to the Minister of Mahaweli Development and Lands & Land Development, Managing Director of Mahaweli Economic Agency, Director of Mahaweli Centre, Special Advisor to the Minister of Plantation Industries and Director General of Mahaweli Authority of Sri Lanka. He has also served as Secretary to the Leader of the Opposition when the late Mr Gamini Dissanayake held that position.

He was the former Chief Executive Officer of Leader Publications Ltd and was the Media Consultant of the World Health

Organization. Mr Palitha Pelpola was also the Senior Advisor of the Ministry of Enterprise Development & Investment Promotion and he has also worked as Executive Director of the Sri Lanka Foundation, Los Angeles, California, USA.

Duliksha Soosaipillai

Director

FCA (Sri Lanka),

FCMA (Sri Lanka)

(Non-Executive Director) R

Appointed Director in April 2015. Mr D Soosaipillai is a fellow of the Institute of the Chartered Accountants of Sri Lanka and a fellow of the Institute of Certified Management Accountants of Sri Lanka.

He is an Independent Non-Executive Director of Commercial Credit and Finance PLC, where he also functions as Chairman of the Board Audit Committee and the Board Executive Committee and Member of the Board Integrated Risk Management Committee.

Mr Soosaipillai has over 30 years of experience in Financial Services and in Risk Management and Compliance, both at the operational and strategic levels. He was engaged by the World Bank as a Short Term Consultant on a Payables Assessment assignment in the Maldives as part of a wider Public Finance Management project in 2012. Mr Soosaipillai also served as the Managing Director of the Maldives Finance Leasing Company (Pvt) Limited for more than 7 years and as the Chief Executive Officer of Ceylease Financial Services Ltd – a subsidiary of the Bank of Ceylon. More recently, he has also served as the Chief Operating Officer of Dunamis Capital PLC, the holding Company of the First Capital

H Member of HR & Remuneration Committee

N Member of Nomination Committee

R Member of Board Integrated Risk Management Committee

A Member of Audit Committee

Group of Companies and the Kelsey Group of Companies.

Nilanth de Silva *Director*

Diploma in Banking (Chartered Institute of Bankers, London, UK)

(Non-Executive Director) 

Appointed Director in April 2015. Mr A N de Silva counts over 40 years of experience in commercial banking. He successfully completed the final examinations of the Chartered Institute of Bankers, London, in 1978 and was consequently elected an Associate of this Institute.

He functioned as the Chief Operating Officer of Union Bank of Colombo PLC from which he retired after 11 & 1/2 years' service, on 31 March 2015. He was also its Acting Chief Executive Officer for approximately 2 years between 2008 & 2010.

Prior to joining Union Bank, he was with Hatton National Bank for 29 years up to August 2003 and was Deputy General Manager - Corporate Banking and a member of all key Committees. He played a leading role in establishing HNB's Credit Risk Division and also compiled the Bank's Credit Manual. He has received extensive training and exposure in banking and management both locally and overseas at institutions such as Dresdner Bank, Germany, National Institute of Bank Management, Pune, India, Centre for Financial Engineering in Development, Washington DC USA, Monash University Mt. Eliza Campus, Melbourne, Australia. He also participated in a study tour of the South African Banking System with the Institute of Bankers, South Africa.

Mr de Silva was also actively involved in HNB's take-over of Indosuez Bank and Habib Bank AG Zurich.

He is a Director of Malwatte Valley Plantation PLC and Holco (Ceylon) (Private) Ltd. He is also a past Director of Lanka Clear (Pvt) Ltd and an alternate Director of the Credit Information Bureau of Sri Lanka.

K A L Thushari Ranaweera (Mrs) *Company Secretary*

*Attorney at Law,
Master's Degree in Law (LLM) - University of Cambridge, United Kingdom.,
Diploma in International Affairs - Bandaranaike Centre for International Studies, Sri Lanka*

Appointed Company Secretary on 2nd January 2012. She is also the Deputy General Manager - Legal of the Bank. Mrs Ranaweera joined the Bank on 7th October 2010 and counts over 26 years of experience in the field of Banking.

Corporate Management



Jonathan Alles

M.B.A. - Finance (Stirling), A.I.B. (Sri Lanka)
Managing Director/Chief Executive Officer



Dilshan Rodrigo

M.B.A. (Cranfield), F.C.M.A.(UK), F.C.C.A. (UK)
Chief Operating Officer



Ruvini Thenabadu

F.C.I.B. (London), F.C.M.A.(UK), C.G.M.A. (UK)
Deputy General Manager - Credit & Transaction Banking



Thushari Ranaweera

Attorney at Law, LL.M. (Cambridge), Dip. in Int'l Affairs (BCIS)
Deputy General Manager - Legal/Company Secretary



Thimal Perera

A.C.A. (Sri Lanka)
Deputy General Manager - Retail & SME Banking



Kalum Wijesooriya

LL.B (Sri Lanka)
Assistant General Manager - Deposits & Remittances



Sidath Wijeratne

M.B.A. (Sri J.), B.Sc. (IT) - UK
Chief Digital Officer



Ruwan Manatunga

F.C.M.A. (UK), C.G.M.A.(UK), A.C.A. (Sri Lanka)
Deputy General Manager - Corporate Banking



Chiranthi Cooray

M.B.A. (Wales), S.C.P. SHRM (USA), I.P.M.A. - CP (USA)
Chief Human Resource Officer/Deputy General Manager-HR



Jude Fernando

M.B.A. (Sri J), A.I.B. (Sri Lanka)
Assistant General Manager (SME)



Asanga Uduwela

M.B.A. (Sri J), B.Sc. Special (Pera.)
Assistant General Manager (Operations)



Niroshana Seneviratne

*F.C.A. (Sri Lanka), F.I.B. (Sri Lanka),
C.P.A. (Sri Lanka), C.I.S.A. (USA)*
Chief Internal Auditor



Damith Pallewatte

M.B.A. (Sri J), B.Sc. Mgmt. (Hons.) London School of Economics, F.R.M. (GARP), A.C.I
Chief Risk Officer/Assistant General Manager - Risk



Arjuna Abeygunasekara

*M.B.A. (Colombo), B.Sc. (Colombo), A.C.M.A. (UK),
C.G.M.A., A.C.I*
Assistant General Manager - Treasury & Markets



Anusha Gallage

*M.B.A. (Sri J), B.B.A. (Special) - Colombo, A.C.M.A. (UK),
C.G.M.A., C.P.A. (Australia), Dip. in Commerce (Uni of PNG),
I.C.A. - Licentiate*
Assistant General Manager - Finance



Nirosh Perera

M.B.A. (Manipal), Dip. in Marketing - L.B.S. (Sri Lanka)
Assistant General Manager - Network Management



Rajive Dissanayake

B.B.A. (Colombo), C.F.A. (USA), F.C.M.A.(UK), C.G.M.A. (UK)
Assistant General Manager - Strategy/Chief Strategy Officer



Janaka Epasinghe

M.B.A. (Edith Cowan), A.I.B. (SL), P.M.P.
Assistant General Manager - Services

Senior Management



Rajini Prabhakaran

A.I.B. (Sri Lanka)

Chief Manager - Treasury Operations



Nirosini Wettasinha

Attorney-at-Law & Notary Public

Chief Manager - Legal



Krishani Balasubramaniam

LL.B (Sri Lanka)

Chief Manager - Human Resource Management



Mangala Wickramasinghe

M.B.A. - IT (Moratuwa), M.Sc. (Colombo), B.Sc. (Pera.)

Head of Electronic Delivery Channels



Chandana Panditharatne

Chief Manager - Procurement & Logistics



Ayanthi Fernando

Chief Manager - Corporate Banking



Chammya Weerasinghe

M.B.A. (Sri J), M.C.I.M. (UK)

Head of Marketing



Janath Ilangantileke

*M.B.A. (Manipal), B.A. (Hons) - Northumbria (UK),
A.I.B. (Sri Lanka), A.C.M.A. (UK), C.G.M.A. (UK),
C.P.A. (Australia)*

Chief Manager - Trade Services/Head of Trade Services



Hisham Ally

M.I.M. (Sri Lanka)

Head of Islamic Banking



Viraj Mendis

Head of Personal Financial Services



Dammiye Dissanayake

Chief Manager - Colombo Region



Prasad Bastiansz

M.B.C.S. (UK), C.I.T.P.

Chief Manager - Payment Systems

**Ruwan Bakmedeniya**

M.Sc. (IT), Uni. of Keele - UK
Head of Information Technology

**Radhakrishnan Maheswaran**

Regional Head - North Western Region

**Jagath Rupasinghe**

Senior Manager - Systems Implementation

**Fazal Mohamed**

M.Sc. (IT), (Uni. of Keele) - UK
Senior Manager - Systems Security & Compliance

**Indrajith Senadhira**

*M.B.A. (Sri J), M.A.L.S. (Colombo), LL.B (Sri Lanka),
Attorney-at-Law, Dip in Mkt. (S.L.I.D.A.),
Dip in Cr. Mgmt. (S.L.I.C.M.)*
Senior Manager - Human Resources Management

**Neil Rasiah**

*M.B.A. - Finance (USQ), M.A. - Fin. Econ. (Colombo)
B.Sc. (Colombo) A.I.B. (Sri Lanka), Dip. in Int. Trade (IBSL)*
Regional Head - Greater Colombo Region

**Candiah Jegarajah**

A.I.B. (Sri Lanka), C.I.M.A. Adv. Dip. M.A.
Regional Head - Eastern Region

**Thusitha Ediriweera**

*M.B.A (UK), LL.B (Sri Lanka), Attorney-at-Law,
Notary Public & Commissioner for Oaths,
M.C.I.C.M. (UK), F.I.C.M. (Sri Lanka)*
Senior Manager - Legal (Recoveries)

**Murtaza Normanbhoy**

A.C.A. (Sri Lanka), A.C.M.A. (Sri Lanka)
Senior Manager - Internal Audit

**Sisira Atapattu**

Senior Manager - City Office

**Nishantha Weerasinghe**

Senior Manager - Head Office Branch

**Manori Mohotti**

*Attorney-at-Law, Notary Public
& Commissioner for Oaths.*
Senior Manager - Legal

Senior Management

**Guhadas Thivakaran**

Senior Manager - Credit Supervision & Recoveries

**Saumya Aryasinha**

Deputy Regional Head - Colombo Region

**Sivarajah Nandakumar***M.B.A. (Sri J), A.I.B. (Sri Lanka)*
Head of Private Banking**Kailaivasan Indravasan***M.B.A. - Finance (USQ), C.M.A. (Australia),
A.I.B. (Sri Lanka)*
Regional Head - Northern Region**Subram Parameshwaran***M.B.C.S. (UK)*
Senior Manager - IT Operations**Kushan Jayasuriya***M.B.A. (Colombo), B.Sc. (Colombo), A.C.M.A. (UK)*
Senior Manager - Market Risk & Special Projects**Supun Dias***Dip in Marketing (U.K.), M.C.I.M. (UK),
M.S.L.I.M, Chartered Marketer*
Head of Business Development**Mohini Seneviratne***B.A. (Hons.) - Uni. of Sussex (UK)*
Head of Compliance**Upul Hettiarachchi***M.B.A. (Manipal), N.D.H.R.M. (I.P.M.)*
Regional Head - South Western Region**Vinodh Fernando**

Regional Head - North Central Region

**Ajith Ferdinando**

Senior Manager - Centralized Operations

**Indrajith Hapuarachchi***M.B.A (Manipal), B.Sc. - IT (Colombo), A.C.S.*
Senior Manager - IT Strategy & Solutioning

**Neluka Fernando**

Senior Manager - Centralized Trade Processing

**Shiral Perera**

Deputy Regional Head - North Western Region

**Sheran Perera***M.B.A. (Buckinghamshire), A.I.B. (Sri Lanka)*
Regional Head - Uva Sabaragamuwa Region**Priyantha Seneviratne***A.C.I.*
Senior Manager - Treasury (Corporate Sales)**Kanchana Karunagama***M.B.A. (Sri J), A.I.B. (SL), M.C.I.M. (UK), A.I.C.M. (SL)*
Senior Manager - Personal Financial Services**Rajith Gunasekera**

Senior Manager - System Support

**Vishwanath Gunawardena**

Senior Manager - Development Banking

**Prashantha Hewapathirana***M.I.E.T. (UK), MASHRAE, C.G.M.P., PG. DIP. in B.M.A.*
Senior Manager - Premises & Engineering**Vijaya Vidyasagara***M.B.A - Finance (Colombo), A.I.B (Sri Lanka)*
Senior Corporate Relationship Manager**Sampath Kukulewithana***M.B.A (Manipal), Dip. in Marketing (UK)*
Regional Head - Southern Region**Dilunika Jayasinghe***M.B.A (USQ), B.Sc. (Colombo), A.C.A (Sri Lanka)*
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Senior Manager - Strategic Planning

Management Discussion & Analysis

Introduction

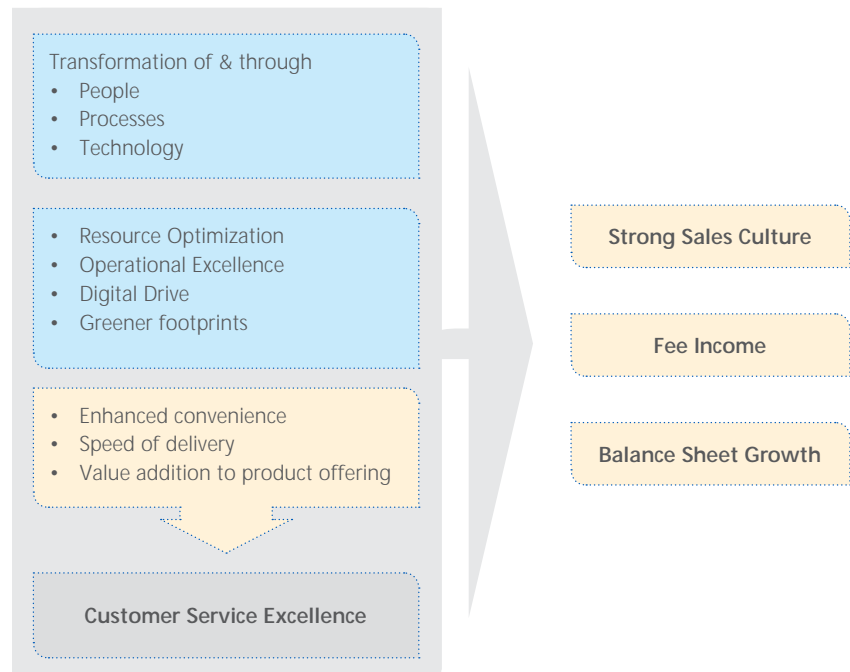
The Bank’s strategic focus in reaching for its Vision, Mission and Objectives continued to be driven by seven strategic pillars for 2015-2017 as enumerated last year. HNB has now begun to harvest the rewards of these strategic initiatives which have been driven by People, Technology and Processes; transforming the Bank to become a “Game Changer” in the industry. The initiatives, in keeping with the Bank’s Triple Bottom Line approach in business, have begun to impact not just its financial capital but Human, Social, Natural, Manufactured and Intellectual capital as presented in the ensuing capital reports as well as the Reviews of Businesses.

As we outlined last year, following a review and analysis of its internal processes and operations, the Bank began a re-engineering of its business processes in 2013. Realising the value of these initiatives for the Bank’s sustained leadership in evolving market conditions, it then established a dedicated change management unit. This unit has been driving the Business Process Re-engineering activities of the Bank and the initiatives during 2013-2016 have begun to enable a more optimal allocation and utilisation of resources on the one hand, and simultaneously, make giant strides in

the Bank’s journey towards customer service excellence on the other. The diagram below illustrates in summary, how this journey of transformation now contributes to achieving the Bank’s key strategic objectives.

The year under review saw the fine tuning and expansion of the initiatives for sustained impact. For example, the Branch Target Operating Model (BTOMS) was extended to look at the efficiencies within each branch, whilst the centralisation of the Bank’s retail credit processing which was completed in 2015 was reviewed to further enhance

Strategic Journey



Management Discussion & Analysis

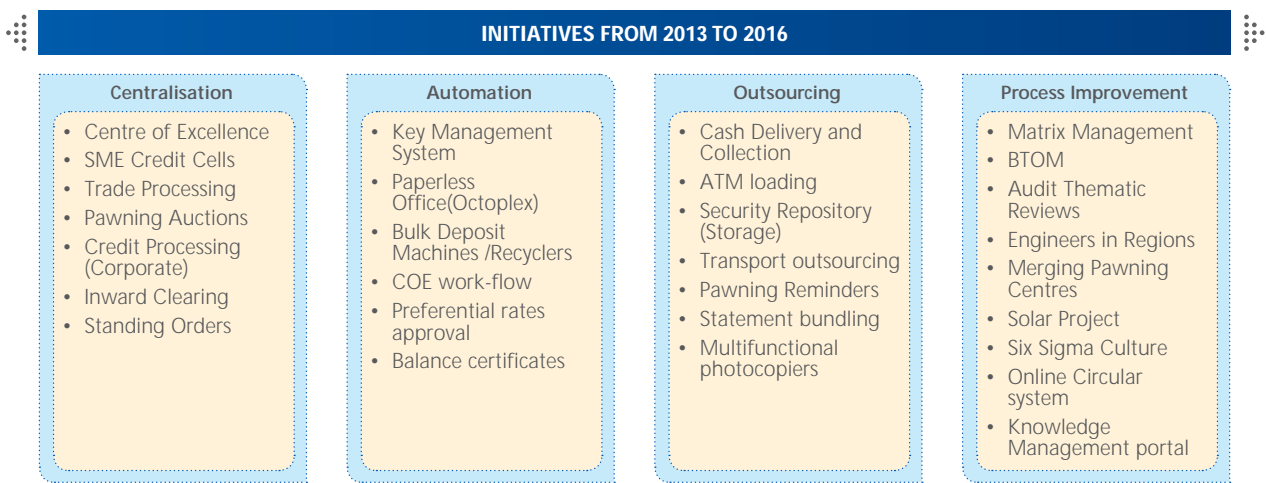
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efficiency and ergonomic factors at the central processing locations. Moreover, recognising the need to sustain and build on these achievements into the future and to instill a change in mindsets across the Group; the year under review saw the Bank establish systems, processes and tools towards this end. These included Six Sigma Yellow belt and Lean Management training,

and 5 S, which would provide a platform for HNB to continue to evolve, in alignment with its Triple Bottom Line objectives.

A Game Changing journey will continue to be driven by our people, and led by technology for enhancing value creation for all our stakeholders and for a triple bottom line impact. The Bank's key People initiatives

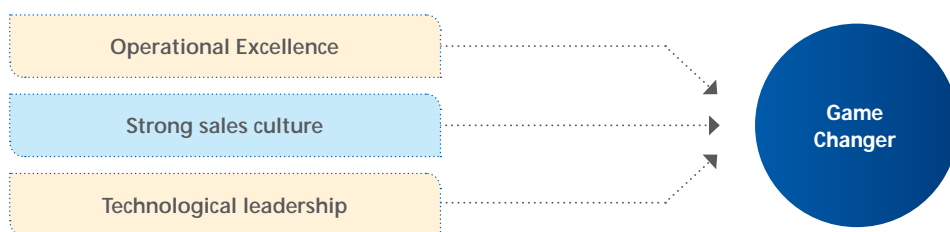
are enumerated in the MD's message and the ensuing Human Capital report. The process improvement initiatives during 2013 – 2016 are given in the diagram below.



During the year under review, the Bank also initiated an exercise to formulate Strategic Plan 2020, involving the top 100 executives of the Bank who followed a rigorous process of discussions and workshops to determine the best way forward towards year 2020 and beyond. The outcome of this process was the prioritisation of the 9 focus areas

depicted in page 38, which were derived from the seven pillars strategic framework of the Bank. These focus areas will be driven through cross functional teams with much more vigour as these are strategic imperatives to achieve the Bank's 2020 vision.

Geared up to Change the Game



Management Discussion & Analysis

A sustainable strategy

The strategic focus areas depicted below reflect the Bank's concentration on the long term sustainability of its profitability and industry leadership. The nine focus areas are on a bedrock of strong corporate governance standards, a risk management and compliance framework; with a talented and engaged team being the enabler and driver of these strategic imperatives. These cornerstones of our strategic platform have nurtured the key attributes of brand HNB - trust, strength, stability and a culture of sustainability. How the corporate governance and risk frameworks at HNB play a key role in creating and sustaining this culture are in the ensuing risk and governance sections of this report.

The Board continues to provide important leadership in the strategic planning process and in monitoring the strategic objectives by asking the right questions and facilitating the required resources. In addition to incorporation of triple bottom line objectives to our strategies, the Bank's Risk Committee

"...long term profitability ultimately depends on how favourably we impact communities and environment of which it is part. Thus arises the need for an enterprise to expand its focus beyond profit to encompass the other two bottom lines that it invariably impacts – people and the planet"

Jonathan Alles
MD/CEO

oversees the Bank's sustainability strategy and its implementation. The Sustainability Committee comprises key functional heads and is administratively responsible for driving sustainability initiatives and reports directly to the Managing Director/CEO. The committee also acts as the think tank in developing the Bank's sustainability agenda, proactively evaluating decisions that impact on the reputation, ethics and values of the Bank; establishing standards for meeting sustainability principles and overseeing progress across the strategic CSR pillars of education, health, entrepreneurship and environment.

In addition, the HNB Sustainability Foundation established in 2009, actions the Bank's social responsibility agenda. The Foundation initiates social projects which are in turn implemented by the Bank and these are discussed in the ensuing social and natural capital reports. Whilst the Managing Director/CEO acts as its chairman, the trustees include the Senior Independent Director, Chief Operating Officer, Deputy General Manager - Credit & Transaction Banking, Chief Human Resource Officer, Assistant General Manager - Finance and the Chief Manager - Legal.



Our material issues

Our material issues are those issues that we believe could seriously affect our commercial viability and our social relevance. These include factors influencing economic growth and political and social stability, and those which impact on how our stakeholders perceive the Bank and its role in society. Effectively managing our material issues is critical to achieving our strategic objectives and meeting our stakeholders' expectations.

Following the engagement with certain internal and external stakeholders that was commenced in 2015, we revisited our material issues. The materiality determination process complemented our day-to-day stakeholder engagements,

going beyond these engagements to place particular emphasis on aspects that are likely to influence the social, economic and physical environments in which we operate.

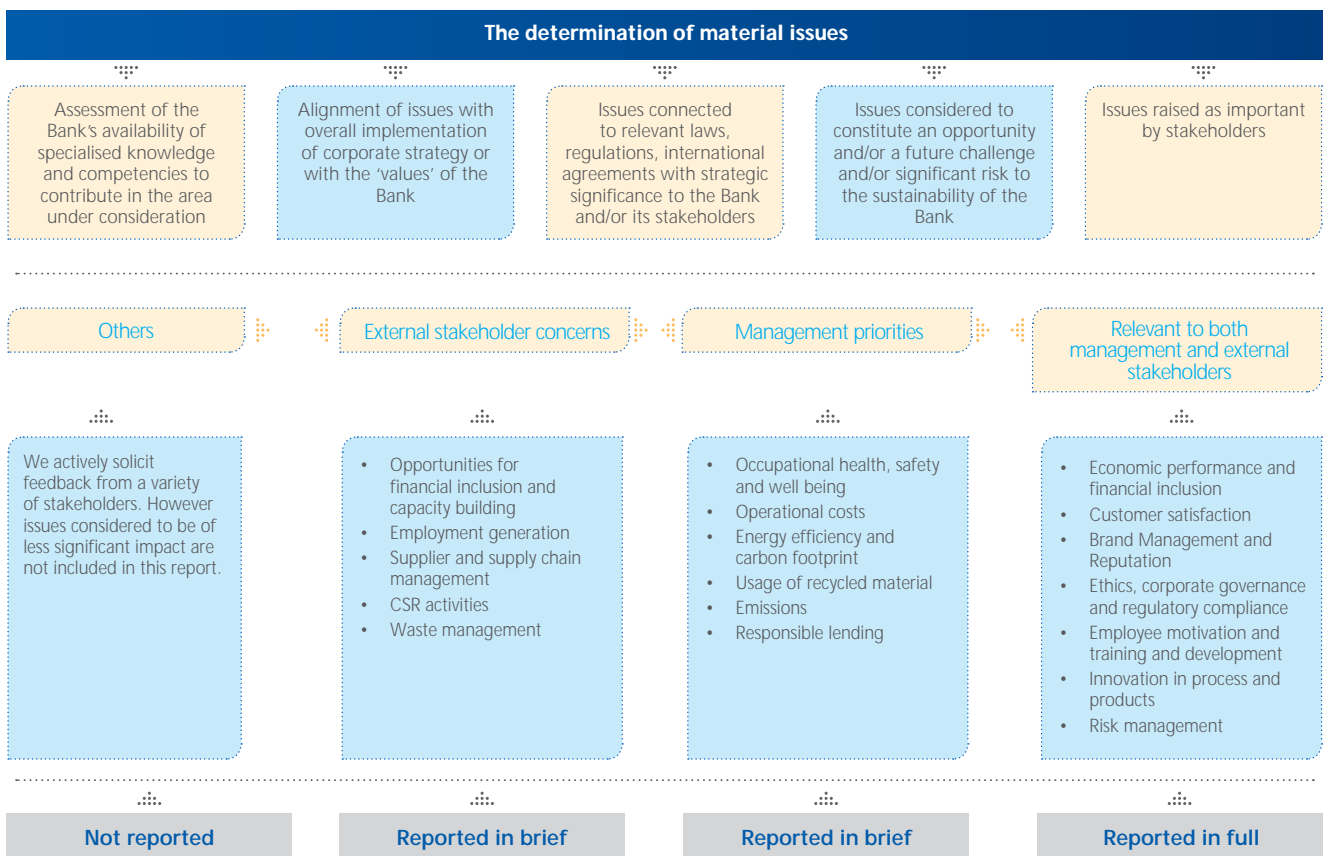
We view the materiality determination process as a business tool that facilitates integrated thinking, and as such the pragmatic approach which was developed during the year will serve as a basis for future materiality assessments.

Our proactive engagement with our stakeholders feeds our business strategy and material issues, shapes our products and services, helps us manage and respond to social expectations, mitigates reputational

risk and influences our operating environment.

Business units and enabling functions are empowered to engage directly with stakeholders and are responsible for identifying stakeholder concerns and taking appropriate action. Strategic engagement at a Bank level, is undertaken through planned interventions by nominated teams based on the identified needs and concerns of our stakeholders.

Material issues identified through the above processes could be condensed into the following topics and have been reported in full in this annual report.



Management Discussion & Analysis

Our Material Issues & Stakeholder Engagement

Balancing financial and non-financial expectations

The materiality analysis carried out during 2015 and 2016 indicated that the Bank's stakeholders were interested in both financial and non-financial issues. Whilst some aspects have shown shift in priorities the core focus areas remained the same. These areas are reported under seven broad headings.

1. Economic performance and financial inclusion
2. Customer satisfaction
3. Brand management and reputation
4. Ethics, corporate governance and regulatory compliance
5. Employee motivation and training and development
6. Innovation in process and products
7. Risk management

HNB firmly believes that banks are an indispensable part of a productive national economy and uses its core capabilities to support sustainable economic growth. Access to financial services and entrepreneur development help deliver sustainable improvements over time. Customer satisfaction and brand management are important topics for all stakeholders. This includes aspects such as usability and accessibility of products and services, customer privacy, responsible lending, communications and trust which are also important to maintain the Bank's reputation. Ethics, corporate governance and regulatory compliance play a vital role in ensuring sustainable performance whilst prudent risk management ensures maintenance of asset quality. Sustainable performance cannot be maintained without talented and engaged people. In a competitive industry, innovation

and customer centricity are keys to achieving business results.

The Bank has strived to strike a balance, taking into account the varying interests and expectations of different stakeholders, to make decisions that are best for all involved. Performance against material issues are reported using performance indicators prescribed by the Global Reporting Initiatives (GRI).

Material Topics	GRI G4 Material Aspects	GRI G4 Disclosures / Indicators
Economic performance and financial inclusion	<ul style="list-style-type: none"> • Economic Performance • Indirect Economic Impacts • Procurement Practices • Product Portfolio 	<ul style="list-style-type: none"> • EC1,2 3,4 • EC7 • EC9 • FS6,7,8
Customer satisfaction	<ul style="list-style-type: none"> • Product and Service Labelling • Customer Privacy 	<ul style="list-style-type: none"> • PR3,4, 5 • PR8
Brand management / reputation	<ul style="list-style-type: none"> • Marketing Communications • Anti Competitive Behaviour • Grievance Mechanism for Impact on Society • Local Community 	<ul style="list-style-type: none"> • PR6,7 • SO7 • SO11 • SO1, FS13,14
Ethics, corporate governance and regulatory compliance (Governance Structure and Composition, Setting Purpose, Values, and Strategy, Evaluating Economic, Environmental and Social Performance Competencies and Performance Evaluation – (G4 34-52, G4 56-58)	<ul style="list-style-type: none"> • Compliance • Grievance Mechanisms • Diversity and Equal Opportunity • Anti Corruption • Audits 	<ul style="list-style-type: none"> • EN29, PR 9, SO8, • HR 12 • LA12 • SO3,4,5 • Disclosure of management approach
Employee motivation and training and development	<ul style="list-style-type: none"> • Employment • Occupational Health and Safety • Training and Education • Labour Practices Grievance Mechanisms • Freedom of Association and Collective Bargaining 	<ul style="list-style-type: none"> • LA1 • LA 6 • LA 9,10,11 • LA 16 • HR 4
Innovation in process and products	Aspects not presently available under GRI G4	Disclosure of management approach
Risk management	<ul style="list-style-type: none"> • Risk management 	<ul style="list-style-type: none"> • G4 - 2, G4 - 45-47

Responding to our stakeholders

At HNB we believe that stakeholder engagement is a strategic activity that is core to creating a sustainable business and promoting good governance. Thus, connecting with our many and varied stakeholders is a vital aspect of our operations. Maintaining an open and constructive dialogue with our stakeholders helps us understand expectations and contributes to risk management, learning

and innovation. It also helps us to identify emerging issues and opportunities for creating new products and services and improving our performance.

We interact with a diverse range of stakeholders but given the criticality of only certain stakeholders to direct business function we choose to have a robust and consistent engagement process. Based on

the materiality and stakeholder engagement initiatives carried out in 2015 and 2016 internally, and with external consultants namely M/s Ernst & Young and M/s Perpetual Solutions there are changes in the scope and accept boundary from the previous report. We have summarised the issues raised by our key stakeholders and our responses to them in the ensuing pages.



Management Discussion & Analysis

Our Material Issues & Stakeholder Engagement

Investors



Sustainable Business Objectives

- To inspire investor confidence by balancing profitability and sustainable business objectives
- To deliver returns on investment by reinvesting earnings and strengthening governance to support future growth momentum
- To establish strong internal processes and policies to combat financial crime and poor quality lending

Reasons for Engagement

- To review business performance against targets and benchmarks
- To identify performance drivers, opportunities and risks
- To review shareholder returns
- To provide assurance on regulatory and statutory compliance

Channels of Communication

- Annual general meeting
- Investor forums
- Investor feedback forms (Ongoing)
- Publications and announcements on performance, launch of new products, services and banking access (When required)
- Access to management via email/telephone (Ongoing)

Key Topics/Issues Raised

- Increasing shareholder returns and growth
- Performance drivers and business continuity
- Share price and dividends
- Strength of governance mechanisms

Our Responses/Achievements

- Dividends of Rs 3.5 Bn declared for 2016
- Dedicated investor relations team
- Investments in technology to position the Bank at the helm of digital delivery
- Inculcation of a sales driven culture
- Business process re-engineering, productivity improvement and cost optimisation initiatives

Customers



Sustainable Business Objectives

- To treat customers fairly and safeguard their interests
- To deliver quality service with passion and dedication
- To be a responsible lender and comply with all regulatory and statutory obligations
- To make finance more accessible
- To promote financial literacy

Reasons for Engagement

- To understand customer needs and expectations
- To obtain feedback on the Bank's products, service quality, reach and brand perception
- To ascertain information for KYC requirements
- To foster better awareness of product and service features and terms and conditions

Channels of Communication

- Monthly/quarterly customer meetings and customer visits/site visits
- Annual site visits to factories, project sites and corporate establishments
- Daily interaction via 251 customer centres located across the country
- Customer surveys
- Formal complaint management process and a centralised dedicated unit to manage and resolve customer complaints, headed by a customer experience officer
- Suggestion boxes at every customer centre
- Feedback form on website
- Access to Financial Ombudsman

Key Topics/Issues Raised

- Access and reach
- Products and service offering
- Greater customer convenience
- Relationship management
- Investment returns and cost of borrowing
- Compliance

Our Responses/Achievements

- Board approved customer charter
- Multi channel distribution strategy for ease of access, physical presence at 251 locations across Sri Lanka and 485 ATMs
- Special provisions for senior citizens and access for the disabled

Management Discussion & Analysis

Our Material Issues & Stakeholder Engagement

Employees



Sustainable Business Objectives

- To foster a diverse talent pool driven to deliver superior, goal-oriented performance in a sustainable manner
- To ensure workforce productivity in line with corporate values and effective worklife balance
- To establish a leadership pipeline
- To position HNB as an employer of choice amongst all generational typologies
- Stability, security and equal opportunity to all our employees

Reasons for Engagement

- To create two-way relationships that inculcate team spirit
- To enhance employees' skills and competencies through training and inspired leadership
- To preserve the psychological contract that exists within an employer-employee partnership
- Hear the voice of employees

Channels of Communication

- Open door policy
- Monthly Town Hall meetings.
- HR roadshows
- CEO's annual strategy presentation and monthly email "From the CEO's Desk"
- Weekly divisional heads meetings, monthly corporate management meetings, and quarterly strategic plan review meetings
- Quarterly In-house magazine 'Hatna Mag', Weekly circulars, daily emails notifications
- Employee engagement surveys
- HR service days (Monthly)
- One to one meetings (as required)
- Structured career conversations (annual/biannual/need based)
- Exit interviews upon resignation

Key Topics/Issues Raised

- Robust talent management system to recruit and retain best talent
- Ensuring compliance with governance policies, codes of best practice and conduct
- More direct access to employees from all regions
- Manage diverse aspirations of a multigenerational workforce

Our Responses/Achievements

- Ensuring value alignment and building a compliant workforce of professional bankers
- Future ready and tech savvy service providers through up-skilling and multi-skilling
- Transforming HR from a service provider to business partner and strategic value creator
- Facilitating a culture of virtual learning across the Bank through cutting edge on demand learning delivery
- Superior rewards for superior performance
- Efficient, productive and healthy workforce

Suppliers



Sustainable Business Objectives

- To deeply embed social, ethical and environmental considerations into how we evaluate and select our suppliers.
- To balance cost considerations with sustainable procurement practices

Reasons for Engagement

- To focus on mutually beneficial, long-lasting relationships
- To foster mutual trust, transparency and accountability

Channels of Communication

- Registration of suppliers and feedback evaluations
- Regular supplier reviews for quality of goods/services and pricing
- Monthly procurement committee meetings
- Green audits (as required)

Key Topics/Issues Raised

- Formal system for handling appeals and other grievances
- Support micro and SME suppliers
- Support and guidance to become sustainable businesses

Our Responses/Achievements

- Two committees to address supplier issues
- Over 60% of the Bank's suppliers are from the SME and micro category of suppliers
- Workshops on sustainable business practices and guidance on implementation (as required)

Management Discussion & Analysis

Our Material Issues & Stakeholder Engagement

Community & Environment



Sustainable Business Objectives

- To engage with the community at every level to foster community development
- To act as a catalyst for positive change through action in healthcare, education and entrepreneurship
- To promote environmental conservation at the work place through the Green Pledge
- To promote responsible lending practices through green banking and green procurement
- To implement an environmental management system

Reasons for Engagement

- To create sustainable, self sufficient communities through education, micro financing, entrepreneurial assistance and health
- To ensure a sustainable planet through conservation and preservation of the environment by introducing best practices

Channels of Communication

- Employee involvement in local community projects (ongoing)
- Continuous dialogue through a network of customer centres (daily)
- Visits by field officers to rural, fishing and farmer communities (ongoing)
- Visits to community leaders, village schools, places of worship and markets
- Efficiency meetings (monthly)
- Site visits and annual reviews of facilities
- Consultancy audits (as needed)

Key Topics/Issues Raised

- Financial awareness and access to funds
- Links and connections to major supply chains for distribution
- Basic infrastructure such as health care, access roads and schools
- Climate change
- Energy conservation and reduction of carbon footprint

Our Responses/Achievements

- Gami Pubuduwa micro finance scheme to assist young entrepreneurs
- Provide agricultural expertise and basic financial skills
- Facilitate connections between rural entrepreneurs and the demand chain
- HNB Sustainability Foundation to focus on community development
- Lead and influence implementation of environmental best practices in the banking sector through the Sri Lanka Sustainable Finance Initiative
- Green buildings and energy efficiencies
- The Green Pledge taken by all staff, integrating environmentally friendly practices into daily operations
- Green banking and green procurement systems
- Tree planting and conservation initiatives
- Systematic implementation of the paperless office concept

Regulator



Sustainable Business Objectives

- To engage constructively with the government and regulators who determine our operating environment and provide us with the legal licence to operate

Reasons for Engagement

- Regulators demonstrate an understanding of the operating environment of the industry and the current and emerging issues that affect the sector
- Obtain feedback on continuous improvement strategies to reduce the costs of compliance

Channels of Communication

- Targeted consultations on policy matters
- Regular meetings with staff and representatives of regulators
- Submissions to regulatory consultations
- Managing regulator reviews and examinations
- Participation in industry engagement/forums
- Hosting regulator delegations

Key Topics/Issues Raised

- Performance against standard
- Compliance with the regulatory framework

Our Responses/Achievements

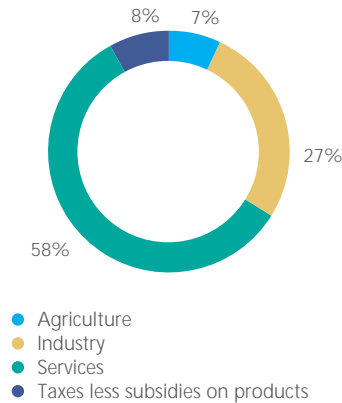
- Published policy and operational procedure for compliance
- Compliance training for employees
- Continued to build and strengthen relationships with regulators and policy makers through regular meetings with senior executives
- Continued open and constructive dialogue with regulators to ensure full understanding of their needs, expectations, and concerns, and to update them on the Bank's strategy and performance
- Continued strong preparation for periodic reviews and examinations undertaken by regulators as part of their normal supervision
- Provided submissions as required
- Working with industry bodies to develop and submit reporting codes
- Documented processes for collecting and acting on feedback received

Management Discussion & Analysis

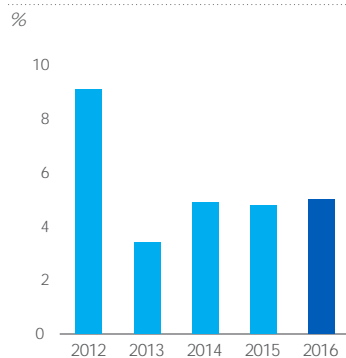
External Environment & Its Implications

GDP Growth

GDP Sectorwise Contribution



Real GDP Growth



2016

GDP growth during the first nine months of 2016 was at 4.0% yoy, propelled by growth in the industrial and service sectors which expanded by 5.7% and 4.8% respectively. Agriculture however experienced a contraction of 2.5% during this period.

The key growth drivers during the nine months to September were Financial Services (which grew by 14.1%), Construction (10.4%) and Wholesale & Retail Trade (4.5%). The contraction in tea, rice, spices, rubber as well as fishing activities arising from suppressed prices and to a lesser extent adverse weather were the key contributors to the contraction in the Agriculture sector. During the 5 year period from 2010 – 2015 the GDP (at constant prices) grew at a Compound Annual Growth Rate (CAGR) of 6.1%. Key sectors that have achieved significant growth over the 5 year period are manufacturing of food, beverage & tobacco products, Information Technology, financial services, growing of spices and animal production.

Outlook

The IMF projects Sri Lanka's GDP to have grown by 4.5% in 2016 and to grow by 4.8% in 2017 whilst the World Bank estimates Sri Lanka to grow by 5% in 2017 and by 5.1% in 2018. In comparison, the Central Bank states that growth will accelerate to 6.3% in 2017 from an estimated growth of around 5.0% in 2016 supported by expanding tourism, information technology, logistics and foreign investments. The Agriculture sector is expected to continue to be affected by adverse weather in the first half of 2017 as an impending drought and the Indian El Nino effect has been forecast by the government, hence resulting in only a marginal contribution to growth in GDP. The drought conditions are also likely to impact other areas of the economy such as food prices and the need for alternatives to hydro electricity in order to maintain the national power supply.

On the positive side, the projected higher growth-which reflects an upturn in economic activity, could lead to a rise in demand

for credit. We also expect infrastructure projects and investments inflows to gather momentum in 2017 as the political and economic environments become more stable. Higher growth in industries and infrastructure projects could spur growth in SME and project financing.

The Central Bank expects growth to increase to 7% in the medium term and this growth potential is envisaged mainly through productivity improvements supported by the adoption of new technology across production sectors. Investment activities are expected to continue a positive growth momentum in 2017, accounting for 30.9% of GDP, contributed by both government and private investment expenditure. Continuation of ongoing and planned infrastructure development projects including Colombo International Financial City and expressway developments, together with the development projects proposed by the Western Region Megapolis Project would contribute positively to improve the investments of the economy. Further, private investment activities are expected to continue its growth momentum supported by construction projects of residential condominium, commercial buildings, hotels etc. to absorb the increasing demand for such activities.

After a lacklustre outturn in the global economy in 2016, economic activity according to the IMF is projected to pick up pace in 2017 and 2018, especially in emerging market and developing economies. Thus, better growth prospects for the world economy, underpinned by higher growth in the U.S (by 2.5%), also augur well for brighter prospects for Sri Lanka and the region. The IMF projects the world economy to grow by 3.4% in 2017. However, there is a wide dispersion of possible outcomes around the projections, given uncertainty surrounding the policy stance of the new US administration and its global ramifications. The IMF expects greater clarity to emerge towards April 2017, on US policies and their implications for the global economy.

Impact to HNB

Slowdown in economic activity compared to the previous year, resulted in demand for credit being relatively lower. Nevertheless, HNB's loan book grew by 17.3% during the year.

Inflation

2016

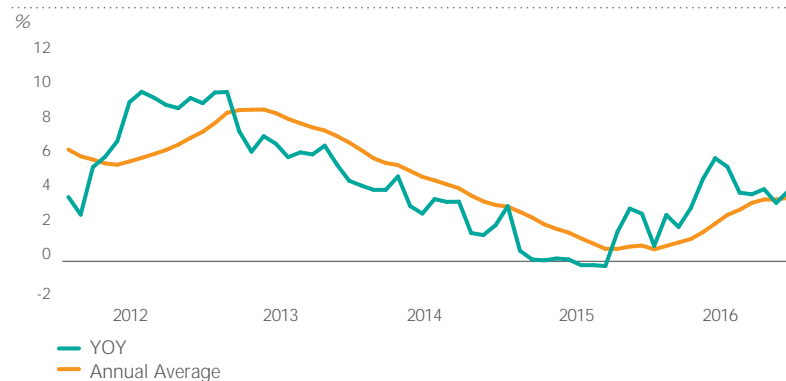
Inflation as measured by the National Consumer Price Index (NCPI) exhibited an increasing trend during the early part of the year and peaked between May – June reflecting the adverse weather conditions experienced. Inflation subsided towards the end of the year to read at 4.2% yoy in December, unchanged from the level experienced at the end of 2015.

Outlook

The low inflation trajectory that prevailed during the past several years is expected to be sustained in the medium term, mainly due to proactive policy measures taken through monetary tightening measures adopted by the Central Bank. Accordingly, the CBSL expects that inflation would be sustained in the range of 4 - 6% in the medium term, which is also consistent with

the inflation target bands stipulated under the Extended Fund Facility (EFF) Programme of the IMF. Nevertheless, the CBSL also cautions that supply shortages stemming from weather-related developments as well as shocks that could arise due to possible reversal of global commodity prices could cause temporary variations in price levels. In addition, the changes to the government tax structure could also elevate price levels whilst the Rupee which is expected to continue its depreciation against the USD will exert further upward pressure. We also expect pressure on purchasing power from the other tax proposals of the 2016 budget which are to be implemented from 1st April 2017, such as the significant increase in Employment (PAYE) Tax from 16% to 24%. Accordingly, the IMF projects Sri Lanka's inflation to edge slightly up to 5.1% in 2017.

Inflation Rate



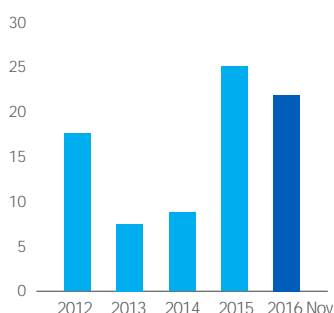
Impact to HNB

Despite inflation picking up during the year HNB was able to maintain controllable operations costs.

Monetary Policy

Private Sector Credit Growth

Annual % change



2016

The monetary policy tightening measures adopted early in the year resulted in a sharp upward pressure on both lending and deposit interest rates. The Average Weighted Prime lending Rate was at 11.52% as at end December 2016 in comparison to 7.53% in December 2015 whilst the Average Weighted Deposit Rate rose to 8.17% compared with 6.2% a year ago. The low interest rate regime which prevailed during 2014-2015 fuelled high

growth in private sector credit creating inflationary pressure, thus prompting CBSL to respond with monetary tightening. However, despite the increase in lending rates, private credit disbursements by commercial banks continued to grow beyond desired levels throughout the year before showing signs of slowing towards the latter part of 2016. Credit growth in November slowed to 21.1% compared with

Management Discussion & Analysis

External Environment & Its Implications

22% in October and displayed a fair decline from the peak of 28.5% observed in July.

Outlook

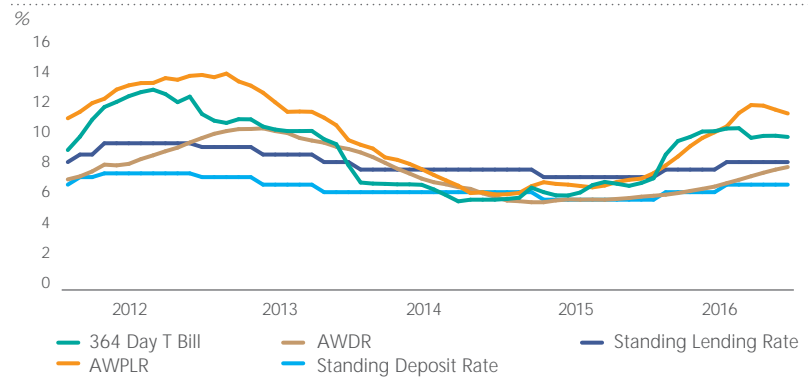
The CBSL expects the intended effects of the tightened monetary policy stance to be lagged and become apparent in 2017 with credit growth slowing down. It seems likely that interest rates would moderate over the medium term but remain at current levels or increase slightly during the year.

The United States Federal Reserves' policy stance will also be a key influence on Sri Lanka interest rates, as a rate hike in the US is likely to see an outflow of funds from emerging and frontier markets such as Sri Lanka, necessitating an increase in rates to attract foreign funds and a greater reliance on domestic financing which would lead to further upward pressure on rates.

Impact to HNB

The slower growth in GDP and the tightening of the monetary policy led to a drop in credit growth compared to the previous year. Nevertheless the tighter monetary policy enabled to record a 30.5% growth in NII and a sound growth in the bottom line.

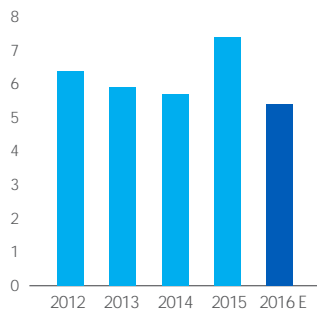
Interest Rate Movement



Fiscal Policy

Budget Deficit

as a % GDP



2016

The government's fiscal policy measures in 2016 were primarily aimed at increasing tax revenue and strengthening the fiscal consolidation process to reduce the budget deficit and the Debt to GDP ratio, and accordingly, the 2017 government budget included several proposals to raise government revenue mainly through increasing taxes.

The recurrent expenditure is expected to remain flat at 15% of GDP in 2017 while public investment is anticipated to increase to 5.2% of GDP in 2017 compared to 4.1% in 2016.

Overall budget deficit in 2017 is expected to improve to 4.6% from 5.4% in 2016.

Outlook

Total government revenue as a % of GDP is estimated at 13.5% for 2016 and expected to improve to 15.5% in 2017.

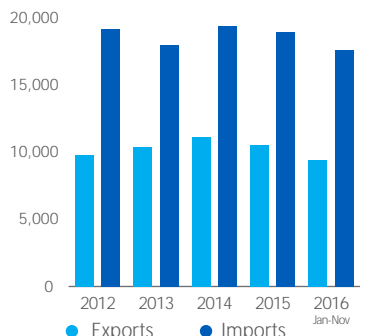
Impact to HNB

The increase in VAT charge during the year resulted in the VAT and NBT payment increasing by 54.7%. The income tax charge also increased by 30.4%, leading to a total tax of Rs 10.4 Bn for the year for the Bank.

External Sector

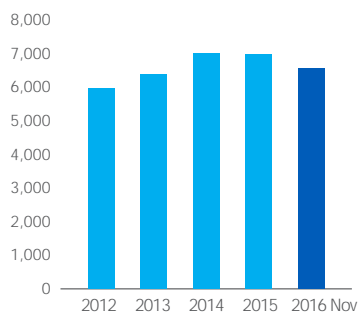
Imports and Exports

(USD Mn)



Worker Remittances

USD Mn



2016

The trade account continued to be under pressure as sluggish global economic activity affected exports, while an increase in consumer and investment imports fuelled growth in import expenditure. The cumulative deficit in the trade account, thus widened by 7.9% yoy as at November 2016. However, steady growth of 14% in earnings from tourism which reached USD 3.4 Bn by year end and the improvement in worker remittances by 3.7% to USD 7.2 Bn during the year enabled a better performance in the current account which as at the end of the first nine months of 2016 witnessed a contraction in deficit by USD 193 Mn. Inflows to the financial account moderated during the first half of 2016. The slow recovery in the global economy amidst the increase in policy rates in December 2015 by the United States (US) Federal Reserve and the anticipation of further rate hikes resulted in an outflow of foreign investments from the government securities market and the Colombo Stock Exchange (CSE), particularly during the first four months of the year.

The outflow of capital combined with a slowdown in exports and tepid foreign direct investment gave rise to an imbalance in the country's external sector and pressure on official reserves. This resulted in Sri Lanka entering into a three year programme of SDR 1.1 Bn (approximately USD 1.5 Bn) from the International Monetary Fund (IMF), under the Extended Fund Facility (EFF), to support the Balance of Payments (BOP) as well as the government's economic reform agenda. The resultant improvement in investor sentiment generated by the country entering into the programme with the IMF and a delay in a further rate hike in the US led to a reversal in the outflow from the government securities market from April 2016. This, together with the proceeds of the International Sovereign Bond (ISB) and the syndicated loans, strengthened the financial account. However the Gross Official Reserves of the country continued to fluctuate and as at the end of December

represented a decline from USD 7.3 Bn in 2015 to USD 6 Bn.

There was also considerable depreciation pressure on the rupee in 2016, particularly during the first four months of 2016. This was mainly due to continued outflows in terms of import expenditure, debt service payments and the unwinding of investments in the government securities market in the aftermath of the rate hike by the US Federal Reserve. The Central Bank intervened in the domestic foreign exchange market to ease the pressure on the exchange rate, particularly during the first four months of 2016. The Rupee depreciated against the US Dollar by 3.9% in 2016 to reach Rs. 149.75 per Dollar as at end December 2016

Outlook

The external sector performance is expected to improve gradually in 2017. The balance of payments is expected to improve in 2017 with the expected positive effects of the IMF's EFF programme, which aims at supporting the BOP position and the economic reform agenda of the government. Accordingly international reserves are expected to rise to US Dollars 7.6 billion in 2017. However, sluggish global growth and continuation of weak global demand, possible increase in oil prices, expected rate hikes in the US and lower than expected growth in FDI and workers' remittances remain as downside risks to the envisaged path of external sector developments.

Export earnings are projected to increase by 9.6% in 2017 with the expected improved economic conditions in the global economy and improvements in trade relations with main trading partners.

As per the World Trade Organization (WTO) forecast in April 2016, the volume of world merchandise trade is expected to increase by 3.6% in 2017. Import expenditure is projected to grow at 7.1% in 2017 mainly due to expected higher commodity prices

Management Discussion & Analysis

External Environment & Its Implications

in the international market, particularly petroleum prices. Further, Sri Lanka's import volumes are also expected to increase in 2017 to support the higher level of domestic economic activity. Accordingly, Sri Lanka's trade deficit, which is expected to expand by 4.2%, year-on-year, is estimated to be around 9.9% of GDP in 2017.

Workers' remittances are expected to record a moderate growth in 2017. The growth in remittances would be supported by the

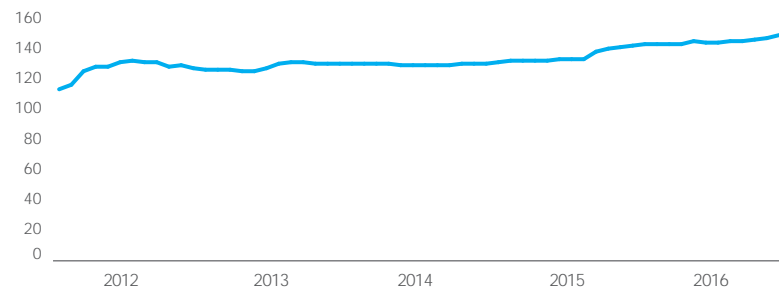
compositional shift in foreign employment with higher contribution from professional employment categories. Meanwhile, the fall in migration under the unskilled category amidst the backdrop of policies aimed at discouraging female migration under these categories and economic stagnation in the Middle Eastern countries, would adversely impact workers' remittances. A modest depreciation against the US dollar is expected to continue in 2017.

Impact to HNB

Despite the overall drop in international trade experienced during the year, the Bank was successful in recording a 9% growth in fee income from trade. The exchange income of the Bank improved by 25% due to volatility and depreciation of the rupee while worker remittances recorded a growth of 12.2%, which is above the industry growth.

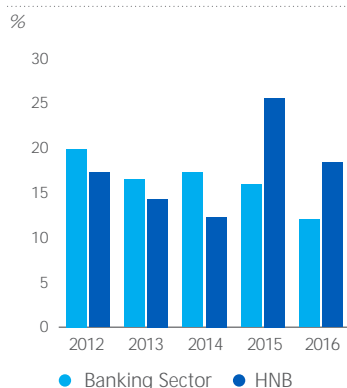
Exchange Rate Movement

LKR/USD



The Banking Industry

Asset Growth



The Banking Industry

The banking system continued its growth momentum while maintaining capital and liquidity well above the regulatory minimum requirements. Total loans rose by 17.5% to Rs 5,541 Bn as at end 2016, driven by increased lending by banks to the private sector. A notable increase in loans and advances was observed in major sectors such as construction, financial and business services, consumption and manufacturing while a decline was reported in the infrastructure sector. This growth in credit led to an increase of 12% in banking sector assets to reach Rs 9,047 Bn as at end of December 2016 compared to Rs 8,077 Bn in 2015.

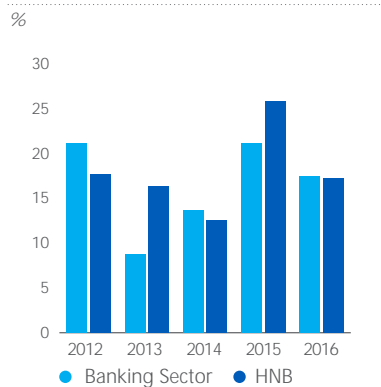
The pawning portfolio continued on the trend of the previous few years and contracted further during 2016.

The growth in sector assets was funded mainly through deposits. The deposits of the banking sector recorded a growth of 16.5% to reach Rs 6,296 Bn from Rs 5,403 Bn in the previous year. However, a notable decrease in low cost deposits was observed during this period with a shift in low cost to term deposits. The borrowings by the industry during the year, reduced by Rs 62 Bn with total borrowings standing at Rs 1,696 Bn as at year end.

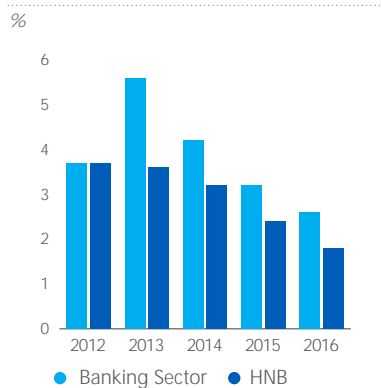
Deposit Growth



Advances Growth



Gross NPA Ratio



	Industry	HNB	Market Share
Assets (Rs Bn)	9,047	858	9%
Advances (Rs Bn)	5,541	584	11%
Deposits (Rs Bn)	6,296	623	10%
Profits (Rs Bn)	116	14	12%
Employees	55,257	4190	8%
Branches	3,614	251	7%

Note : Banking sector data is based on previous GAAP while figures relating to HNB are based on SLFRS.

The asset quality of the banking sector continued to improve during the year with the non-performing advances (NPAs) ratio improving to 2.6% as at December 2016 compared to 3.2% in end December 2015. This low NPL ratio was mainly due to the combined effect of the recovery of NPAs and increased loan growth during the period. Provision coverage also improved by 790 basis points from 62.3% in 2015 to 70.2% as at the end of 2016 mainly due to

the increase in loan loss provisions and the decrease in NPAs.

The accessibility of banking facilities was also enhanced with the expansion of branch networks and ATM facilities.

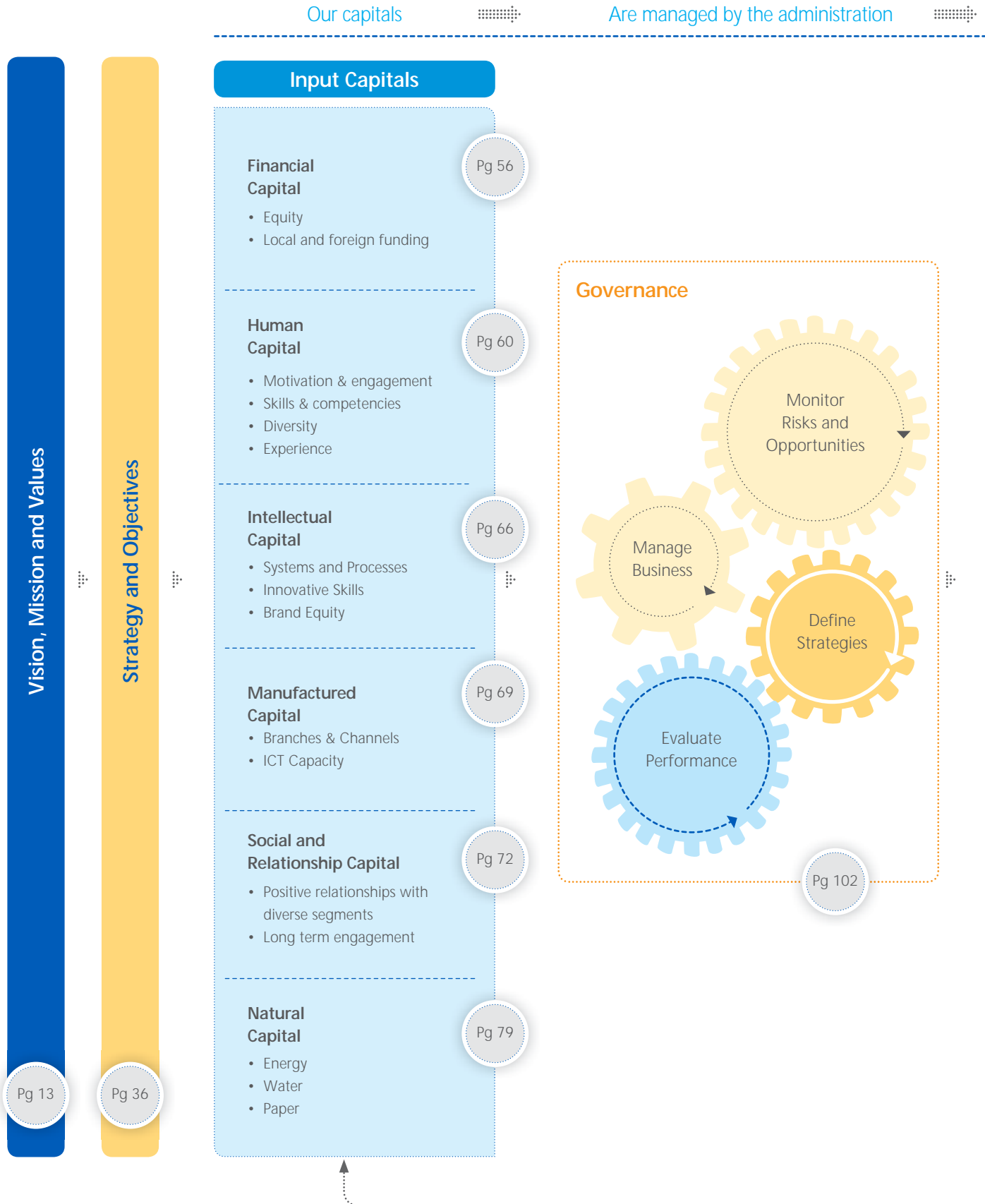
The summary of Key Performance Indicators of the Industry vis a vis HNB, demonstrates the Bank's new benchmark setting performance during the year.

KPI	Banking Sector	HNB
Asset Growth	12%	18.4%
Advances Growth	17.5%	17.3%
Deposit Growth	16.5%	18.3%
NIM	3.6%	4.3%
Cost to Income	48.5%	42.2%
NPA	2.6%	1.8%
ROA	1.4%	1.8%
ROE	17.3%	19.9%
CAR	14.1%	15.4%

Data Sources : Central Bank of Sri Lanka, IMF and World Bank

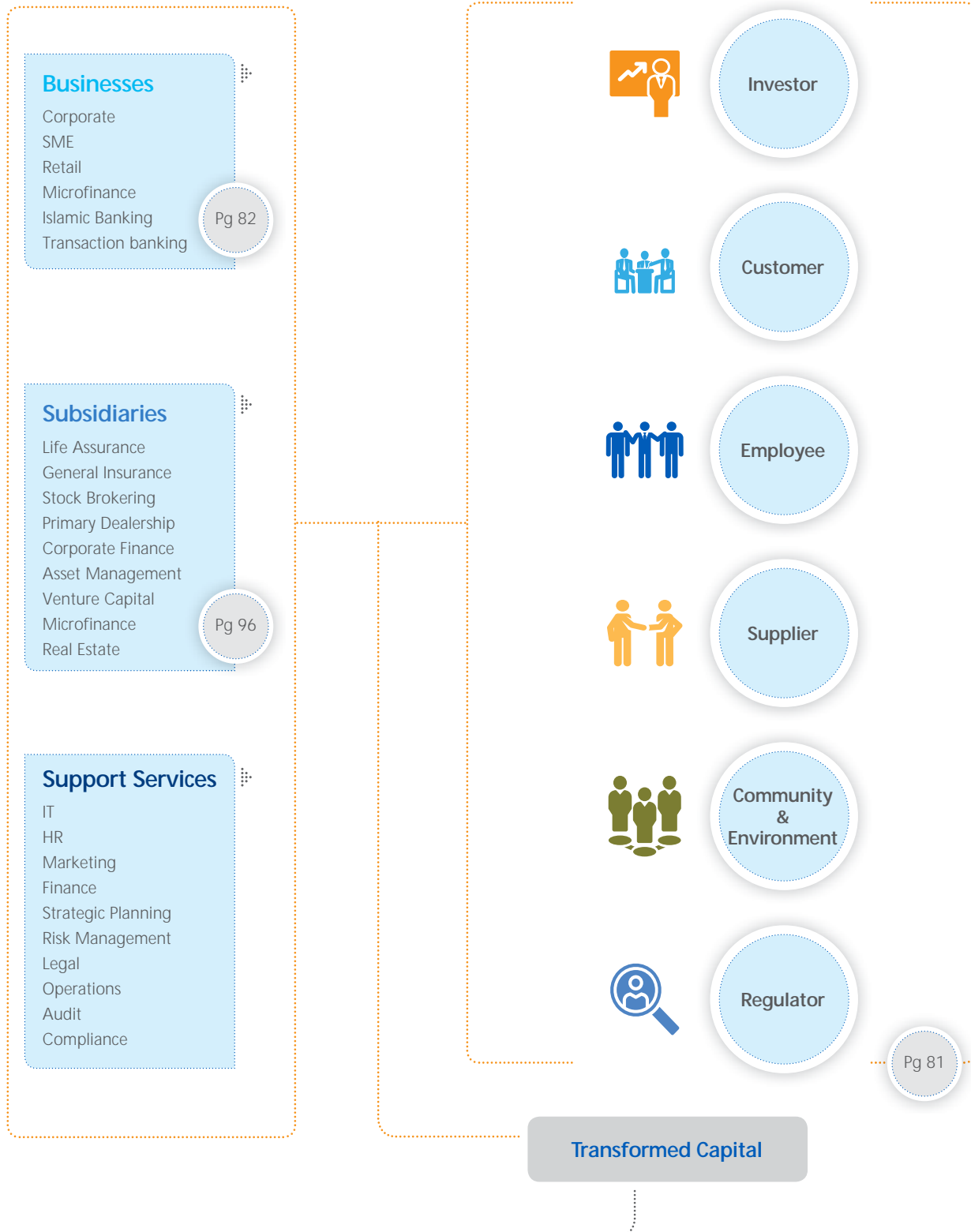
Management Discussion & Analysis

Business Model



For the offer of products and services

Generating shared value for our stakeholders



Management Discussion & Analysis

Capital Management Report

Financial Capital

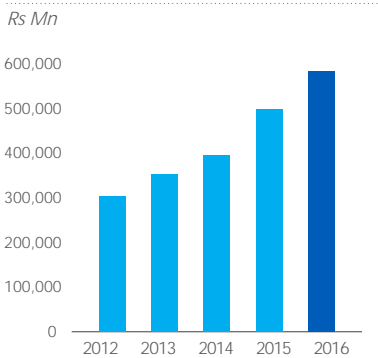
Initiatives 2016

Objectives	Status
16% growth in assets	Achieved 18.4%
Drive CASA growth	Growth of Rs 7.4 Bn. The increase in interest rates saw a shift from low cost deposits towards fixed deposits across the industry.
Improve asset quality < 2%	NPA improved from 2.43% to 1.8%
Improve cost to income ratio	Improved from 45.9% to 42.5%
Obtain funding to support balance sheet growth	Rs 13 Bn raised via LKR subordinated debentures and USD 100Mn obtained through a long term loan
Expand the Outsourced and Direct Sales Force teams	Sales team increased from 52 to 108

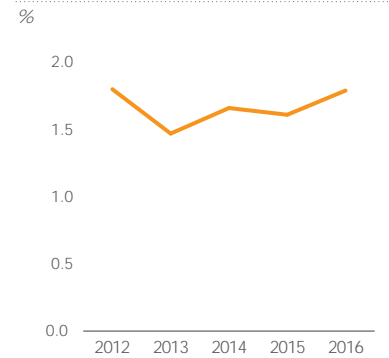
Way forward

- Achieve a balance sheet of Rs 1 Trillion
- Improve cost to income ratio to below 40%
- Improve market share

Advances Growth

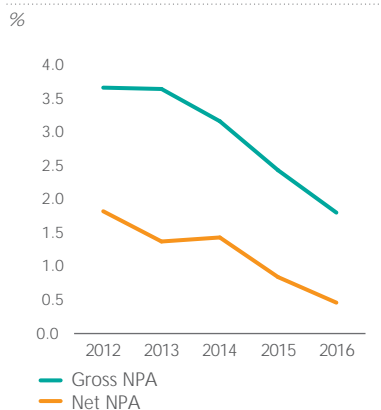


Return on Average Assets

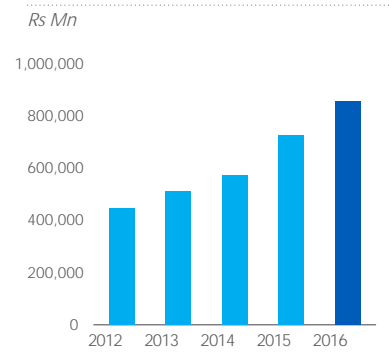


Assets in 2016

NPA Ratio



Asset Growth



Excellent Financial Results

The year 2016 witnessed HNB posting the best financial results in its history. An outstanding performance throughout the year culminated in the Bank's profit after tax (PAT) growing by 35.4% to surpass Rs 14.1 Bn, while an 18.4% growth was achieved in the balance sheet which expanded to Rs 858.9 Bn. The performance of the Group mirrored the excellent results of the Bank with Group PAT growing by 41.2% to Rs 15.7 Bn while Group assets were recorded at Rs 901.5 Bn and represented a 19% growth. This strong performance was driven by our robust business model and the dynamic strategies on sales, asset quality, operational excellence and technology.

Strong Growth in Core Banking Income

Prudent Asset and Liability Management (ALM) practices along with timely repricing of the bank's loan book enabled HNB to reap the benefits of rising interest rates during the early part of the year. The increase in interest rates coupled with the healthy growth of 17.3% in advances, enabled the Bank to post a NII of Rs 34.4 Bn representing an outstanding growth of 30.5% compared to the 5.8% increase reported in the previous year while the net interest margin (NIM) for the Bank improved from 4.5% in 2015 to 4.8%.

Similarly, Group NII grew by 31.6% to Rs 39.1 Bn with a significant contribution

from HNB Grameen which grew its NII by 40.1% during the year, while the NIM for the Group improved by 32 bps to 4.71% for the year.

Fee Income and Other Income

Growth in net interest income was well complimented by a strong performance in Fee and Commission income which grew by 22.0% to exceed Rs 7 Bn. While Credit Cards along with Trade Finance, Guarantees and Remittances once again collectively constituted over 60% of fee based income, there was substantial growth in fees from digital banking products and services.

The growth in fees represents the dividends of a proactive approach which commenced a few years ago to automate all fee collection processes and move towards enhancing fee income from alternative sources such as digital channels and the introduction of mobile POS machines which is branded as MOMO. The Bank continues to concentrate on improving the fee income by introducing innovative products and services to the market, with a view to reducing the impact from fluctuations in interest rates and compressing interest margins.

The Group posted net fee income of Rs 7.7 Bn representing a 23.7% increase with HNB Grameen witnessing its fee income growing by 48.2%.

The Bank reported a net trading loss of Rs 1.8 Bn due to higher swap cost

incurred during the year on swaps taken to hedge foreign currency borrowings. The corresponding impact on on-balance sheet open positions as well as a significant growth in exchange income contributed to the growth in other operating income. Net gain from financial investments reduced to Rs 111.7 Mn from Rs 253.8 Mn recorded in the previous year, largely due to the dividend income from our quoted investments declining by more than Rs 140 Mn. An increase of Rs 810.8 Mn in net insurance premium income from HNB Assurance boosted Group Income while profits from the Bank's investment in the Joint Venture, Acuity Partners, grew by Rs 88.7 Mn on a net of tax basis.

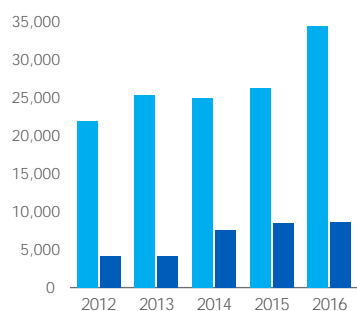
Maintenance of a High level of Asset Quality

Asset quality is one of the key strategic imperatives which is directly related to enhancing return to shareholders. As such the Bank embarked upon a journey to achieve transformational improvement in asset quality and adopted many initiatives such as the centralisation of retail and SME credit evaluation, intense training on credit underwriting and rigorous focus on recoveries.

As a result, the Bank's asset quality continued to improve over the past five years with gross NPA ratio improving from 3.66% recorded in 2012 to a historical low of 1.80% in 2016. The net NPA also

Income

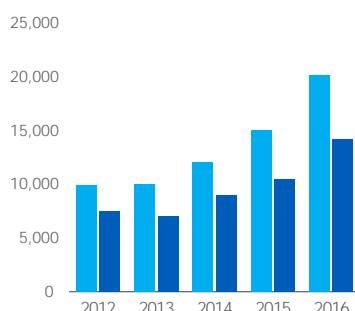
Rs Mn



- Net Interest Income
- Non Interest Income

Profit for the Year

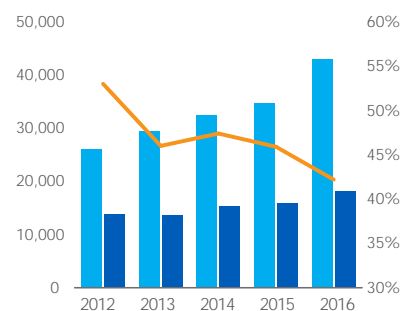
Rs Mn



- Profit Before Tax
- Profit After Tax

Operating Expenses

Rs Mn



- Total Operating Income
- Operating Expenses (Excl VAT & NBT)
- Cost to Income Ratio

Management Discussion & Analysis

Capital Management Report

Financial Capital

improved from 1.82% in 2012 to 0.46% in 2016. The NPA position of the Bank compares well against the industry averages of 2.6% and 1.3% recorded for gross NPA and net NPA respectively.

The recovery of large overdue facilities during the year led to a substantial decline of Rs 449.5 Mn in Impairment charges on individually significant loans while collective impairment charges declined by Rs 125.1 Mn.

Continuous Decrease in Cost to Income

The Bank's total operating expenses increased by 14.5% to Rs 18.3 Bn, while staff cost constituting 47.6% of expenses increased by 9.8% during 2016. Similar to our endeavours on other key value drivers, we have expended much effort towards improving productivity and efficiency. The set up of a BPR unit in 2012 proved to be the turning point in our quest for operational excellence as it championed among many projects the centralisation of credit evaluation, numerous cost optimization initiatives and a branch target operating model. As a result the Bank's cost to income ratio continued to decline steeply, dropping by 344 bps in 2016 to 42.51% while the decrease over a 4 year period exceeds 10.5 percentage points.

19.9%
ROE

The increase in operating expenses of the Group was also contained to 14.7%, and the Group Cost to Income ratio also improved by 438 bps to 48.3%.

Strong Growth in Profitability

The Bank's Profits before VAT, NBT and corporate taxes increased by 37.1% to Rs 24.5 Bn. Charges for VAT and NBT increased significantly by 54.7% due to the increase in the rate of VAT from 11% to 15%. Accordingly, Profit Before Tax (PBT) grew by 33.9% to Rs 20.1 Bn which represented an increase of Rs 5.1 Bn from the PBT of Rs 15.1 Bn reported in 2015. HNB's PAT of Rs 14.1 Bn represented a growth of 35.4% compared to 2015. Accordingly the Bank posted a Return on Assets (ROA) of 1.79% and Return on Equity (ROE) of 19.91% which is a significant improvement from 1.61% and 16.59% posted during 2015. Group companies namely HNB Assurance PLC, HNB Grameen Microfinance Ltd and Acuity Partners (Pvt) Ltd contributed to the outstanding growth in profitability, while Sithma Development

Rs 3.5 Bn
Gross Dividends

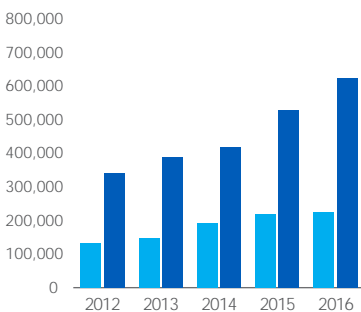
(Pvt) Ltd saw a marginal drop of 3.6% in profits mainly due to the revaluation of property. Accordingly the Group PBT improved by 39.2% to Rs 22.5 Bn while Group PAT improved to a record high of Rs 15.7Bn, increasing by 41.2%. Group profit attributable to shareholders increased by 39.8% to Rs 14.8 Bn with ROA and ROE for the Group recorded at 1.89% and 17.69% respectively for the year 2016.

Balance Sheet Performance

The Balance Sheet of the Bank which grew by Rs 133.7 Bn, represented an 18.4% increase which surpassed industry growth of 12%. During the first half of the year, the Bank adopted a cautious approach in lending with the growth in loan book being subdued. Nevertheless, through its strategic focus on improving the sales culture and enhancing customer experience the Bank was also able to grow its lending portfolio by 17.3% in line with the industry growth of 17.5% for the year. This represented an increase of Rs 86.1 Bn to Rs 584.4 Bn in the loan book.

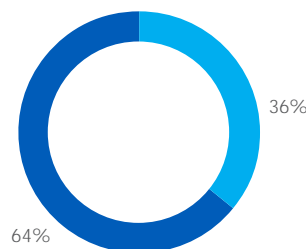
Deposits

Rs Mn



● CASA
● Total Deposits

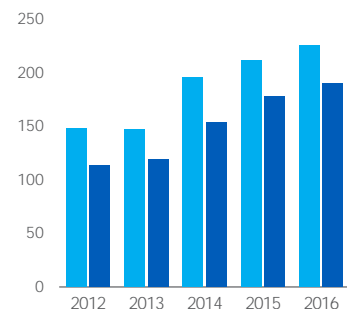
Deposit Mix



● CASA
● Other Deposits

Market Price (Voting & Non Voting)

Rs



● Voting
● Non Voting

The total deposit base of the Bank grew by Rs 96.4 Bn to Rs 623.5 Bn, an 18.3% growth compared to the industry growth of 16.5%. Despite a shift into higher yielding deposits witnessed across the industry the Bank grew its CASA base to Rs 225.5 Bn and notably grew its minor deposit base by 16.8%. During 2016 the Bank also raised Rs 13 Bn in Subordinated Debentures through two separate issues of Rs 7 Bn and Rs 6 Bn. Further, the Bank also raised US\$ 100 Mn as long term debt from a foreign bank to support its balance sheet growth. Group assets grew by 19.0% to Rs 901.5 Bn with HNB Grameen once again setting the benchmark with a growth of 38%.

Capital Adequacy

HNB continued to remain one of the best capitalized Banks in the country with strong profitability enabling an improvement of 69 bps in Tier I Capital Adequacy to 11.22%. The receipt of Rs 13 Bn via the two debenture issues further boosted the Total Capital Adequacy Ratio which increased by 257 bps to 15.27%.

Dividends and Return

The Bank declared a final dividend of Rs 7.00 per both ordinary voting share and ordinary non voting share in addition to the interim dividend of Rs 1.50 per share

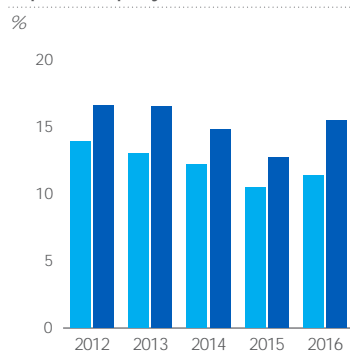
declared in December 2016. The final dividend comprises of a cash dividend of Rs 3.50 per share and a scrip dividend of Rs 3.50 per share. Total Dividends during 2016 amounted to Rs 3.5 Bn while the EPS attributable to the equity holders of the Group amounts to Rs 35.73.

The price of a voting share increased by 6.84% to Rs 225 while the non voting share price increased by 6.80% to Rs 190. The total return during 2016 to Voting and Non Voting shareholders of the Bank was at 10.9% and 11.6% respectively and is superior to the market compared with the ASPI which declined by 9.7% during the period.

	2012	2013	2014	2015	2016
Earnings per Share	18.94	17.59	22.47	25.41	34.25
Earnings per Share (Adjusted) (Rs)*	18.24	16.97	21.81	25.30	34.25
Dividend Yield (%) - Voting	5.7	5.8	4.4	4.0	3.8
Dividend Yield (%) - Non Voting	7.6	7.1	5.6	4.8	4.5
Asset Growth (YoY) (%)	17.3	14.3	12.3	26.6	18.4
Cost to Income Ratio (%)	53.0	46.0	47.4	45.9	42.5
Share Price - Voting (Rs)	148.00	147.00	194.90	210.60	225.00
Share Price - Non Voting (Rs)	112.50	119.00	152.90	177.90	190.00
Gross Dividends (Rs Mn)	3,379	3,400	3,431	3,451	3,517

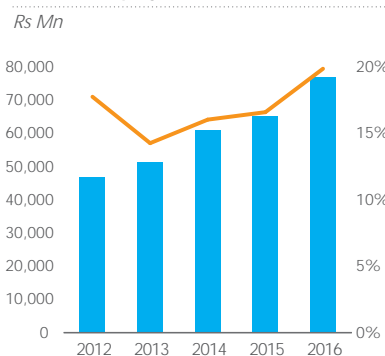
* Earnings per share has been calculated using weighted average number of shares during the current year.

Capital Adequacy Ratio



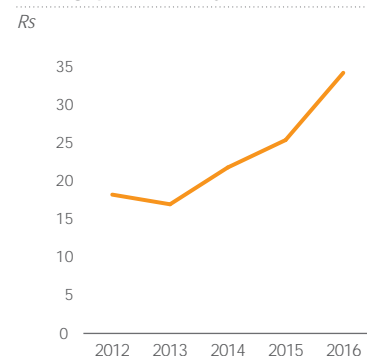
- Tier I
- Total Capital

Return on Equity



- Shareholders Funds
- Return on Equity

Earnings per Share (Adjusted)



Management Discussion & Analysis

Capital Management Report

Human Capital

Initiatives 2016

Objectives	Status
Upskilling, multi skilling and transforming in line with the strategic imperatives of the Bank by seamless learning and talent pipeline development	<ul style="list-style-type: none"> Increased investment in talent development. Leadership and management development programmes Average training hours per employee 39.56 (excluding external and foreign training) Number of internal promotions 111
Agile talent acquisition and sourcing	Optimised deployment of employees across the customer centre network focusing on customer service with more processes being confined to centres of excellence
Coaching, mentoring and enhancing professionalism	Phase I of 'Rise' employee champion programme was launched covering all branch managers and assistant managers. 1,000 mentor-mentee partnership programme commenced
Agile rewards to drive a performance culture	A competency based executive performance management system developed for implementation in 2017
Ethics and codes of conduct	<ul style="list-style-type: none"> Dissemination of code of conduct in English, Sinhala and Tamil Introduced anti-harassment policy

Way forward

- Listening to employees and hearing them - 900 employees voices heard through organisational culture assessment an impact audit
- Driving agile rewards and incentives strategy
- Flexible hiring to suit the needs of the Gen Zs
- Continue upskilling and multi skilling of employees in line with the strategic imperatives of the Bank
- Implement formal mentorship programme for all employees

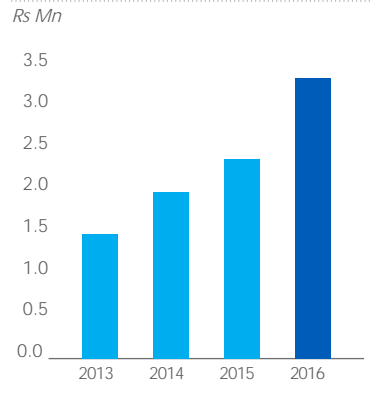
Staff Category		
4	Corporate Management	14
9	Senior Management	36
145	Managers and Executives	469
371	Junior Executives	764
790	Bank Associates	1,077
265	Secretaries	5
0	Support Staff	209
Employment Type		
16	Contract Staff	16
1,584	Permanent	2,574
Geographical Diversity		
82	Central Province	221
41	Eastern Province	158
15	North Central Province	100
65	North Western Province	159
76	Northern Province	128
39	Sabaragamuwa Province	98
49	Southern Province	202
20	Uva Province	90
1,213	Western Province	1,434
46	Recruitments	29
69	Employee Turnover (excluding natural attrition)	100

HNB's heritage spanning well over a century, with its brand attributes of stability, security and sustainability stands as testimony to the successful dynamics of deriving sustained value whilst enhancing value of a vital capital - its human capital. The passion and commitment of the HATNA family comprising 4,190 individuals of diverse ethnic, religious and social backgrounds, harnessing and honing their potential has fuelled HNB's game changing journey.

The alignment of our HR strategy with the Bank's strategies has been a key enabler of the Bank's excellent performance during the year. International recognition of this achievement at the Best Employer Brands, Asia Awards, is thus fitting and rewarding. A list of all the accolades for our people efforts during the year are listed under accolades in 2016 in the intellectual capital section of this report.

As we enumerated last year, the HR strategy supported the Bank's key strategic imperatives with a multi pronged effort. Lean management, a key imperative was supported through the re deployment of staff from processing functions to value creating activities such as sales and marketing. This enabled the Bank to continue on its journey of enhancing profits per employee as presented below:

Profit per Employee



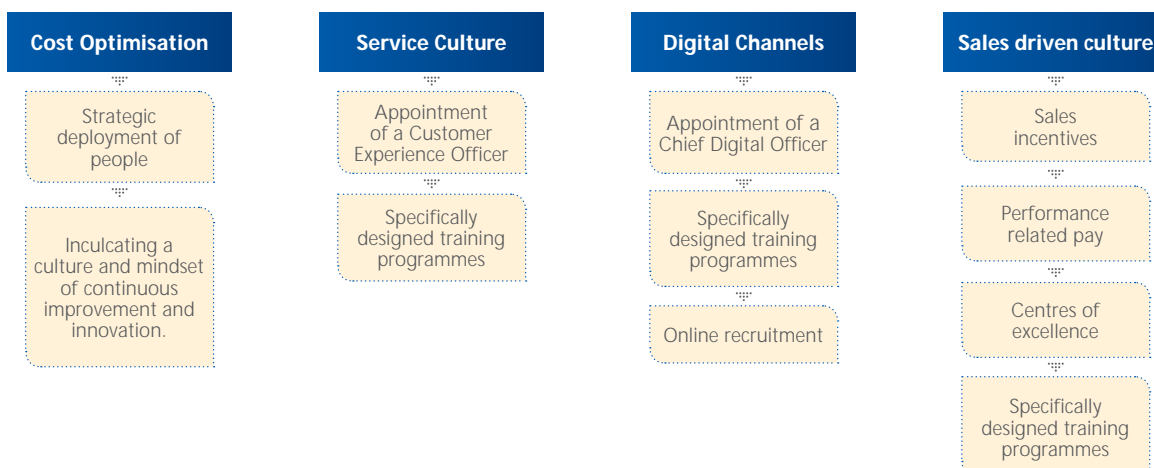
As mentioned elsewhere in this report, the year under review saw the Bank expand the re-engineering of its business processes whilst focusing on sustaining the comparative advantages gained thus far. Hence, instilling a culture of continual improvement in which our people embrace a mindset of optimal resource utilisation and constant innovation took priority. The Bank thus launched six sigma, yellow belt training towards this end.

Listening to employees and providing them an open platform to express their views was a high priority in our people agenda for 2016.

Looking ahead, we aim to:

- Strengthen our culture and people practices in line with the Bank's purpose, vision and values.
- Revise our talent management and reward policy to augment customer experience whilst fulfilling employee aspirations.
- Continue to invest in the development of talented people to ensure that they are ready to take up more senior and critical roles when the time is right.
- Strengthen a diverse leadership base that is able to lead in times of uncertainty, inspiring others, and passionate about helping our people reach their full potential.
- Enhance our speed and agility to adapt to an ever-changing world of work through a continued focus on learning and development.
- Review our policies and procedures to further drive and support our transformation agenda and to firmly entrench a culture of inclusion.
- Transition the majority of our HR systems to a single global template in 2017 which will enable our people to easily initiate and action human capital transactional activities relating to their daily work life. We will also introduce a people portal in 2017 that will serve as a single point of entry for human capital-related information, solutions and practices.

Aligning our People with the Bank's Strategies to fuel a Game Change



Management Discussion & Analysis

Capital Management Report

Human Capital

Meaningful work

We aim to make Hatton National Bank an institution that people are proud to work for. We believe that how our people think and feel about work directly correlates with customer satisfaction levels and that people bring out their best when they believe in the higher goals of the Bank. Thus, the top management invests time and effort to drive a culture where our people feel valued, have a clear sense of belonging, know what is expected of them and are recognised and rewarded for their contribution towards achieving our ambition of being a true partner in progress i.e. to place our customers at the centre of everything we do.

The Bank permanently employs 4,190 people. Our level of voluntary turnover in 2016 remained healthy at 2.4% and below the general benchmark of 4%.

During the year we introduced alternate sources of employment for youth in the form of internships, which has afforded more flexibility in allocating resources. These internships have provided young school leavers/graduates a sense of corporate careers. It has also paved the way to identify best fit talent for permanent hiring.

Caring and fair work practices

We aim to ensure that caring, supportive and fair work practices are applied and that we respect the individual and collective rights of our people in the workplace and we adhere to local and international labour regulations and legislation. We actively engage with recognised trade unions, whom we view as a crucial stakeholder and partner in our long-term success and sustainability. As at end 2016, 80.5% (2015: 81%) of our people were members of the Ceylon Bank Employees Union and the HNB Officers Union.

Developing and managing talent

Insights obtained from surveys held in 2014 have been used to inform our strategy and our people priorities for the short to medium term. Going forward, we will focus on gathering and responding to insights shared, using innovative, real-time platforms, and using these insights to shape our culture on an ongoing basis.

“Digital Banking” and thinking digital necessitates that our people are prepared to execute this strategy and work in a fast paced and fast changing work environment. The Bank thus promotes a culture of continuous learning, professional development and adaptability.

The introduction of a single learning management system across the Bank in 2015 has provided all our people with online access to learning opportunities which enables them to fulfil their learning needs including compliance training obligations, at their convenience.

We invested more than Rs 30 Mn in developing our people in 2016.

Bold and inspirational leadership and grooming leadership for the future

We continue to focus on enhancing our development propositions so that future executive leaders gain critical experience and skills that will prepare them for

future roles. We recognise the need to capacitate leadership to deal with increased complexity, adapt quickly to a rapidly changing operating environment and lead, rather than manage, an increasingly diverse workforce. The execution of our strategy challenges our leaders to create meaning and direction, and to inspire and influence others. To this end, we have reshaped the leadership development landscape, to shift the centre from being a training facility to playing a vital role as a vehicle for strategic change and dialogue. HNB's future readiness is about its technological capacities just as much as it is about ensuring a talent pipeline for continuing on a journey of sustainable growth into the future. We have invested in our top leaders, supporting their development in becoming true catalysts of change and serving as inspirational role models, moving the Bank towards its desired future.

The leadership development model introduced in 2014 continued to offer tailor-made personal and management development programmes. Extensive Bank leadership programmes were offered for senior managers and newly promoted staff including a comprehensive programme on Covey's 7 habits. 1,132 (2015:825) leaders from across the Bank benefited from a wide range of leadership development programmes. Rise – an employee champion programme was launched during the year to further inspire and groom our people.



Excellence in training and development for the 5th consecutive year

'Rise' – employee champion programme

The purpose of the "Rise" Programme is to have a formal workplace champion programme to mentor/coach employees and to effectively communicate the exciting vision and opportunities ahead using techniques of mentoring and reverse mentoring. Rise is expected to facilitate knowledge transfer, coaching and guidance from an experienced member of the Hatna Family to another. Rise would thus be a collaborative, mutually beneficial partnership between a Champion (who possesses greater skills, knowledge and experience) and an Empowered Learner (who is looking to increase his or her skills, knowledge and experience).

Learning and development:

Training schedules are developed according to training needs which are analysed in consultation with various business/department heads. An extensive bouquet of training programmes is delivered covering on-boarding, product and process training, advanced programmes and behavioural training. The on-boarding training ensures that new employees are offered a comprehensive training and empowered with the necessary know-how, as well as functional and behavioural skills required for the role. The product training and advanced programmes enable skill development, regular updates and build expertise in staff.

The training methodology has evolved from application based training to include simulations, case studies and games with over 100 learning interventions on the e-learning platform.

Talent Development - Employee Category

Average learning hours (internal training)		No. of Participants		
		Internal	External	
				
13.8	Corporate Management	384	72	7
7.12	Senior Management			
11.12	Managers and Executives	1243	269	34
12.02	Junior Executives	1,487	73	6
8.76	Bank Associates	2,562	24	2
11.97	Secretaries	87		
5.92	Support Staff	24	2	
10.7	Contract/Outsourced Staff/interns	760	1	

Talent Development - Learning Category

	No. of Participants			Total
	Internal	External		
				
Leadership & Management Development	1,089	43	-	1,132
Marketing, Sales and Customer Service Excellence	2,111	36	3	2,150
Banking Operations Competency tests	822	11	6	839
Credit Evaluation and Administration	636	26	11	673
Treasury, Trade Finance & International	537	58	10	605
Compliance, Assurance, Risk, Legal	133	58	2	193
Electronic Banking	33	6	-	39
IT	9	23	15	47
Communication Skills	70	13	-	83
Financial Reporting and Taxation		80	-	80
Environment, Energy Efficiency	21	16	-	37
Orientation and People Management	899	44	2	945
Investment Advisory	187	27	-	214
Total	6,547	441	49	7,037

Talent Development - E learning

No. of Programmes - courses, quizzes, library	340
No. of Participants	32,841
Average participation per employee (activities)	7.84

Management Discussion & Analysis

Capital Management Report

Human Capital

Diversity and inclusion

The diversity of our people brings richness in perspective, skills and experience that we leverage as an advantage in serving an equally diverse customer base. HNB is an equal opportunity employer and rewards are strictly based on merit.

Category wise age analysis

Category	18-24	25-34	35-39	40-44	45-49	50-54	>55	Total
Corporate Management	0	0	1	5	6	6	0	18
Senior Management	0	0	0	8	16	21	0	45
Managers & Executives	1	57	102	182	174	98	0	614
Junior Executives	0	218	266	377	220	54	0	1,135
Bank Associates	169	1,237	191	164	82	24	0	1,867
Secretaries	0	3	35	76	78	78	0	270
Contract Staff	15	3	0	0	1	2	11	32
Support Staff	0	1	23	52	67	66	0	209
Total	185	1,519	618	864	644	349	11	4,190

Service Analysis

No of Years	2016
<2	377
2-5	575
5-10	852
10-15	337
15-20	998
20-25	715
25-30	217
30-35	117
>35	2
Total	4,190

2.4%
Attrition (Voluntary)

39.6
Training hours per employee
(excluding external and foreign training)



25 years service excellence award



Annual bakthi gee



Sports fiesta

Delivering value to our customers

Empowering our people with the right skills, tools, processes and technology to deliver on our commitment to place our customers at the centre of everything we do, is at the heart of our people strategy. We are testing new ways of working that will empower our people to respond to customers' needs with agility and speed. This new work design structure will embrace digitalisation and find the appropriate balance between providing exceptional customer experiences and meeting our risk and regulatory responsibilities.

Rewards

Merit is the driving force in the Bank. The distinctive element of the system of rewards both financial and non-financial is the objectivity and transparency with which it is carried out. This fair and equitable approach encourages our people to give their best. The Bank has a comprehensive compensation policy that has been articulated in line with the regulatory guidelines. This compensation policy ensures that remuneration is one of the highest in the industry. "Star Awards" is an institutionalised recognition programme that periodically recognises high performers. Rewards are determined following a discussion based evaluation and two level managerial appraisal. This makes the system free of bias.

Employee Health and Safety

The Bank's health and safety policy supersedes the minimum H&S regulations stipulated by the authorities and promotes the highest standards of H&S based on a holistic concept, to ensure accident free environments across all the operational units. The H&S policy is also accessible on the intranet for the reference of any employee.

Further, in 2016 we also commissioned an ergonomic study of the centralised processing centres as part of our continuous monitoring of employee health and safety.

During the year under review there was 1 minor injury reported in the western province where a drawer of a fire proof cabinet was dislodged from its railing and injured the foot of an employee.

Being in the Banking industry, a key priority also includes ensuring that our employees are protected from intimidation and violence in the case of a bank heist at any of our locations. Security equipment such as CCTV cameras, deployment of security service providers and insurance minimise risks to employees. In addition, regular briefings and a news letter by the in house security department provide updates and advise to promote vigilance and minimise risks. The Bank, starting with the orientation provided to new recruits, gives all employees to understand that at a time of threat the Bank expects every employee's first priority to be to safeguard their life, with cash or property being secondary. There were no such incidents of aggression reported during the year.

Promoting Work Life Balance

HNB's paradigm for facilitating the health of its employees extends far beyond the mandatory standard of health insurance and awareness. We adopt a sustainable approach, also encouraging mental and emotional well being by promoting a work life balance and have found that it is win win for all. It has been proven to increase productivity, employee morale and staff retention and reduce absenteeism. The scope of the work life balance policy which encompasses all employees includes provisions for employee leave, integration of family in social and sports activities of the Bank, access to health related information

and guidance as well as employees' access to counselling where necessary.

Programmes Promoting Employee Health & Wellbeing	No. of Participants
Seminar on Stress management	150
Seminar on Women's Health	120
Seminar on Men's Health	50
Eye Camp at a discounted rate	80
Discounted packages for health checks	For all employees

The HATNA family

Creating a culture of open speak without any fear of reprisal was a key achievement of the Bank. During the year employees used the open and empathetic platform to raise issues to improve work environment.

Employees have resolved workplace issues and conflicts through open interactions. As such no major grievances were filed during 2016.

To further augment our commitment, we have also introduced a formal anti-harassment policy and procedure that includes a direct hotline number to the Chief Human Resource Officer during 2016.

During the year, the Bank provided support to 30 of our staff who were badly affected by natural disasters; 15 who needed medical assistance including family members of our people and 6 children of staff with scholarships.

Management Discussion & Analysis

Capital Management Report

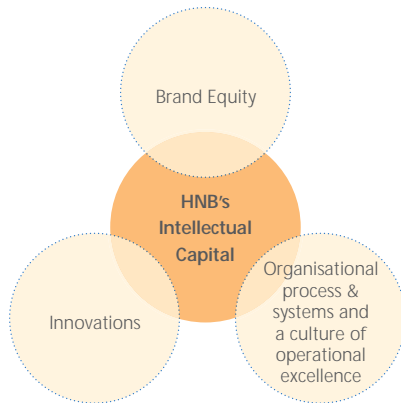
Intellectual Capital

Initiatives 2016

Objectives	Status
Launch new products to cater to the changing needs of customers	Launched WalleyE, Ijarah and several other new products and enhancements as referred to in page 74
Complete implementation of a centralised security repository	Operation to commence from early 2017 and to be rolled out during 2017
Improve the processes at the Centre of Excellence further, to provide a speedier service	Workflows redesigned to improve turnaround times
Restructure the Risk Management function to improve the credit evaluation process	Executed as outlined on page 67

Way forward

- Complete the brand audit project
- Centralise disbursement of credit
- Outsource the central security repository
- Centralise collections



Receiving the award for the third place at the Business Today Top 30 Awards

Rs **18.6**Bn
Brand Equity by Brand Finance Lanka

3rd
By Business Today

Harnessing and enhancing the potential of our Brand Value

As the oldest private commercial Bank in Sri Lanka HNB enjoys a unique brand equity in Sri Lanka. With its 128 year heritage, brand HNB has been synonymous with the attributes of trust, stability and strength which we will continue to re-emphasise and reinforce. Over the past few years the Bank also identified a need to integrate new strengths and communicate these new attributes which cater to evolving life styles and market expectations.

Following the roll out of the "New World Banking" campaign in 2015, the year under review saw the Bank launch its second phase themed "Banking Beyond Transactions". This campaign deviated from the product based advertising strategy applied by the Bank over the past several years and communicated the many Game Changing leadership initiatives of the Bank, across different product and customer segments and as a whole, in Sri Lanka's banking space. It also communicated and reinforced brand attributes of agility, technological leadership and the future readiness of the Bank and the importance of relationships rather than mere transactions.

During the year we also launched a process to re-look at 'brand HNB', to think anew and obtain fresh insight on what the brand means and what it ought to symbolise for all its stakeholders.

The value of Innovation

Innovation is a key value at HNB, affecting what we do or how we do it. We understand the importance of a culture which encourages our human capital to unleash their talent, to apply creative thinking and intelligent strategies in order to stay ahead in an intensely competitive industry environment. The products and brands we have developed and introduced to the market over the years are many, such as "Pathum Vimana" - the flagship deposit product "Shanthi Housing loans", "Gami Pubuduwa" - a micro finance initiative and "HNB MoMo" - the mobile POS solution.



Visit of the members of the Asian Bankers Association to the Centre of Excellence

During the year, we introduced another novel product branded as Wally E – the first pre- paid Visa card specially designed for teenagers. The card empowers teenagers by enabling them to purchase goods and services from pre-approved merchants, pay their school fees or tuition fees and make ATM withdrawals with pre-set limits whilst alerting parents via a sms with transaction details upon each transaction.

Organisational Processes & Systems in 2016

The business transformation journey during the last few years saw HNB achieving many strategic objectives. For example automation has enabled a work role shift and enabled the Bank to leverage Matrix management to contribute significantly to sales growth, whilst centralisation of our retail as well as SME credit processing and our Trade operations during 2014-2015, enhanced the value of our knowledge base by fostering specialisation, which led to operational excellence. The process improvements initiated in 2016 are discussed below.

Following this transformation, 2016 saw the BPR team focus on ensuring the continuity of process re-engineering and nurturing a commitment amongst the entire team. Changing employee mindsets and building a culture which "thinks digital" whilst constantly striving for operational excellence to sustain HNB's market leadership into the future were key priorities. Thus, Six Sigma

Yellow Belt training and certification, Lean Operations and 5 S training were introduced during the year, enhancing the intellectual capital of the organisation across the different divisions.

Process Enhancements undertaken in 2016

- Paperless office Initiatives, introduction of automated workflows
- Converting paper statements to e-statements
- Outsourcing of the security documentation repository
- Re-designing some of the workflows and processes at the Centralised credit processing unit to improve turnaround time.

HNB's Risk Management Framework

A robust risk Management framework has been a cornerstone of the Bank's sustained success for over a century and we consider it a key intangible in our future readiness as well. The record low level of our NPA this year, at 1.8%, is further testimony to the effectiveness of our risk management approach.

During the year, the Risk division initiated several changes to its processes to further strengthen Risk management at HNB, which included the following:

- The Risk function and process was reorganised to facilitate a more holistic

Management Discussion & Analysis

Capital Management Report

Intellectual Capital

and integrated perspective, so that risk evaluation does not take place in isolation but incorporates Credit, Marketing and Operations.

- We also began to create a mindset change across the Bank for all employees to have a greater awareness and understanding, in order to play a more proactive role in mitigating risks. Thus the Risk Division began to engage with the branch network across the country.
- Strengthened several practices that are associated with lending and recoveries.

External endorsements

External Endorsements are a valuable component of our intangible capital and these include the certifications of our processes and services as well as the awards won.

The ISO 9001:2008 certification of our Trade Operations continued into its twelfth year and is a key differentiator for the Bank to sustain its leadership in the Trade solutions market.

Accolades in 2016

- “Best Retail Bank in Sri Lanka” by “The Asian Banker” at the annual Asian Banker Excellence in Retail Financial Services” Awards , 2016 for the eighth time.
- Jonathan Alles, Managing Director / CEO was conferred the award “CEO with HR Orientation” at the Global HR Excellence

Awards 2016, sponsored by CIMA – the Chartered Institute of Management Accountants UK and endorsed by World HRD Congress and Asian Confederation of Businesses.

- Award for Excellence In Training & Development Award – Overall Award for Best Results Based Training, at the Asia’s Training & Development Excellence Awards 2016
- Award for Best HR strategy in line with Business under the Asia Best Employer Brand Awards 2016
- Third place in the National Productivity Awards, under the ‘Service Sector- Large’ category for the second consecutive year. First and second places were not awarded
- Third in the Business Today TOP 30 Awards 2015/16
- “Top 10 Best Corporate Citizens of Sri Lanka” at Best Corporate Citizen Sustainability Awards 2016 presented by The Ceylon Chamber of Commerce
- Award for Best Presented Application for the Best Corporate Citizen Sustainability Award 2016 presented by The Ceylon Chamber of Commerce. The Jaffna Green Building won the prestigious ‘CIOB Green Mark - Gold Plus’ award at the second CIOB Green Mark Awards Ceremony
- Special Award in recognition of the contribution as a service provider to exporters at the 24th Annual National Chamber of Exporters – Exports Awards 2016
- Silver Award for the ‘Deal of the Year’ and Bronze Award for the ‘Entity of the Year’ at the Islamic Finance Forum of South Asia, organised by UTO EDU Consultant
- Silver Award for ‘Excellence in Investor Relations’, by CFA Sri Lanka
- Silver Award for overall reporting in the Banking Institutions category at the Annual Report Awards organised by the Institute of Chartered Accountants of Sri Lanka.
- Niroshana Seneviratne, Chief Internal Auditor was conferred the “People Leaders Finance Award 2016” at the Institute of Personnel Management’s (IPM) National HR Conference in June 2016. This is a joint award by the IPM Sri Lanka in collaboration with the Institute of Chartered Accountants Sri Lanka (CA Sri Lanka).



Receiving the National Productivity Award under Service Sector – Large Scale category



At the CA Sri Lanka Annual Report Awards



Receiving the Award for Excellence in Investor Relations

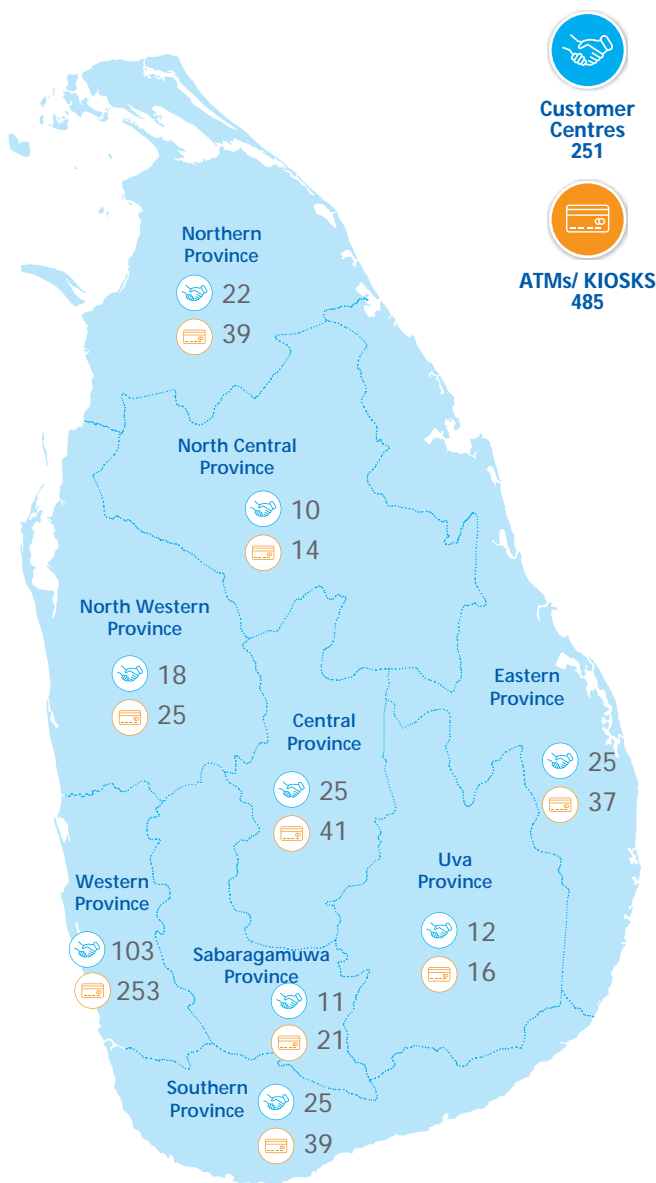
Manufactured Capital

Initiatives 2016

Objectives	Status
Complete the upgrading of the electronic banking solution to enable introduction of new products and services	Completed
Rationalise the distribution network	In progress
Deploy value added ATMs	Expanded by 17 ATMs

Way forward

- Set up digital branches
- Introduce digital products / services
- Increase ebanking penetration
- Install kiosks, recyclers



12,755
POS merchants

73
Payee Partners



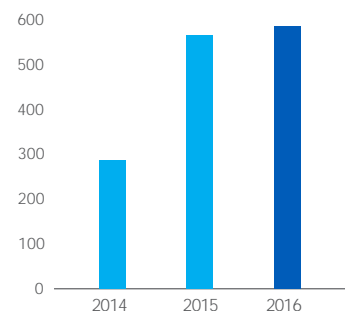
The Bank operates in all

09
Provinces

25
Districts

Investments in IT

Rs Mn



Management Discussion & Analysis

Capital Management Report

Manufactured Capital

Our physical presence, with 251 customer touch points located across the length and breadth of the country has been one of our key competitive advantages. However, in keeping with evolving life styles, customer needs and expectations, the Bank began to develop multiple channels for banking, with a focus on enhancing customer convenience and efficiency through technology driven banking spaces.

Technological platforms at HNB

Our investments into IT platforms and systems over the past four years have created a robust technological platform and paved the path for the Bank's Game Changing use of technology. Our technological platform has enabled our strategic objectives whilst enhancing the value we can create for our customers at the same time.

HNB's technological investments have sought to impact all aspects of the enterprise; achieving operational excellence,



At the opening of the new branch at Lanka Hospitals

customer service excellence and product innovation, over the past decade in particular.

Initiatives for 2016 included the implementation of Finacle Alerts on transactions, online self-service customer on boarding for internet banking, transfer of remittance proceeds to any bank via CEFT and implementation of USD SLIPS to enhance customer experience through a faster and more convenient service.

The Bank also continued to leverage upon state-of-the-art technology to improve operational efficiency. For example, infrastructure was upgraded to provide mobile access to internal workflows that are used by the Bank's staff attached to regional offices and the infrastructure of the bill portal was upgraded to improve efficiency.

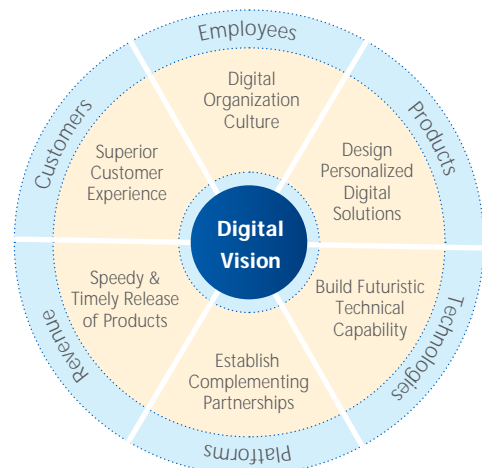
Our commitment to best in class risk management systems and processes was reaffirmed through the implementation of cyber security dashboards and strengthening of the security mechanism for IPG payments. In 2016 we also provided extended infrastructure to facilitate ATM facilities for third parties while also ensuring that our ATM network remains the most sophisticated through the replacement of 113 ATMs.

The Digital Drive

The Bank's thrust towards growing electronic channels has been a most significant value driver over the past few years, for customers, as well the Bank's bottom line in terms of fee income, sales, higher productivity and new product development. HNB serves its customers at

Game Changing enhancements to our Manufactured Capital, in 2016

- Launched a state of the art fully integrated electronic banking platform for Corporate and Retail banking; enabling product innovations and incorporation of Trade transactions, a first of its kind amongst local banks.
- Was a pioneer in installing cash deposit machines across the island, with a network of 48 machines.
- Introduced cash recycling ATMs enabling greater operational efficiency and cost savings.
- Commenced "clustering" and restructuring of branches located at close proximity to each other, to optimise resource allocation.
- Rationalised IT equipment across the branch network as per the analysis by the BTOM (Branch Target Operating Model) to enable optimal utilisation of our physical resources.



their home or office or while on the move, and in any corner of the world via its e-banking and mobile banking channels. In line with the Bank's objective of being the most future ready bank, a 'Chief Digital Officer' who is responsible for driving digital transformation across the bank was appointed during the year. This will be an added advantage in expanding the technological advancements and investments to remain a Game Changer in the Sri Lankan banking sector.

The Branch Network and Optimising its Value Creation

HNB's branch network, amongst the biggest in the industry, has been a key manufactured capital for creating value. It has been a key enabler of financial inclusivity, accessibility and convenience for people living in rural hinterlands or the most cosmopolitan locations.

With the Bank's strategic focus over the past few years being to innovate and grow the digital channels of delivery, its traditional brick and mortar network increased only by two, to 251 during the year. The two new branches were opened at the Ministry of Finance Sri Lanka and the Lanka Hospitals Corporation Ltd, increasing convenience for employees as well as visitors to these two institutions.

Moreover, in line with the Bank's strategic imperative to enhance customer experience and create greater operational and cost efficiency, we streamlined operations at many of the branches. For example, the operations of two of the branches located at close proximity to each other in Panchikawatte and Maligawatte were restructured to focus on specific areas of business. These measures have begun to contribute to an improved cost to income ratio at the branch network.

The Bank also commenced a process to revisit the layout within each branch, with the objectives of making them more customer as well as employee-friendly, improving efficiency and improving the customer experience and service levels.

During the year, the Bank rationalised its extensive student banking centres with a view to optimising resources. As a result operations in 18 centres where the Bank has experienced challenges over a long period of time, were discontinued. Upon completion of this exercise, the Bank embarked on a journey to expand its reach to this segment by opening more student banking centres.

Customer Touch Points

	2016	2015	2014	2013
Customer Centres	251	249	249	250
HNB Student Banking Centres	150	168	168	168
Village based Gami Pubuduwas Units	-	-	2	3
Branch based Gami Pubuduwas Units	129	127	125	121
Micro Banking Units	9	9	9	9
Mobile Banking service units	1	1	1	0
ATMs (including kiosks)	485	468	451	413



At the opening of the new branch at the Ministry of Finance

Management Discussion & Analysis

Capital Management Report

Social & Relationship Capital

Initiatives 2016

Objectives	Status
Launch payment and cash management services to support corporate and SME business	Launched
Introduce an online trading platform	Launched
Appoint a Customer Experience Officer	Appointed in May 2016

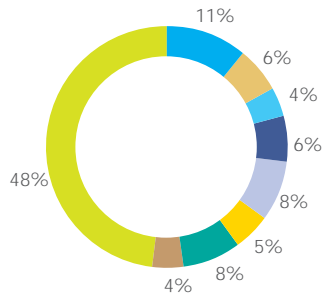
Way forward

- Revamp the call centre operation
- Streamline the complaint management process
- Improve access to finance through microfinance and SME
- Conduct capacity building programmes

Rs 10.4Bn
In Taxes

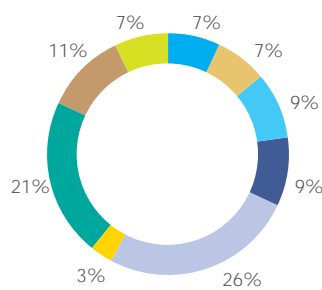
Rs 105Bn
Disbursed to SME & Micro customers

Geographical Distribution of Customers



- Central Province
- Eastern Province
- North Central Province
- North Western Province
- Nothern Province
- Sabragamuwa Province
- Southern Province
- Uva Province
- Western Province

Regionwise Distribution of Micro Finance Advances



- Central Region
- Eastern Region
- Greater Colombo Region
- North Central Region
- North Western Region
- Northern Region
- South Western Region
- Southern Region
- Uva / Sabaragamuwa Region



340,000
Likes



405,893
Views

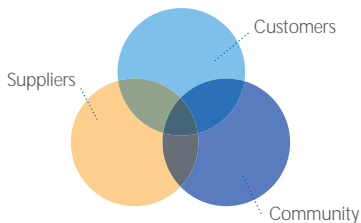


18,000
Followers



3,131
Followers

CUSTOMERS



For more than a century, HNB's brand identity has been one which transcends ethnic and geographic divides; and today, the diversity of our customer base spans demographic as well as geographic diversity.

Geographic diversity of our customer base

We reach our customers through an extensive network of 251 branches spread across the island and a fast growing alternative of digital channels which extends the Bank's reach beyond its branch network, to offer customers the convenience and flexibility of banking from the comfort of their home or another part of the world.

Engaging our Customers

Marketing Communication

Following the "New World Banking" campaign of 2015, which created awareness of "a whole new world" of possibilities in banking, driven by technology, the year under review saw the campaign's second phase themed "Banking Beyond Transactions", which took a much needed break from a product led advertising strategy adopted over the past few years, to reinforce the Bank's many leadership initiatives across product segments and customer segments and in the industry as a whole. The campaign also set the tone for the future. HNB remained one of the top five Marcom spenders amongst Sri Lankan banks. We were also the only corporate to offer an ocular swift experience to customers.

Achieving greater cost optimisation as well as efficacy, and maintaining a healthy mix of communication, the Bank spent approximately 15% of its marketing



Top ten best corporate citizen award

communication budget on social and digital media during the year. HNB's allocation for digital media during the year was the highest percentage amongst the Banks. Thus, the Bank's own social media platforms such as Facebook, Twitter, and LinkedIn were also further strengthened. Social and digital media communicate which mainly caters to the Millennials, conveyed the vibrancy and dynamism of HNB's new value proposition.

The Bank also launched several credit card promotions with attractive discount offers for customers by partnering a range of outlets. In addition, it also conducted several seasonal promotions for Inward Remittances both locally and overseas.

Listening to Customers

A brand reflects customer opinion on the one hand and shapes customer opinion on the other. As a first step in our brand led strategy which we embarked on, we commenced a brand audit.

In addition the Bank also launched a process of Social Listening through Buzz monitoring to track conversations for mention of our brand.

Journey towards service excellence - the initiatives in 2016

Reflecting the Bank's strategic focus on customer service and in line with a global trend of focusing on "experience" management, the Bank created a new

business vertical known as the "Customer Experience Unit" and created a new designation and appointed a Head of Customer Experience during the year, to give leadership to the Bank's effort to enhance the customer experience. The establishment of a Customer Experience Unit also underscores the role of every employee to deliver an excellent client experience.

A series of initiatives were launched during the last quarter of 2016. A pilot project was launched with 11 selected branches in order to identify operational challenges and system restrictions which hinder the delivering of an excellent customer service by branches. A report based on observations of a mystery shopper exercise and staff interactions along with proposed action was presented to the Board Strategy & Investment Review Committee.

The operational challenges and system limitations identified are currently being addressed based on priority and severity and the project will be extended in 2017 to cover the entire branch network.

The Unit also initiated an exercise to identify Subject Matter Experts from each business division in order to facilitate branches to support in product or process related clarifications and assist the Customer Experience Unit to develop content for a knowledge portal, which will be launched in the 1st quarter of 2017. The portal will cater to all staff with up-to-date information related to campaigns and product launches

Management Discussion & Analysis















Capital Management Report

Social & Relationship Capital

Products for the business segments

Microfinance and SME   	Mid Corporate 
Corporates and Multinationals Wholesale & Transactional Banking	Government Project Finance

Products for individuals

Minors  	Teens / Youth   
Mass Market    	
Professionals/ Executives  	Private Banking  
Senior Citizens 	

along with FAQs on all products and top processes. The objective of this portal is to enhance staff product and process knowledge as well as to improve uniformity and consistency of information shared with customers at any touch point.

In order to further strengthen the service delivered by the branch network, the Customer Experience Unit also launched a network help desk.

Continuing to enhance our Customer Value Proposition

We continued to enhance our value proposition through new products, new delivery channels as well as improvements to service standards, primarily through Game Changing technology. They include the following, and are also discussed at length under the respective Business Reviews of this Report:

- Introduced a fully integrated suite of cash management and trade solutions for Corporate Banking through “HNB Online”.
- Introduced Custodial and Trustee services.
- Launched “Ijarah” a new Islamic financing solution
- Enabled single credential logging into the internet banking site, such as through Facebook.

- Enabled real time fund transfers through CEFT.
- Enabled card-less Peer to Peer fund transfers for non-HNB customers.
- Expanded the Payee network on the internet portal to offer the highest number of payee partners, including 70 utility companies; thus enhancing customer convenience, whilst reducing traffic at our counters.
- Introduced an unique “Fast Track in-Principle” loan eligibility approval process within 48 hours, for housing loan applicants, empowering them with prior knowledge to find a house within their budget.
- Relieved Home Loan customers of significant hassle by introducing a value added service, of arranging documentary support and obtaining approval required from regulatory bodies to begin construction of a home.
- Launched bulk cash deposit machines with real time crediting of accounts.
- Introduced an Emergency Medical Loan facility with fast tracked approval at times of need.

Product and service labelling

We adhere to the requirements of the Central Bank of Sri Lanka customer charter which requires that any information displayed or provided to our customers, including our written agreements with our customers, is in plain language and easy to understand. This also applies when communicating our pricing structures. All communication is carried out in the 3 national languages.

SUPPLIERS

Suppliers are a key stakeholder group who enable our value creation process. As an enterprise that is mindful of the broader role it can play in the development of the nation,

HNB looks to its supply chain as another avenue to stimulate economic activity; thus, nearly all our procurement is from Sri Lankan suppliers, and as much as 60% of these suppliers are micro and small enterprises. We are humbly proud that becoming a

Type of Suppliers	Location
Stationery	Sri Lanka
Fixed Assets	Sri Lanka
Outsourced services	Sri Lanka
Premises	Sri Lanka
Computer hardware & software / communication equipment	Sri Lanka & Foreign
Utilities	Sri Lanka

Product	Impact
HNB Singithi and student Savings units	Encourage a savings habit amongst children
Yauwanabhimana	Empower youth
Gami Pubuduwa	Foster commercial viability for entrepreneurs from disadvantaged communities.
Adhistana	Create value for migrant workers and encourage savings.

supplier to HNB has in fact fuelled many an enterprise to grow from Micro level to SME.

We ensure regular engagement with our suppliers to help create awareness of best practices and to ensure that there is mutually beneficial commitment to meet the Bank’s stringent sustainability criteria. All suppliers who are registered with the Bank must meet all regulatory requirements, ethical standards set forth by the Bank and its procurement and sustainability criteria.

Ensuring the highest standards in procurement

Aspect	Process followed
Transparency	<ul style="list-style-type: none"> • Tender process ensures transparency of expectations • More than one procurement evaluation committee • Final approval by the Board of Directors
Confidentiality	<ul style="list-style-type: none"> • Supplier information treated with confidentiality • Fair trading
Selecting one supplier over another	<ul style="list-style-type: none"> • Through a rating process based on criteria laid out in the procurement policy
Supplier concerns / discontent	<ul style="list-style-type: none"> • Raised through supplier engagement • Appeal schemes to raise issues directly or whistle blow to the AGM - Services and/or to the Chief Operating Officer
Facilities to support suppliers	<ul style="list-style-type: none"> • Credit accommodation
Termination of suppliers	<ul style="list-style-type: none"> • Based on stringent review process and following dialogue and subsequent to other mechanisms such as penalties
Service Improvements	<ul style="list-style-type: none"> • Operation and procedure manuals on service quality checks

Management Discussion & Analysis

Capital Management Report

Social & Relationship Capital

COMMUNITY

As one of the leading financial institutions with a customer base that ranges from the leading corporates and the multinational to the SME and the Micro enterprise, “partnering the progress” of diverse communities across the rural hinterlands and cosmopolitan localities is inherent to our value creation process.

Some of our products which have a win-win impact beyond immediate monetary benefits include the following :

Financial empowerment and beyond

The contribution we make to the country's development goals is one we hold high and is intrinsic to the Triple Bottom Line approach we have adopted.

A strong culture of SME lending which dates back to the Bank's inception, has meant that our involvement with the rural communities and economically less advantaged across the country has become intrinsic to our business model. The Bank continues to uplift the micro finance sector through “HNB Divi Saviya” launched over two decades ago, and its pioneering in house financing initiative branded as “Gami Pubuduwa” whilst the recent acquisition of HNB Grameen has further widened our involvement in this sector.

Our Bank's engagement with this sector has extended beyond mere lending and includes the following:

- Training to improve financial literacy management and technical skills.
- Entrepreneur Development and Customer Awareness programmes across the country
- Creation of marketing opportunities through trade fairs.
- Establishing market linkages
- Introduction of technology to promote customer products and link producers to online buyers;
- Facilitating tripartite arrangements to facilitate backward integration for small scale suppliers. Over the years these partnerships have helped generate new employment, adopt new technologies and facilitate a transition from subsistence farming to commercial scale.
- Assisted quality improvements through the introduction of quality assurance experts

Objective	No. of initiatives	Coverage	Beneficiaries	Staff engagement	Outcome	Continuity
Gami Pubuduwa Avurudu Pola	9 fairs	Islandwide	Micro entrepreneurs, SMEs	Branch and microfinance staff	Improved market for products, introduction of buyers and suppliers.	Will be continued in 2017
Providing assistance to farmers	2	Mahaweli H zone, Kekirawa, Siyambalanduwa	Maize cultivators, farmers in Mahaweli H-zone	Microfinance staff	Improved income and buy-back arrangements	Will be continued in 2017
Financial support for dairy farmers	2	Kalutara district, Dambulla	Dairy farmers	Microfinance staff	Better prospects for farmers, assistance to achieve national goals	Will be continued in 2017
Supporting women entrepreneurs	1	Katugasthota area	70 women entrepreneurs	Microfinance staff	Improved income for 70 families	Will be continued in 2017
Workshops/ awareness programmes on Financial Management and Skills Development	14	Islandwide	Micro entrepreneurs	Microfinance staff and SME units	Improved skills and financial discipline among micro entrepreneurs and SMEs	Will be continued in 2017
Rural economic development	5	Islandwide	Rural communities islandwide	Branch staff, Microfinance staff, SME units	Improved rural economy through empowering entrepreneurs	Will be continued in 2017
Youth education	1	North Western province	Youth in NWP	Branch and microfinance staff	Empowering youth	Will be continued in 2017

Programmes and community initiatives for micro entrepreneurship development by region

Region	Financial Literacy		Entrepreneur Development		Farmer Awareness		General Awareness		CSR		Avrudupola (Trade Fair)
	No. of Programmes	No. of Participants	No. of Programmes	No. of Participants	No. of Programmes	No. of Participants	No. of Programmes	No. of Participants	No. of Programmes	No. of Participants	No. of Participants
Central	10	1,336	6	218	17	2,848	11	2,626	12	1,245	16,000
Eastern	26	598	24	565	48	1,171	31	698	3	140	800
Greater Colombo	5	391	5	595	6	186	11	760	6	1,464	1,140
North central	5	100	9	345	11	615	3	110	11	1,875	1,500
North western	5	1,318	11	385	2	64	7	225	6	1,131	2,800
Northern	15	415	16	411	56	1,178	36	997	1	225	1,280
South western	2	20	1	20	3	330	8	855	4	1,300	2,550
Southern	-	-	20	691	14	677	-	-	-	-	4,200
Uva Sabaragamuwa	2	30	1	13	2	27	3	100	1	3	1,400
Total	70	4,208	93	3,243	159	7,096	110	6,371	44	7,383	31,670

In addition to the role we play in partnering the progress of countless individuals through our business model we also strive to make a difference in lives of communities we operate in, to be socially relevant and give back to those communities by participating different activities organized by these communities as well as by giving leadership to espouse different causes and topical issues. It is these engagements and relationships which enrich our brand and strategy.

Impacting a multitude of communities, causes and lives through our CSR initiatives in 2016

The Bank and its employees continued to be actively involved in serving the community beyond of their considerable involvement in the CSR programmes initiated at corporate level i.e by the HNB

Sustainability Foundation and our numerous customer awareness and financial literacy programmes.

With 4,190 employees and 251 customer touch points, these activities are too many to enumerate. Nearly all teams engage in the following:

- organising a variety of Almsgivings for Vesak and Poson as well as sponsoring and taking part in Bakthi Gee programmes
- sponsoring sports days, prize givings and other events in schools in their command area with the branch manager being invited as chief guest to the occasion
- providing meals for the inmates of a charitable institution in the locality to mark significant milestones such as the branch anniversary

- organising or actively participating in blood donation campaigns

In the year under review, the Bank's employees also donated generously towards supporting people affected by floods and to the Trail walk.

(Please refer the section on Natural Capital section for environment related projects)



Trail walk Gold sponsor



Flood relief activities



Avrudhu Pola – trade fair to support micro entrepreneurs

Management Discussion & Analysis

Capital Management Report

Social & Relationship Capital

CSR Pillar	Description of initiative	Location	Number of beneficiaries	Continued/ One-off
Education	Donation of English books (in collaboration with The Asia Foundation)	Islandwide	200 schools	Will be continued
	Renovation of library facilities; donation of furniture and books	Central province and southern province	4 schools	Will be continued
	Establishment of school library	Central province	2 schools	Will be continued
Health	Sponsorship of TRAIL walk – towards building a cancer hospital in Galle	Walk - islandwide	Cancer patients in the southern province	One off
	Maintenance of counseling centre for cancer patients	Apeksha Hospital, Maharagama	Cancer patients	Will be continued
	Financial assistance for cancer patients	Island wide	Cancer patients	Will be continued
	Provision of safe drinking water facilities to schools in areas affected by chronic kidney disease	North central province	3 schools	Will be continued
	Safe drinking water facilities to hospitals	Northern province	7 wards of the Mannar General Hospital	One off
	Sponsoring the National initiative to prevent HIV/AIDS by conducting an HIV testing day	Northern province	5,000	Will be continued
	Sponsorship of HIV/AIDS awareness campaign under the World AIDS Day national event	Western province	General public	Will be continued
	Sponsorship to establish an Emergency Trauma Unit at the Batticaloa Teaching hospital	Eastern province	Patients in Eastern Province	One off
	Support to set up a Dengue High Dependency Unit at the Kiribathgoda Base Hospital	Western province	Dengue patients in Western Province	One off
	Renovation of the half way home at the National Institute of Mental Health, Mulleriyawa	Western province	Mentally ill patients	One off
Other infrastructure projects	Displaying warning signals at unsafe railway crossings	Island wide (30 boards were placed during phase I of the project in the Dehiwala Mount-Lavinia area)	General public	Will be continued
	The Sri Pada Indikatupahana rest room renovation project	Central province	Pilgrims	One off
Entrepreneurship development	Awareness programme for young entrepreneurs on tech start-ups	Northern province	35	Will be continued
	Supported the 'Yarl Geek Challenge' on creativity and innovations by awarding a gold coin to the winners	Northern province	35	Will be continued
Preservation of Sri Lankan heritage	Sponsor of the "National Trust"	Western Province / Island wide	General public	Will be continued
Responding to natural disasters	Assistance to the people affected by disasters with contributions from employees	Western and north-western province	General public	One off

Natural Capital

Initiatives 2016

Objectives	Status
Energy efficiency and use of renewable energy	<ul style="list-style-type: none"> Solar panels installed in 37 branches Enhanced the radius of our green and sustainable sphere by installing a Solar Photovoltaic (PV) system at the head office building. Continued investments in measures such as energy efficient lights, energy efficient Inverter type air conditioners, solar PV systems Continued awareness programmes to reduce energy consumption at customer centres Converted the conventional type air conditioners to the energy saving type. Maintaining the correct temperature settings for air conditioners Maintaining the correct indoor air quality Merger of two branches located at close proximity and the amalgamation of the back office functions of two other branches located at close proximity, enabling a more efficient utilisation of resources including energy and space Introduction of a concessionary loan scheme for employees to purchase solar energy systems for their homes.
Paperless Office	<ul style="list-style-type: none"> Automation of several internal documentation processes helped reduce paper usage during the year. For example, engineering tenders which were hitherto submitted and reviewed on paper were converted and limited to Electronic format. Significant paper saving during the year i.e 8,457 Kgs being 6.2% of total paper consumption despite increased business volumes
Training on the ESMS	<ul style="list-style-type: none"> Implemented comprehensive certificate course on ESMS 275 employees were provided training

Way forward

- Reduce carbon footprint by 50% by 2020 through converting 50% of the energy for administrative buildings from renewable sources
- Reduce paper usage in administrative work by 75% by 2020
- Achieve 100% training and certification of all employees responsible for business loan approval by 2018

Rs. 2.85 Bn worth of loans allocated to Hydro, Wind and Solar power generation

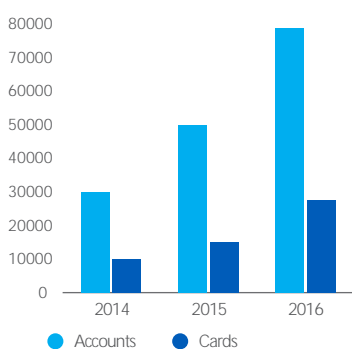
The Bank installed Solar energy at 37 of our branches during the year, to generate 2 Mega watts of power; reducing dependence on the national grid by 25% and achieving a reduction in our energy bills at a total investment of Rs 354 Mn.

8.88 MT/sqft
Carbon footprint

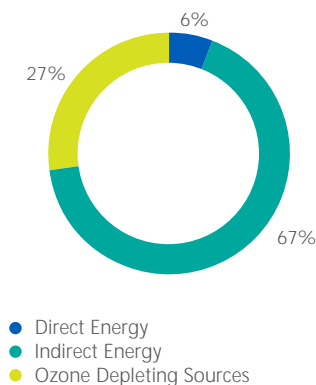
10.2%
Reduction in Greenhouse Gas Emission

E- Statements Conversion Progress

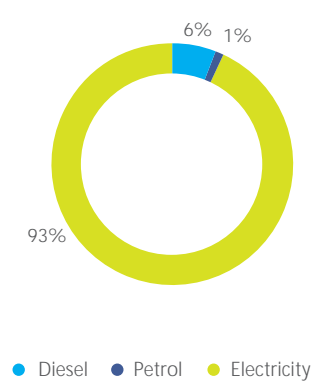
No. of statements



Carbon Footprint



Greenhouse Gas Emission



Management Discussion & Analysis

Capital Management Report

Natural Capital

Given the nature of the industry, the Bank's operations are not natural resource intensive and the carbon footprint of our activities is relatively limited. However HNB values a Triple Bottom Line approach based on the belief that preserving the environment is ultimately and in the long term everyone's responsibility and is in everyone's best interest. We are also aware of the tremendous impact we can have indirectly through our business as well as through engagement with customers and society. The HNB Green Pledge by every employee serves as the fundamental point for their commitment to reduce environmental impact, and is a catalyst for behavioural change, both within and outside the organisation.

The Bank's strategy of digitalisation and BPR have had a Triple Bottom line impact. An expansion of the BPR efforts during this year contributed to reduce our costs as well as our carbon footprint. The automation of processes across the different business verticals continued to reduce the use of paper whilst driving banking in the digital space reduced the need for customers to visit a bank, thus reducing fuel consumption. The year ahead will see us open the first ever digital branch - a stride in our journey towards a paperless world

Energy - reducing consumption and promoting renewable energy

The year under review saw the Bank begin the systematic conversion to solar power in the branches and to encourage investments

into solar energy panels by our employees, the details of which are reported under initiatives for 2016 in this report.

Green Procurement

Our procurement policy ensures that the Bank's sustainability criteria are included in the specifications we send to suppliers and that the criteria are met and the suppliers' environmental credentials are evaluated when awarding contracts. We follow a comprehensive process of engagement in this regard with suppliers whose turnover exceeds Rs. 1 Million.

Environmental and Social Management System (ESMS)

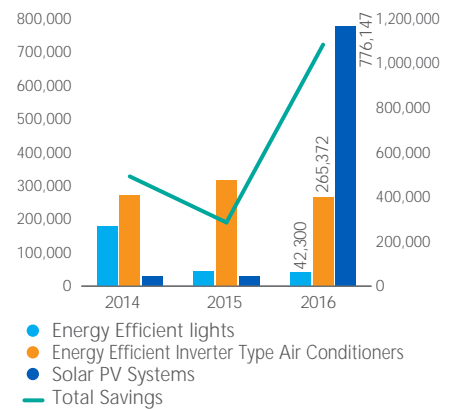
The Bank's Environmental and Social Management System (ESMS) ensures that the Bank's credit portfolio conforms with all financial, judicial, regulatory and socially acceptable standards and applies a process of Environmental and Social (E&S) risk assessment to ensure that the portfolio is E&S risk free. In addition the ESMS also promotes improved social and environmental performance by customers which may arise from existing weaknesses in local legislation.

CSR green Initiatives to in 2016

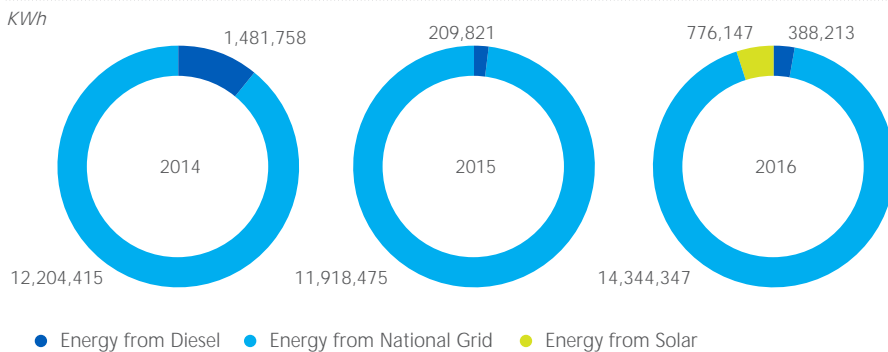
- HNB is a Patron member of Biodiversity Sri Lanka and offered a sponsorship for their AGM

- HNB was the principal sponsor for the national event for World Wetlands day 2016.
- Green sponsorship and staff participation for the Sri Pada Cleaning Project organised by the Young Biologists' Association and the Leo Club of Colombo to clean the road from Hatton to Adam's Peak.
- Assisted a tree planting project at the Nawalapitiya General Hospital to promote the growing of native trees in government department premises.
- Continued to hold the Green Quiz competition for staff to promote environmental awareness.

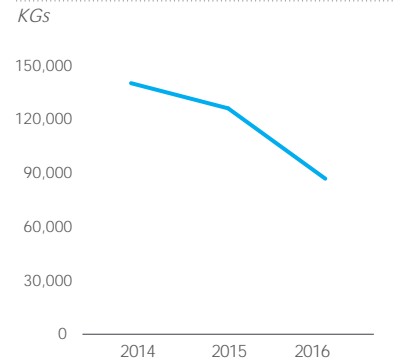
Total Savings during the period (kWh)



Energy Mix



Paper Recycling



Impact to Stakeholders

Investor

ROE	ROA
19.9%	1.8%
Gross dividends	Holding period return
Rs 3.5 Bn	10.9%

Compared to the decline of 9.7% in ASPI

Supplier

Utilities	Rent
Rs 490 Mn	Rs 955 Mn
Technology providers	
Rs 585 Mn	

Customer

251	485
Branches	ATMs

- Offering choice and convenience through omni channels (branches, ATMs, electronic and mobile banking)
- New products and services to cater to customer needs such as Payment and Cash Management, Wally-E, Ijarah
- Faster turnaround times through process improvements

Community & Environment

Taxes	
Rs 10.4 Bn	Rs 105 Bn
	Disbursed to SME and microfinance customers
432	1,083,819 kWh
Entrepreneurship development programmes	Energy saved

Employee

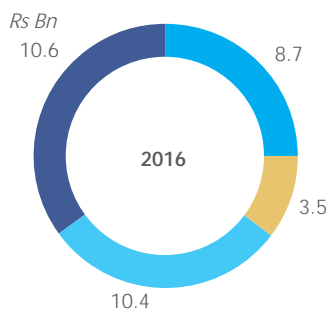
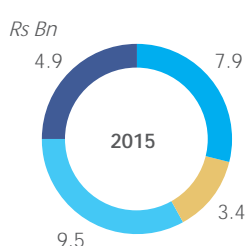
Training per employee	Employee benefits
39 Hrs	Rs 8.7 Bn

- Empowerment and equal opportunities
- Career development and recognition

Regulator

Strengthen stability of the banking industry through prudent management and policies, fair banking practices and by ensuring compliance to regulations (LAR -24.2% CAR-15.3% against the regulator minimum of 20% and 10% respectively)

Analysis of Value Addition



- To employees
- To providers of capital
- To Government
- To expansion and growth

Management Discussion & Analysis

Business Performance Review

Corporate Banking

HNB's Corporate Banking creates value for its clientele through a comprehensive portfolio of best-in-class financial solutions and service offerings, for local and multinational, large and mid-sized enterprises; served by a skilled and experienced team of Relationship Managers, state of the art integrated electronic banking channels as well as an island-wide footprint of one of the largest branch networks in the country.

17%
Growth in Assets

Rs 300 Bn
Assets

81%
Growth in NII

Performance

The year under review saw the Corporate Banking business reinforcing its leadership position in terms of lending book and profitability. It is also noteworthy that this performance was in a backdrop of subdued economic activity which inhibited demand for corporate borrowings across all industries. Nevertheless, the lending book grew by 17% in 2016, compared with a growth of 30% in the previous year.

The remarkable performance by Corporate Banking was primarily driven by its holistic approach towards client relationship management, led by a seamless approach to marketing of the Bank's customer offering in Trade, Treasury, Cash Management as well as Custody and Trustee services. The Bank will continue to focus on offering total value solutions for its clients in order to further deepen its relationships across all corporate banking customer bases. The depth of the product suite and service offering - which positions Corporate Banking business as "the preferred corporate banking partner amongst the targeted clientele", as well as the long lasting relationships nurtured with clients once again proved to be key competitive advantages. Deepening the Bank's wallet share in Trade, Treasury and Cash Management solutions from key customers contributed significantly during the year for the business to make progress towards achieving some of the Bank's strategic priorities such as increasing fee income.

Moreover, the NPA, at 0.8%, reached the lowest for the last decade and is amongst the lowest in the industry. The depth of the relationships maintained with our corporate clients and the up-skilling of Relationship Managers, in order to enable a thorough understanding of the Bank's clients' businesses and the early identification of signs of potential distress, helped in managing the quality of the business portfolio.

Corporate Banking's Game Changing initiatives during the year were the launch of the state-of-the-art fully integrated electronic banking platform as well as the launch of the Custody and Trustee business – becoming the only local Bank to offer these two banking solutions. Branded as "HNB Online", this new electronic banking portal enables corporate customers to manage cash, payments,

liquidity investments as well as international trade transactions better through this end to end integrated banking solutions and has strengthened the Bank's platform for sustained growth and continued leadership in the Corporate Banking business.

The year under review saw "HNB Online" facilitate a considerable contribution to the businesses' key strategic objectives by driving sales and fee income. The year ahead will see Corporate Banking expand its offering through "HNB Online" as well as penetrate the Custodian and Trustee Services business, thus continuing to add value across the entire value chain, consolidating its position as the preferred corporate banking partner of its targeted clientele.

Following Corporate Banking's venture into overseas markets in 2015, with lending in Cambodia and Uganda, the Bank expanded on its overseas presence during the year in Bangladesh and the Maldives.

In line with HNB's Triple Bottom Line focus, the Corporate banking division ventured into funding its first Solar energy project during the year, in Hambantota. The business also funded two new hydro power projects in the country which together with the solar power project will add a further 34 Gwh to the national grid.

The Bank continues to play a valuable role in supporting the development of the country's infrastructure development and during the

Game Changer

HNB's Corporate Banking business in 2016:

- » Launch of "HNB Online", a fully integrated end to end electronic banking channel, the first to be offered by a local bank
- » Launch of Custodial and Trustee business
- » Continue to deploy significant lending assets overseas
- » NPA of less than 1%

year it funded several projects in road, water and healthcare sectors.

Ensuring an excellent service to our clients continues to be a priority as well as an unique selling proposition of HNB; hence our continuous priority to ensure that our Relationship Managers (RM's) are experienced and empowered to do so and to expand the value they can create for our clients. During the year, the Bank provided technical training on credit, financial analysis, trade and treasury as well as development of soft skills such as leadership and relationship management, in order to enable our RM's to be on par with the best in the world.

Strengths

- Depth and breadth of the corporate client portfolio and the strength to provide banking solutions to customers across the entire value chain, including supplier and distributor financing
- Ability to support large and complex project financing engagements
- Longstanding client relationships established with key corporate customers
- Skill sets and experience of Corporate Relationship Managers
- A long and trusted brand name
- A state of the art, fully integrated electronic banking platform which offers end to end solutions to corporate clients



Signing an agreement with Hela Clothing

Challenges

- Low liquidity
- Rise in interest rates
- Intense competition and narrowing margins
- Depreciation of the Rupee

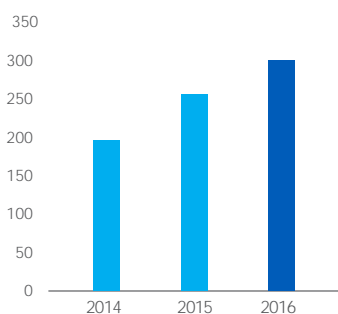
Way Forward

- Expand business opportunities by further strengthening client relationships and enhancing HNB's value creation for clients
- Continue to invest in up-skilling of Relationship Managers to sustain a key competitive advantage of the Bank
- Fully leverage the first mover advantage created by some of the Game Changers

- of 2016 such as the launch of the Payments and Cash Management platform and the Custodial and Trustee business
- Harness new opportunities we expect from an improved investor climate, enhance international relations, increase in trade following from a possible resumption of the GSP+ and anticipated bilateral trade agreements
- Continue to expand our overseas presence

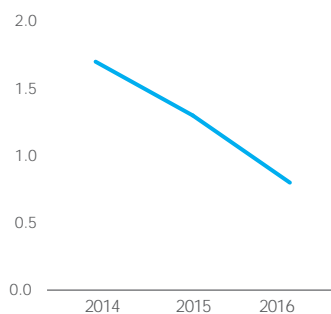
Corporate Assets

Rs Bn



Corporate Banking NPA

%



Management Discussion & Analysis

Business Performance Review

SME

HNB's pioneering role in the SME sector dates back to its inception in 1888, in the rural hinterlands of Sri Lanka. Today it continues to be a market leader in the SME sector, a role which is sustained and continuously expanded by the Bank's Triple Bottom Line approach in business. HNB's SME customers constitute enterprises with an annual business turnover of less than Rs 750 Mn and lending exposure of less than Rs 200 Mn. Its clientele spans the entire gamut of sectors which range from Agriculture, Plantations and Agro based industries to Services such as IT and Tourism and manufacturing industries, with Trading constituting a larger share. The SME portfolio during the year contributed 29.5% and 27.1% to HNB's interest income and loan book respectively.

Performance

The Bank's SME portfolio performed as expected, recording a growth of 25% and a 21% growth in disbursements which totalled Rs 75 Bn during the year. This year's performance was supported by comparatively higher growth in the country's agriculture and tourism sectors. The curtailment of rice imports to the country helped realise its intended impacts - of increasing local production and boosting related businesses such as rice milling, thus contributing to growth in agriculture led SMEs. Moreover, the depreciation of the rupee also increased the competitiveness of Sri Lanka's exports and supported higher export earnings by the SME sector. Despite the rise in interest rate during the year, demand for credit in the SME sector continued to grow in the areas out of the western province. Additionally, the

continued political and economic turmoil in Sri Lanka's main export markets such as the Middle East and Russia continued to dampen the performance of some key sectors such as Tea and other agri products. At the same time, a most welcome decision by the EU to lift the sanctions it had imposed against fish imports from Sri Lanka, is yet to yield the anticipated impact on Sri Lanka's fisheries sector.

Several of the Bank's operational initiatives during the year helped enhance service and speed of delivery and contributed to performance. Having recognised the need for quick decision making in the SME sector, with those decisions often needing to be made sans projected long term cash flows and other MIS; HNB enabled greater empowerment for more decision making to take place at regional levels. These measures have strengthened the Bank's platform to

Game Changer

HNB's SME business in 2016:

- » SME Cells
- » Distributor and supplier financing

harness the prospects it foresees in the next few years for sustained and enhanced growth of the SME sector. The year under review also saw HNB's access to low cost funds expand further, thus strengthening the Bank's capacity to lend to the SME sector at appropriate interest rates.

Distributor Financing - the new channel of business we launched in 2015 gathered momentum during the year, to achieve growth of over 260% in total disbursements. This business model provides payment solutions for large corporates who operate with a distributor network and benefits distributors with the offer of a revolving line of credit. The model also offers flexibility to customise as per the client's requirements.

In keeping with our Triple Bottom Line approach, HNB continued to partner agencies such as USAID, GIZ, private accountancy bodies and the Federation of Chambers of Commerce of Sri Lanka for win-win initiatives to train, impart knowledge and develop entrepreneurship in order to uplift the SME sector across the country, and these are elaborated on in the Social Capital section of this report.



Entering into a distributor financing agreement

25%
Growth in Assets

Rs 161 Bn
Assets

28%
Growth in NII

Key strengths

- A strong culture of SME lending established since the Bank's inception in 1888
- Strong in house expertise and ten regional cells which focus on delivery to SME's
- Wide geographic spread of our branch network and the ability to reach rural markets in hitherto inaccessible locations
- A faster and superior service facilitated by an online credit approval system, an empowered regional structure supported by fully operational SME Credit Cell which manage the entire relationship of selected SME clients
- A wide range of products/services available within the Group to meet any financial need of SMEs
- HNB's lending in the Micro Finance space which empowers startups and facilitates their progressive advancement to become SME clients
- Ability to offer a comprehensive financial package to customers with pre-approved limits
- A robust risk management framework with representatives at each level of SME lending for facilities above Rs 20 Mn
- The long standing relationship with donors such as ADB/Govt Agencies and a few organisations which enable the Bank to arrange value additions to SMEs apart from concessionary funding under different schemes

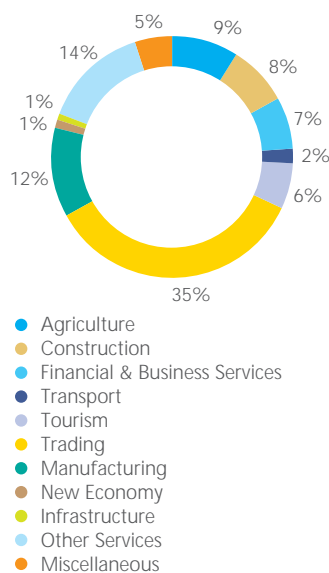
Challenges

- A rise in interest rates during the last nine months and the likelihood of a continuing upward trend
- Constraints to proper credit evaluations due to lack of audited financial statements and other MIS in the SME sector
- Industry weaknesses such as constraints against lending without collateral, which hinders SME growth due to their inability to provide collateral
- Sri Lanka's SME sector's disinclination to utilise state of the art technology due to high costs of investments and a lack of awareness, vis a vis some other countries
- The vulnerability of some of Sri Lanka's SME sectors to global market conditions and commodity prices
- Impacts of climate change on the Agriculture sector, which currently constitutes 9% of our portfolio

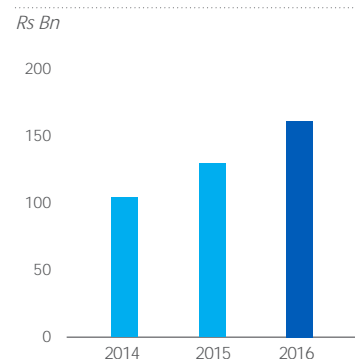
Way Forward

- Brighter prospects in the Sri Lankan economy led by the projected growth in export tourism, construction, infrastructure investments, including Megapolis, regional industrial estates and higher consumer spending in the next few years, which augurs well for SME growth
- A younger generation who is very IT savvy will provide opportunity to expand the Bank's digital solutions and innovations to change the game in the SME sector
- Enhanced focus on re-financing business
- Expand cash flow based lending
- Further strengthen capacities of ARMs for SME focused lending and appraisal methods
- Expand credit to women and youth entrepreneurs
- Be the Best SME Bank with best delivery standards and quality
- Provide better resources to SME cells and redesignate staff for better recognition

Sectorwise Distribution of SME Advances



SME Assets



Management Discussion & Analysis

Business Performance Review

Retail Banking

HNB's Retail Banking business, true to its brand promise, strives to be a "partner to its customers through the different stages of life" - from birth to childhood, student to adult and senior citizen; with a comprehensive portfolio of lending and investment products which includes Leasing, Housing Loans, Personal Loans, Pawning, Current & Savings Accounts, Fixed Deposits & Credit Card Services; delivered digitally or through its extensive branch and ATM network. The portfolio also encompasses both Inward and Outward remittances.

6%
Growth in Assets

Rs **130**Bn
Assets

30%
Growth in NII

Performance

The Bank's Personal Financial Services performed well to grow by 6.4% amidst rising interest rates, as it continued to reap the dividends of the Bank's key strategic initiatives such as creating a more "sales driven culture", the "digital drive" and "service excellence" which have begun to change the game in the retail market space. The fee income from Retail Banking thus grew by over 90%, making a robust contribution to the Bank's key strategic objectives.

The rise in interest rates which began towards the end of 2015, continued its upward trajectory through 2016, propelling a demand for term deposits during the year. The high yielding Fixed Deposits hence surged to grow by 29% whilst the Bank's asset portfolio grew by 18.4%.

The "New World" of banking possibilities we unveiled last year, combined with the "Feet on Street" initiated through the deployment of the Direct Sales Force (DSF), contributed to drive sales during the year. Our Children's Savings proposition "Singithi", which was revamped and re-launched with expanded rewards and greater flexibility in 2015, continued to attract deposits. Minor Savings hence grew by approximately Rs 2 Bn during the year, and promotions during the international thrift month of October saw Children's savings deposits soar to a record Rs 900 Mn for the month. The School savings units,

which were infused with new vigour as students of the schools themselves who had completed their studies were trained to operate these units, also contributed to the growth in the Bank's minor savings during the year.

The year under review also saw the Personal Financial Services create new avenues to "Change the Game" for an important segment of the country's population, by becoming the exclusive banker to employees of a leading garment manufacturing group in the country. HNB thus facilitated financial inclusion for a segment of the population which hitherto had no access to formal banking facilities. Following engagement and discussion with these factory employees, a majority of whom are females, the Bank was able to identify and prioritise their financial needs to offer propositions that encompass all those financial needs, such as medical insurance for their aging parents, credit cards and even attractive discounts on electronics and furniture items. This ground breaking, win-win initiative reflects the Bank's aim to integrate business objectives with sustainable value creation for society at large. Accordingly, the Bank also extended its engagement by providing its new customers with training in managing their finances and this would continue as an on-going initiative. During the year, HNB opened over 2,000 accounts across the different factories of the Group.

"PAY FAST" – the Bank's payroll processing business continued to grow with the addition of 785 new employers during the year, bringing the total number of companies using PAY FAST to over 2000

Game Changer

Some of our Game Changing digital strides in the Retail Banking space:

- » Launched a single platform for both mobile & internet banking enabling access with single login credentials
- » Ability to sign up for internet Banking with the HNB Debit card
- » Customers Facebook profile integration to the Internet Banking profile; where customers can access internet banking using their Facebook login credentials
- » Card-less ATM transactions for bank/ non bank customers, facilitating P2P payments across the country
- » Real time Fund transfers through CEFTS using Internet Banking and ATM channels;
- » Deployment of Recycler and bulk cash deposit machines in strategic locations
- » Sri Lanka's first ever fully fledged digital branch to be opened in the 1st quarter of 2017.

Leasing

The Leasing business, reflecting the market's performance, decelerated during the first half of the year due to the impact of the increase in vehicle taxes, which resulted in a sharp drop in new vehicle registrations in the country. However, the second half of 2016 saw demand resume, thus enabling the Bank to achieve a growth of 3.6% and maintain its leadership in Leasing amongst Banks. Moreover, HNB was able to cater to a growing trend in the market - of a rising demand for high end vehicles, by establishing links with suppliers and by offering a variety of value added services for customers. Step up & step down leases, Residual balance leases, Structured leases, "My Dream" option for vehicle upgrades, machinery and equipment lease financing as well as free life insurance cover and special insurance packages offered in collaboration with HNB Assurance are important value additions to the product. It augurs well for the market that the demand for machinery leasing grew vis a vis vehicles, reflecting an increase in revenue and GDP activity in the economy.

Shanthi Housing Loans

HNB's flagship product "Shanthi" continued to maintain its leadership position in the housing finance market, supported by the Bank's concerted efforts to develop and grow this sector whilst fine tuning the product to meet evolving needs. HNB introduced several unique "Game Changers" in this segment which helped enhance the product offering, customer service and convenience, whilst also

augmenting fee income for the Bank. During the year the Bank became one of the first in the market to offer customers the option of combined interest rates - that of a fixed interest and a floating interest rate; which gave flexibility to potential home owners to structure their financing based on their outlook on interest rates.

One of the unique initiatives to enhance customer convenience was the introduction of a Fast Track in-Principle loan eligibility approval process, giving customers the convenience of finding a house within their budgets.

Moreover, the Bank also launched more value added services for home owners by offering them documentation support services to obtain the required documents and approvals for a loan. Everything from title searches to building approvals and other onerous requirements that are prerequisites for purchasing or building a home, is facilitated through this service. The service offered by the Bank through outsourced subject matter experts, saves home owners significant time and the hassle that is usually associated with the processes of approval, and thus, true to the Bank's advertising tag line, seeks to "lower the heart rate" for those who look to own a home of their own.

In recognition of customer loyalty, the Bank introduced a Loyalty Card for existing and new housing loan clients, offering a range of discounts and other benefits at outlets that supply building materials and other white and brown goods that are required to set up a new home.

Additionally, the Bank also began to offer expert mortgage advisory services at the door step of prospective clients, through their mobile mortgage advisors who zip around the city in their 'Shanthi vehicles' visiting clients at their home or office and completing the entire application process at a time and location as per the customer's convenience.

The Bank also continued to reinforce its dominance in the condominium market by entering into 31 new tripartite agreements with developers of new properties in Colombo, its suburbs and some key outstation locations. The total number of tripartite agreements currently stands at 49.

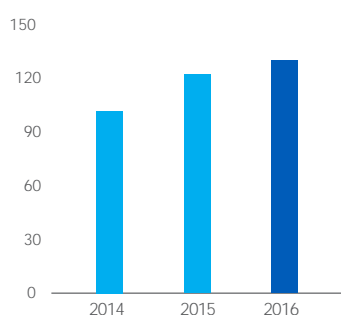
Personal Loans

HNB expanded its wide range of Personal Loan facilities during the year. Our portfolio continues to cater to the varied needs of customers at the many different stages of their lives, which range from education to home renovation, purchase of a vehicle to investments and a host of others. During the year, the Bank broadened its portfolio of loans to offer Emergency Medical Loans and thus ease the burden for an individual or a family, at a difficult and critical time in their life. Emergency loans are approved in a matter of hours, recognising that time in such instances could often mean a matter of life and death. This product offering exemplifies the Bank's effort to combine its sense of social responsibility with product development.

The Bank also enhanced and revamped its Education loan offering to make the product

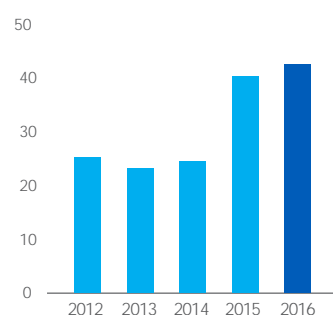
Retail Assets

Rs Bn



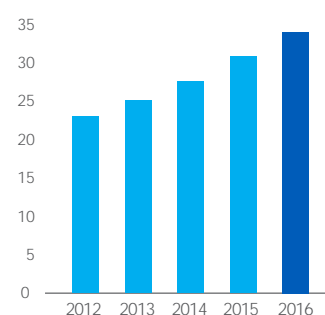
Leasing

Rs Bn



Housing Loans

Rs Bn



Management Discussion & Analysis

Business Performance Review

Retail Banking

more relevant and in sync with the payment patterns of the different educational institutions and the repayment capacity of the borrower.

Another addition to the portfolio during the year was the Debt Consolidation product to ease the burden for those encumbered by debt. By undertaking to pay up the many debts that an individual may have obtained from many different providers, HNB enables a person to consolidate his or her debt with a single provider, thus facilitating convenience and ensuring that the burden of debt is contained, providing reprieve for those saddled with multiple borrowings. We have found this product to be particularly beneficial to newly employed recent graduates who are suddenly overwhelmed by their higher earnings and are over burdened by debt, due to the poor management of their finances. The Bank also extends and creates additional value for such clients by offering financial management awareness and training.

The Personal Loans portfolio grew by 10% over the previous year and the Bank's predominant target market continued to constitute corporate employees and professional segments of the country.

Pawning

Following a policy decision and a concerted effort to limit our exposure to Pawning in 2014, the Bank re-examined this policy during the year. In the context of several factors such as HNB's significant and strategically important role in Sri Lanka's micro finance sector where rural farming communities often rely on pawning to fund their working capital requirements, the Bank decided to re-enter the pawning market, with a policy to maintain pawning at not more than 5% of the Bank's total lending. The year under review hence saw an year on year decline of 15.5% in its Pawning portfolio compared with a decline of 26.5% in 2015. A modest month on month growth in the portfolio was recorded in the 2nd half of the year.

Payment Cards

The Bank's card business recorded an excellent performance in both volume and value terms, and continued to be one of the key drivers of the Bank's Fee Income growth. A strong sales drive at a multitude of customer points supported by a strong re-positioning campaign themed "Don't Postpone Happiness" supported the growth in the Bank's card business. Income from merchant commission increased by 30% during the year whilst card revenue increased year on year by 23%, and the number of cards exceeded 110,000 as at year end. HNB also continued to maintain its market leadership position in merchant acquiring with 44% share of the market.

HNB Momo - the mobile POS app launched in 2014, gathered momentum to become the Game Changer for many small and medium scale entrepreneurs, ranging from dental surgeons to a fish monger and cab drivers, to facilitate ease of business and convenience for all stakeholders.

During the year we also commenced issuing chip enabled Debit cards under Visa Classic and Visa Platinum tiers. The card can be obtained from any HNB customer service centre as an "Instant Issuance" card with a PIN given over the counter.

Inward Remittances

The Bank's Inward Remittances grew by 12.2% ahead of the growth in total remittances to the country and well above previous year's.

The growth in volumes was also supported by an increase in the number of Sri Lankans securing overseas employment and the opening up of new markets to offer a wider range of employment opportunities for Sri Lankans. Although global economic conditions in several regions resulted in instability of inflows of remittances from these markets, the long standing relationships established by HNB with overseas remittance partners and its brand equity amongst the Sri Lankan diaspora combined with its fair tariff policy applied to transactions, supported increased volumes in the sector. Moreover, the facilitation of Access Point Integration technology transfers with minimal human intervention which enhanced speed of delivery to customers and improved efficiencies, also contributed to achieving higher volumes from our existing remittance partners.

The year under review also saw HNB introduce several Game Changers in the Remittances market in Sri Lanka. It established remittance agreements with overseas Telecommunication service providers, thus venturing into a rapidly growing remittances channel in the global and local landscape. The venture into this



At the Asian Banker Excellence in Retail Financial Services Awards.

space has also opened avenues for new markets which were inaccessible till now.

The Bank also implemented CEFT (Common Electronic Fund Transfer) to enhance value for our remitting agents, by ensuring a speedy delivery of their payments to other banks. We expect the enhanced service to generate higher volumes and hence higher income in the years ahead.

As part of the Bank's concerted efforts to achieve a more sales driven culture, the Inward Remittances division increased deployments of overseas representatives to identified growth markets during the year, and also implemented an exclusive incentive scheme for HNB representatives to garner remittances and cross sell HNB's other products.

Priority Banking

HNB's proposition for the high net worth segment was rebranded as 'HNB Priority Circle' during the year subsequent to the research conducted in 2015. The value added service offering was rolled out in 2016 across the entire network, to serve high net worth clients around the country. During the year, the business segment performed exceptionally and with the plans to open centres in key locations in the coming year the Priority Circle is expected grow even stronger.

Key Strengths

- The strength of our 251 island-wide branch network and 485 ATM network

- Being a bank of choice which transcends regional, ethnic and religious divides.
- Brand attributes of strength, stability and trust.
- Technological leadership.
- Extensive product range.
- One of the largest and fastest growing internet & mobile Banking customer bases.
- Speed of delivery.
- Flexibility of approach in business relationships which facilitate innovative and tailor-made solutions.
- A focused strategy and drive at the highest level for technology driven banking and market leadership.

Challenges

- Intense competition and reducing margins in the industry
- High volatility in market rates and the difficulty in attracting low cost funds
- Barriers to entry into certain high potential markets for Inward remittances such as visa restrictions or rigorous visa procedures and high costs of investments to establish representation. For example Australia, Scandinavia and Canada
- Competing with the non-formal players in the industry who do not adhere to the same stringent procedures as the banks
- More competitive exchange rates offered by competitor banks to capture market share

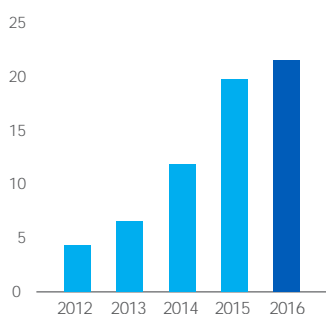
- Protectionist regulations by some other countries, such as the imposition of ceilings on outward remittances. These could also prompt customers to use illegal channels

Way Forward

- Leveraging technology and ebanking platforms and integrated e based channels to offer an enhanced service proposition and derive fee income
- Upgrading of more ATM's to include more sophisticated features
- Developing the school savings units with greater value addition
- Opening digital branches
- Venturing into untapped market segments
- Harnessing the growing demand for speedy remittance products vis a vis conventional forms of remittances; thus expanding mobile money and E-wallet over the next two years
- Implementation of the fully automated platform as a core remittance technology solution
- Establishing partnerships with businesses in less competitive markets
- Promotion of the HNB Remittance loyalty card which was launched in 2015 to enhance customer convenience, streamline processes and reduce paper work
- Harnessing expanding overseas employment markets for Sri Lankans and the opportunities for growth of inward remittances
- Creating more awareness amongst customers of paperless and e based banking solutions and converting them to same

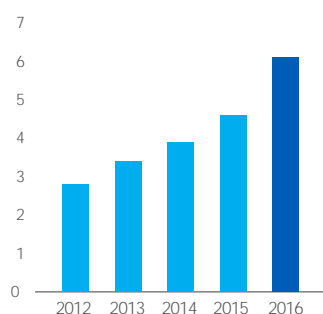
Personal Loans

Rs Bn



Credit Cards

Rs Bn



Management Discussion & Analysis

Business Performance Review

Micro Finance

The Bank's Micro Finance sector has empowered individuals across the country, enabling entrepreneurship for over 150,000 and livelihood creation for over 500,000 in diverse sectors of the economy, led by the agri and dairy industries. With "Gami Pubuduwa", the first branded micro financing programme by a commercial bank in the country, HNB has been a Game Changer in the rural economic landscape of Sri Lanka. Today it offers a comprehensive package of banking solutions to enterprises with exposure not exceeding Rs 5 Mn and a Turnover of less than Rs 60 Mn.

Performance

The Bank's Micro Finance sector performed exceptionally during the year with the loan book growing by 25%. An improved performance in the agriculture sector during the year helped by favourable weather conditions, supported the sector's performance. However, an excess supply due to bumper harvests exerted drastic downward pressure on prices and hence impacting farmer income and the Micro finance sector. Despite this background Bank was able to reduce its NPA by almost 50% over the past two years. It is also noteworthy that the Bank was able to participate in almost all of the refinance/ interest subsidy loans schemes funded by international donor agencies and the Central Bank of Sri Lanka to incentivise the Micro and Agricultural sectors of the country by offering affordable interest rates to end borrowers.

In the backdrop of the Bank's strategic priorities to re-engineer its processes in order to achieve dual objectives of optimising costs and enhancing customer experience, the Micro Finance division also fine-tuned its processes. Accordingly, regional offices were empowered to process all loans above Rs 5 Mn, which were hitherto processed at Branch offices, thus improving the speed of delivery to customers as well as freeing up branches and field offices for marketing activities.

As discussed in the Social Capital section of this report, the Bank also continued to provide programmes in partnership with corporates to enable transfer of technology and financial education and to develop entrepreneurship amongst existing and prospective microfinance clients. Further the bank continued the Avurudu Pola initiative

25%
Growth in Assets

in all nine regions with a view to provide market linkages to Micro clients

The year under review also saw a number of Micro finance clients under the Gami Pubuduwa scheme progress and advance themselves to reach SME status, and simultaneously, a new set of clients entered into relationships with the Bank from the bottom end of the pyramid as micro financing clients. The value HNB places on nurturing long term relationships will thus continue to be a key factor in its sustained profitability into the future.

Key Strengths

- The brand equity of "Gami Pubuduwa" - the only brand identity for micro lending amongst private commercial banks in the country, which celebrated its 27th year in 2016
- Our extensive and widespread branch network
- Competent and experienced field force of 134 field officers including 42 Agri professionals.
- Being a participating bank for many donor funded and refinance and interest subsidy schemes

Challenges

- Lack of formal accounting practices and managerial skills within these enterprises.
- Relatively low use of technology by micro enterprises in comparison to the high level of mobile penetration in the country

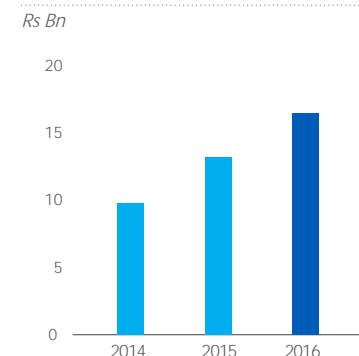
Rs 16Bn
Assets

- Weather dependency of key sectors such as agriculture and agro based industry
- The micro finance industry remaining unregulated
- Lending without proper assessment by finance companies and micro finance enterprises resulting in multiple funding as well as diversion of funds from income generating activities and sustainable wealth creation to consumption

Way Forward

- Growth of the dairy industry and trends such as the increasing preference for fresh milk vis a vis powdered milk
- Rising demand for green friendly projects
- The need and potential for buy back arrangements in partnerships with corporates

Micro Finance Loans and Advances



Islamic Banking

“Al Najah” – the Islamic Banking proposition of HNB, has grown over a mere 5 year period, to become one of the largest and amongst the top three IB institutions in the country. The brand expanded its footprint during the year with the opening of three branch offices and continued to be a leading player in the industry.

Performance

The Islamic Banking business performed remarkably, achieving a profit growth of 90% and a credit growth of 47%. And it is particularly commendable that credit growth was achieved whilst maintaining the NPA ratio at 1.2%, for the fifth consecutive year. CASA reached 50% of the segment's total deposit base whilst the Current Accounts increased from 5% to 11% of the total deposit base during the year. The 'New World Banking' campaign in 2015 also supported the growth in CASA during the year. The Lending portfolio stood at Rs 9.7 Bn as at year end. The rise in rates in the market also supported the business to gain higher margins. The reduction in Sri Lanka's imports however, somewhat inhibited growth in commission income and other ancillary business.

Al Najah also launched “Ijarah” - a new Leasing product to cater to a wider customer base. Moreover, reflecting the Bank's focus on driving sales, the segment also opened three extension offices during the year, one in Pettah and the others in the Central and Eastern provinces - two high growth potential regions for IB. The Bank also continued to provide training on Islamic Financing as well as sales skills to staff at Head office and the branch network to support and further strengthen sales efforts.

The Bank's strides towards many strategic imperatives such as cost optimisation and sales growth are also reflected in the improvement of the segment's Cost to Income ratio which reached 11.9% and the growth in profit per employee to Rs 23 Mn.

The Islamic Banking model has proven to be a win-win due to higher cost effectiveness as well as higher recovery rates. Prompted by its success and impact, Al Najah will look

90%
Growth in Profit

to expand its group lending in identified growth regions in the year ahead.

Key Strengths

- The “first mover advantage”
- The size, strength and brand equity of HNB in a market where most of the other players are smaller banks and financial institutions
- The extensive branch network vis a vis other institutions offering Islamic financing to reach new markets
- A strong and dedicated team that is well experienced and competent in Shariah rules and regulations
- The ability to offer speedy solutions to customers due to HNB's agile decision making structure and understanding, by the management

Challenges

- Increasing likelihood of new entrants to a constantly growing and evolving industry, thus increasing the levels of competition
- Lack of investment avenues for excess funds, such as Islamic Bonds (Sukuk) and other money market products, which in turn places greater challenge on maintaining satisfactory Advance to Deposit ratios

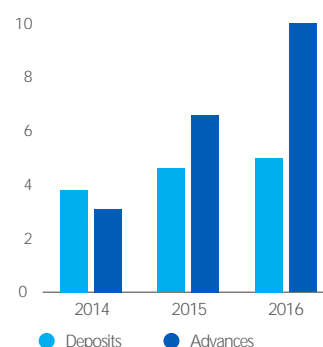
47%
Growth in Advances

Way Forward

- Expand reach
- Launch new products to improve market share
- Upgrade system capabilities
- Raise funds through Sharia compliant instruments

Islamic Banking Deposits and Advances

Rs Mn



Management Discussion & Analysis

Business Performance Review

Transaction Banking

HNB's Transaction Banking encompasses Financial Institutions, Trade and Treasury operations, each of which contributes significantly to the Bank's profitability

Financial Institutions

Performance

The Bank's FI Division achieved an excellent performance during the year, despite the continuation of the status quo of 2015 with economic activity remaining subdued, well into 2016. Thus, projects related guarantees remained low during the first half of 2016. However, the division continued to focus on growing the Bank's international guarantee business in order to contribute considerably to one of the Bank's key strategic objectives. Following a pickup in Infrastructure projects during the 2nd half of 2016, HNB was able to partner several projects in areas such as water, hospitals, bridges and highways. Total fee based income from issuance of International Bank Guarantees thus increased by 65% over the previous year whilst fee sharing income also grew by 21% over 2015.

The Bank continued to widen its international network with the addition of several new Correspondent Banking Relationships. Moreover, it also enhanced its existing International Guarantee limits and also established new limits to facilitate infrastructure projects. HNB also opened several project related bank accounts during the year on behalf of foreign contractors, thereby contributing to an increase in the Bank's CASA.

Service excellence through a dedicated team continues to be a high priority of the division, and accordingly, staff training in operational aspects as well as soft skills continued during the year through internal and external programmes.

The FI division continued to look at its Nostro account operations to review the value addition by each account and streamlined the number of accounts maintained.

800+
Correspondent Banking
Relationships

65%
Growth in fees from
Guarantees

Key Strengths

- A long established and expansive global network of over 800 correspondent banking/financial relationships
- The Bank's international rating which is on par with the Sovereign and hence has global recognition
- An extensive island wide branch network, which enables us to offer the convenience of total banking solutions for investors and project contractors
- A dedicated and experienced team which can advise local and international clients on the issuance of Letters of Guarantee that best support their business requirements and which can ensure that their knowledge of regulatory requirements remains current
- Reputation of being one of the largest private sector banks involved in the financing of Infrastructure projects in the country

Challenges

- Competition from reputed overseas Banks represented by branch offices in Sri Lanka when vying for the issuance of international bank guarantees
- Adhering to the escalating compliance requirements

Way Forward

- Strengthen our global FI network to meet various business requirements
- Explore new business opportunities via the strong relationships with government organisations, reputed suppliers and foreign contractors for infrastructure development projects in Sri Lanka
- Harness opportunities that may arise from the expected increase in foreign investment inflows to the country, enhanced international relations and potential bilateral trade agreements
- Focus on identified growth sectors
- More emphasis on providing guidance and required knowledge to staff to enhance efficiency and value addition

Main Correspondents - Worldwide



Management Discussion & Analysis

Business Performance Review

Transaction Banking

Trade

Performance

The Trade services performed well during the year with fee income growing by 9%, despite a decline in exports and the drop in imports witnessed upto October 2016. The growth in income in such a backdrop is thus significant and reflects the Bank's concerted effort to drive its Trade business. Moreover, the division also recorded a Net Interest Income growth of a significant 54%.

A ground breaking achievement during the year was the launch of a state of the art internet banking platform for Trade services, which facilitates customer convenience and operational efficiency. This new internet banking platform for Trade has empowered the Trade division to innovate and launch new products, thereby continuously enhancing the value it creates for its customers through this digital channel.

One of the strategic initiatives launched in 2015 was the integration of 14 of the 26 Trade units under a special trade unit at the centre, thereby relieving the branch network of all processing activities. Following the unit's first year of operations, this centralisation has proven to be a significant step forward in the Bank's strategic direction; enabling the Trade division to increase efficiency and customer reach to enhance customer convenience.

The specialised skills and competencies of the Trade team which continues to be one of the Bank's key competitive advantages were further strengthened during the year under review, with the number of internationally recognised CDCS (Certified Documentary Credit Specialist) qualified team members increasing to 13. The Bank continued to enhance technical knowledge of trade and non-trade staff through several training and development initiatives.

The Bank also conducted a number of customer training and awareness programmes during the year.

9%

Growth in Fee Income

54%

Growth in NII

Key Strengths

- A strong relationship network with global financial institutions which enables HNB to accommodate and route trade financing transactions
- ISO 9001:2008 certification for Trade Operations, which is an endorsement of HNB's service excellence
- Skills and competencies of the trade team, with the CDCS qualified team members increasing year on year

Challenges

- A high interest rate regime, depreciation of the Sri Lankan rupee and the increase in import duties on consumer goods such as vehicles, contributed to the decline in imports
- Low export growth due to depressed commodity prices in the global market, and political uncertainty in some of Sri Lanka's key export markets such as the Middle East and the depressed economic environment in Europe

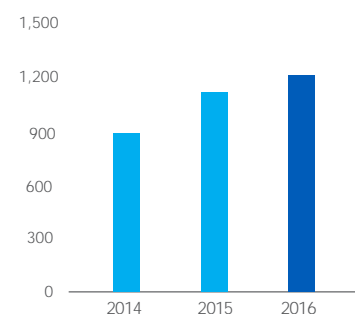
Way Forward

- Work closely with Corporate, SME banking and the regions to garner new trade business
- The implementation of credit products to cater to the identified growth sector of SME's
- Acquire new business from international markets via stronger correspondent relationships

- Make Trade processes more lean and efficient
- Enhance the technical knowledge of staff to be well prepared to win new trade business
- Continue to enhance the value we create for customers through electronic delivery channels
- Harness opportunities from potential bilateral trade agreements

Trade Fee Income

Rs Mn



Treasury

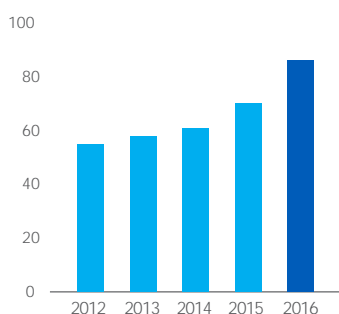
Performance

The Treasury recorded a commendable performance with profitability growing by 30% and exchange income increasing by 25% and a Net Interest Income growth of 32%. HNB's Treasury Bills and Bond portfolio, stood at Rs 85.8 Bn as at year end. The Bank's access to low cost overseas funds and low cost short term LKR funds were key factors which drove profitability and net interest income during the year. Moreover, the rise in interest rates and the depreciation of the Rupee also offered more trading opportunities whilst customer loyalty, which the Treasury has identified as one of its key advantages, as well as an influx of new customers generated higher volumes into the Bank. The latter in turn, reinforced the Bank's ability to offer the best rates. The Bank will look to grow volumes in the context of narrowing margins due to intense competition in the industry.

During the year foreigners were net sellers of government securities and with their exit, pressure was exerted on the exchange rate. As a result the Rupee depreciated around 4% in 2016. The government's agreement with the IMF helped markets stabilise and rebuilt investor confidence. HNB's brand equity and the Trust it has earned was a key factor in attracting higher volumes during the year, particularly in a backdrop where a few non bank primary dealerships were alleged to have had fraudulent practices and defaulted; thus prompting investors to seek trusted banks.

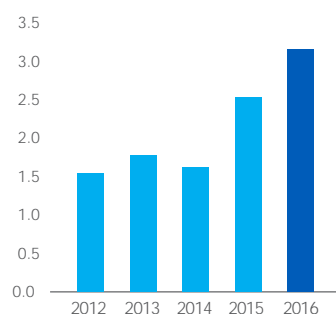
T Bills & T Bonds

Rs Bn



Exchange Income

Rs Bn



25%

Growth in Exchange Income

In line with the focus on a sales driven culture, Treasury sales teams performed exceptionally well. This team synchronised well with other teams to achieve a common goal of providing superior customer service which in turn is reflected in customer retention and loyalty.

Key Strengths

- Access to low cost funds in the international market
- Being a market maker for the US Dollar/ LKR exchange rate for spot and forward markets
- The ability to offer a sophisticated range of Treasury Products
- Experienced and dedicated staff to manage the critical functions of the Treasury

Challenges

- Diminishing margins which necessitate higher volumes for profitability
- Thin interbank trading volumes
- Policy inconsistencies which make predictability more difficult

32%

Growth in NII

Way Forward

- Launch of a state of the art software solution which will enable customised and more sophisticated solutions
- Operational excellence and product innovation in the year ahead
- More volume based operations to offset the drop in margins
- Agility and ability to adopt to quick market changes

Management Discussion & Analysis

Business Performance Review

Performance of the Subsidiaries

HNB Assurance PLC.

Following the regulatory requirements to segregate the Life and General Insurance Businesses in 2015, HNB's Insurance business now comprises two entities - HNB Assurance PLC (HNBA), a leading Life Insurance solutions provider in the country; and HNB General Insurance Ltd, which offers a comprehensive portfolio of both conventional as well as Takaful solutions, in Motor and Non Motor, with an island wide branch network of 56.

Performance

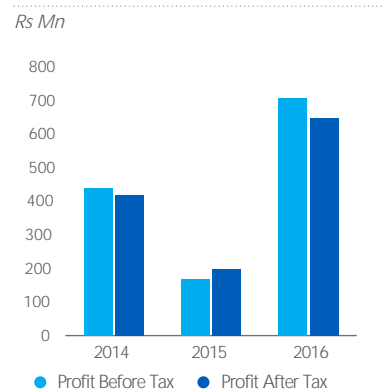
Life Insurance Business

HNBA's Life Assurance Business achieved a commendable performance during the year, with GWP (Gross Written Premium) growing by 27% to Rs 3.5 Bn, and outperforming the industry which grew by 19%. Profitability grew by 40% enabling a surplus transfer of Rs 461 Mn to shareholders. The main contributor to GWP was the Endowment business which marked a 32% growth. It is particularly noteworthy that the Company was able to grow its new business by 41% during the year. Given the long term nature of Life Insurance, the premiums of the new business augur well for enhanced revenue in the future. The synergies of being part of the HNB Group supported the growth in both Mortgage reducing policies and Group Life which grew by 15% and 52% respectively.

General Insurance Business (HNBGI)

The year under review saw a significant turnaround of HNBA's General Insurance business, well supported by its strategic

HNB Assurance PAT & PBT



Rs 647 Mn
Profit After Tax

26%
ROE

focus since the beginning of the year; to achieve a Profit After Tax of Rs 47.2 Mn from a loss of Rs 227 Mn the previous year. HNBGI's GWP grew by 16% to reach Rs 3.1 Bn during the year, mainly driven by the motor insurance segment which contributed 71% to total GWP in comparison to a contribution of 76% in the previous year. The Company also changed its product mix to give more emphasis to the non motor insurance segments and align itself with the overall insurance industry.

Pricing adjustments and operational efficiencies also contributed to profitability during the year.

The process of centralisation of the underwriting and claims management operations carried out in 2015 in keeping with the Bank's imperatives, yielded significant operational efficiencies during the year. Moreover, improvements to online assistance and the Help Desk enabled us to offer an enhanced service to customers. The performance during the year was also supported by the Company's focus on strengthening its claims management as well the management of other expenses.

The year posed several challenges as well. For one, the floods during the year increased General Insurance claims costs. In addition, the taxes imposed on motor vehicles reduced vehicle imports, thereby impacting the motor insurance industry.

This impact was further exacerbated by the increase in VAT which impacted the prices of spare parts, and hence the cost of claims. Moreover, the prevailing macro economic environment prompted the Company to reduce its equity exposure. Additionally, the Company also had to resolve the operational challenges associated with the transition from a Rule Based Regime to a Risk Based Solvency Regime, which became effective on 1st January 2016. On the other hand the increase in interest rates impacted positively on the reinvestment income of the investment portfolios whilst the underperformance of the equity market had negative impact on profits and shareholder equity.

Key Strengths

- The equity of brand HNB and the fast developing identities of HNBA and HNBGI
- The Bancassurance network
- The islandwide branch network
- Network connectivity
- Offering both conventional and Takaful arms of business under one roof
- Presence in digital and social media marketing

Challenges

- The likelihood that the low penetration level in the Life Insurance segment is likely to continue in the short to medium term future
- Redefining the tax formula for Life Insurance
- The revised VAT rates and their impact on claims and expenses of life insurance
- Intense price competition in the market, especially in General Insurance
- Unfair competition from a few players whose Life and General Insurance businesses are yet to be segregated

- The depreciation of the Rupee and new taxes which continue to increase the prices of spare parts, and hence, the Claims Costs in the General Insurance business

Way Forward

- Harnessing opportunities from the expected technological development of Online brokering
- Developing products to meet the rising demand for retirement benefit plans driven by an ageing population
- Expand Non Motor segments such as Fire and Engineering to seize opportunities

arising due to the increasing occurrence of natural disasters

- Expand the Broker channel as a key growth channel
- Continue to automate and achieve a paperless office environment and leaner operations
- Expand the Bancassurance channel beyond the HNB network to encompass other Banks

Acuity Partners (Pvt) Ltd

Acuity partners (Pvt) Ltd.- a joint venture between HNB and DFCC Banks is a leading Investment Bank in Sri Lanka; serving as a One Stop Shop offering integrated full service solutions for Stock Broking, Fixed Income Securities, Corporate Finance, Asset Management and Venture Capital with significant market share in all its product lines.

Performance

The Acuity Group performed well despite adverse market conditions which prevailed throughout the year due to a lackluster economic environment. Negative investor sentiment continued into 2016, largely on account of continued policy uncertainty and overall subdued earnings growth. The Group's profitability increased to Rs 534 Mn from Rs 305 Mn the previous year. The largest contribution to profitability came from Lanka Ventures, whilst Acuity

Rs 535 Mn
Profit After Tax

10%
ROE

Securities, Acuity Stock Brokers and Corporate Finance also made commendable contributions despite challenging capital market conditions. Guardian Acuity Asset Management consolidated its position by significantly increasing its asset portfolio during the year.

Despite a recovery in emerging market equities as tracked by the MSCI Emerging Market Index, the uncertain policy environment and some of the deteriorating macroeconomic fundamentals such as the Balance of Payments at the beginning of 2016, discouraged investor interest in Sri Lanka's equity market. Nevertheless, the Extended Fund Facility by the International Monetary Fund, regulatory and policy initiatives and projects such as the Colombo International Financial Centre augur well for

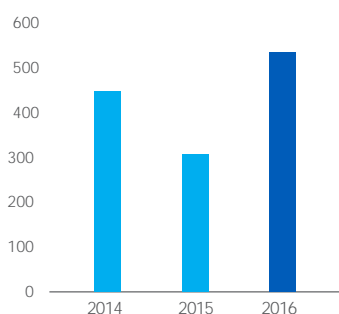
Game Changing opportunities for Acuity in the next few years.

Acuity Stock Brokers completed the implementation of its fully integrated, back office and front end IT solution which will enable the Company to introduce derivative instruments and be on par with the proposed developments of the CSE, such as a Central Clearing House, enabling faster delivery and payment.

The Company's Corporate Finance division maintained significant market share in the listed debenture market and placed corporate debentures and other debt instruments amounting to over Rs 25 Bn during the year. However, the Company's revenue generation was negatively impacted by the interest volatility and the significantly

Acuity Paterners PAT

Rs Mn



Management Discussion & Analysis

Business Performance Review

Performance of the Subsidiaries

lower volume of debentures issued during the year. Corporate Finance also maintained its market share and visibility in the listed equity space as Manager for the IPO of Amana Takaful, the only IPO to be placed in the market in 2016. The adverse conditions in the market in 2016 curtailed the roll out of a significant number of IPO's for which Corporate Finance was mandated. Last year, private equity was identified as a potential growth sphere which would allow Acuity to build on the existing experience through Lanka Ventures. Progress has been made on this front with potential seed investors for a private equity fund.

Acuity also made substantial progress in rolling out its services in the Maldives with a local joint venture partner, whereby Acuity would become a Game Changer as the first Investment Bank (IB) to set up operations in the Maldives.

Lanka Ventures (LVL), the Company's Energy sector arm increased its profitability by a significant 62% during the year, as the investments it has made into the power sector over the past few years came into commercial operations. LVL is poised to raise further equity through its investment vehicle - LVL Energy Fund Ltd, which will expand its portfolio of investments and contribute to growth of earnings in the future.

Due to the interest rate volatility and the sharp upturn in the yield curve, Acuity Securities (ASL) refrained from any significant investments into the government

securities market. However it took short term lending positions as and when opportunities arose and was thus able to increase profitability over the previous year.

Key Strengths

- Being a leading investment bank which is a joint venture of two leading banks equips it well to withstand the competition
- Possesses one of the most experienced Capital Market teams in Sri Lanka who are dedicated and committed to take Acuity to greater heights in the IB arena
- Excellent brand equity supported by the two parent companies – HNB and DFCC Banks
- A comprehensive portfolio of services

Challenges

- The need for increased market activity and resumption of inflows into the equity market.
- The poor quality of available investments in the private equity space
- Intense competition within the investment banking industry
- The large number of new Stock Broking licenses issued since 2009 has exerted pressure on the market shares and profitability of existing players who have invested heavily in branch expansion and research

- Lack of regulation or minimum capital requirements in Corporate Finance/ Investment Banking, facilitating an emergence of many boutique operators which has led to a further erosion of margins, whilst fees have historically remained amongst the lowest in the region
- Intense competition in the Fund Management segment due to the entry of many unlicensed and unregulated Fund Managers
- Low entry barriers for the regulated segment of the industry has led to the launch of many new unit trusts and unit trust management companies

Way Forward

- Launch the IPO's which were kept on hold for more conducive market conditions.
- Establish our presence in the Maldives
- New investments for the private equity business to further expand its contribution to Group profitability

Sithma Development Pvt. Ltd.

Sithma is the Bank's subsidiary which owns and manages the premium office space at HNB Towers, which houses the head office of HNB. Sithma is currently engaged in expanding its portfolio into new areas.

Performance

Sithma continued to perform well despite intensifying competition in the market place due to the proliferation of new office space. The Company's Revenue grew by 1.8% to Rs 920 Mn whilst Profit After Tax decreased by 3.6% during the year. Profits of Sithma were adversely impacted by the re-valuation of the building during the year.

Recognising the limited opportunity for growth in Colombo due to the saturation of cheaper properties, Sithma has begun to venture into outstations and the suburbs of Colombo. The company commenced construction of its first outstation property, in Kegalle, and this will be ready for occupation in 2017. Enhancing the environmental friendliness and energy efficiencies of our new and existing properties will also be one of our key priorities for the next few years.

Strengths

- Brand Image as an up-market grade A office building developer
- Ownership of one of only two buildings which meet the requirements of BPO businesses

Rs 556 Mn
Profit After Tax

6%
ROE

- High quality of our facilities management
- Technological leadership as a technically advanced building
- The best fire protection mechanisms and close proximity to the Fire department.
- Experienced and customer friendly staff
- Seize opportunities relating to the development plans of the Government of Sri Lanka such as Financial City, the Megapolis initiatives, KPO and BPO growth
- Expand the use of solar energy

Challenges

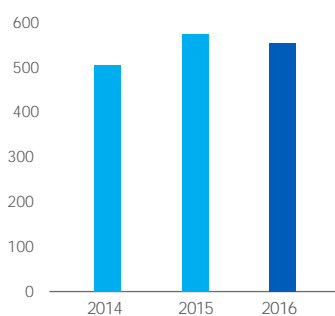
- High operational costs
- Intensifying competition due to the entrance of Grade A office space, resulting in narrower margins

Way Forward

- Venture into areas of business such as Facilities Management, for which demand is expected to grow with the increase in Grade A office space

Sithma PAT

Rs Mn



Management Discussion & Analysis

Business Performance Review

Performance of the Subsidiaries

HNB Grameen

HNB Grameen, the pioneer in Micro Financing in Sri Lanka is the newest addition to the Group's portfolio. With a clientele of over 385,000, it is today, one of the premier Licensed Finance Companies (LFC's) in the country with a mission to create financial inclusion and socially empower lives across the country, through a sustainable model of Micro Financing solutions based on the Grameen model.

Performance

HNB Grameen continued on its growth trajectory, achieving a remarkable performance during the year with Profit After Tax (PAT) rising by over 33%. The quality of relationships HNB Grameen maintains with its customers, and close monitoring of collections have been key supporting factors in ensuring a quality portfolio.

The Company continues to harness technology to improve customer convenience as well as efficiency. During the year HNB Grameen complemented its mobile cash and Telco solutions with the launch of ATM facilities for clients across the country, thus introducing the convenience of this electronic facility for an underprivileged segment of the population who became first time users of it. Following the introduction of Point of Sale (POS) Machines as a pilot project in 2015, the machines were launched across the network in 2016, and supported revenue growth well in 2016.

Service Centres	Regions
Nochchiyagama	Anuradhapura
Bandarawela	Badulla
Tissamaharamaya	Hambantota
Rikillagaskada	Kandy
Dehiaththakandiya	Ampara
Pittigala	Kalutara
Hatton	Kandy
Walapane	Badulla
Mallavi	Jaffna
Kilinochchi	

Rs **1,305**Mn
Profit After Tax

38%
ROE

Reflecting the sales driven focus of the Group, the company was able to increase its customer base by over 39,000, to exceed 385,000 as at year end, and also opened 10 new service centers during the year, bringing the total number of service centres to 21 whilst the total number of branches as at year end stood at 48.

As we described last year, HNB Grameen ventured into Leasing solutions in 2015, in order to offer bundled solutions to its customers and focused on micro and small sector customers which HNB PLC had hitherto not served. In the current year, this segment gathered momentum to achieve total lease disbursements of over Rs 1.3 Bn during the year. Moreover, it is noteworthy that the company was also able to maintain a recovery rate of 100% on the micro leases provided.

The Company has just begun to reap the rewards of many synergies and shared knowledge with HNB PLC, as reflected by the progressive growth and performance during the year. It thus looks to the next few years with much anticipation to expand its potential and impact on the nation's economy via win-win solutions to empower the underprivileged segments of the population.

Game Changer

A Game Changing Journey:

- » Pioneered Micro Finance in Sri Lanka
- » Profit growth of 33% in 2016
- » Membership growth by 39,000
- » Launch of POS machines -adding value to customers
- » Introducing ATM facilities to a segment of the population who primarily consists of first time users
- » 97% of our customers being women entrepreneurs

Key Strengths

- Our sustainable time tested model of value creation, and the very high percentage of female clientele who have a higher propensity to pay back
- The synergies of being a subsidiary of one of the largest private commercial banks of Sri Lanka
- The first mover advantage of being the pioneer in Micro Financing in Sri Lanka
- A strong deposit base representing all segments of the economy

- Customer service which offers “service at their doorsteps”
- A team of employees with specialised knowledge, passion and commitment, a majority of whom have been with the company since its inception 16 years ago

Challenges

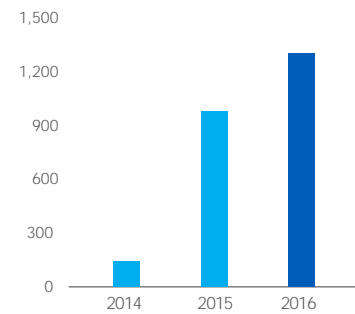
- Lack of a monitoring and tracking mechanism in the economy to know of multiple borrowings by customers and hence the constraints to maintain a low NPA due to poor financial discipline amongst certain borrowers
- Un-regulated market conditions, as the administrative framework, for the Micro Finance Act which has been passed in Parliament, is yet to be finalised
- Pressure on interest margin
- Intense competition in the industry and unethical practices by the competition

Way Forward

- Diversify into new customer segments.
- Expand digital delivery channels for greater efficiency, efficacy and to widen the customer base
- Venture into new products for a comprehensive portfolio
- Launch fee based income generating solutions such as utility bill payments through POS machines

HNB Grameen PAT

Rs Mn



Your Board Room Governance Report

Chairman's Statement

The Board of Directors of Hatton National Bank is strongly committed towards maintaining highest standards in Governance for the creation of long term shareholder value and sustainable growth. The trust we have earned over generations as a reputed financial institution in the country is ample testimony to our stability, integrity and strength, which clearly reflects on our adherence to highest standards in Governance.

The Bank's Corporate Governance Framework is well structured and primarily based on the doctrine and principles of Accountability, Fairness, and Transparency. We strive to achieve the highest level of standards in Corporate Governance Practices in the industry as well as in the country.

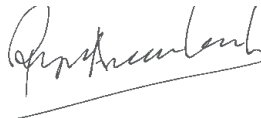
With our zealous intention of encouraging Good Governance within the HNB Group, a fresh Charter titled " Good Governance for the Group's Subsidiary Companies" was introduced during 2016.

The Board sets the tone at the top by promoting highest Standards in Corporate Values that cascade down to all employees of the Bank. The well codified policies, procedures and processes incorporating effective controls are some of the key mechanisms through which these Standards and Values are upheld across the Bank.

The report below enumerates the approach for maintaining highest standards in

Corporate Governance and its compliance status with the Corporate Governance regulations made under the Banking Act Direction No 11 of 2007 (and subsequent amendments thereto) for Licensed Commercial Banks issued by the Central Bank of Sri Lanka. The report also covers Bank's level of compliance with the Code of Best Practice on Corporate Governance issued jointly by the Securities and Exchange Commission of Sri Lanka and the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) in 2013.

As required by the above Code, I hereby confirm that, I am not aware of any material violations of any of the provisions embodied (i) in the Board Charter by the Board of Directors of Bank; or (ii) in the Bank's Codes of Conduct and Ethics by any member of the Corporate Management team of Hatton National Bank PLC.



Rienzie Arseculeratne
Chairman

Colombo, Sri Lanka
23rd February 2017

Corporate Governance Initiatives during 2016 at a Glance

FEBRUARY

Board Approval of a Comprehensive Policy on Succession Planning for KMPs and Directors

MARCH

Board Approval of the Charter for Management / Good Governance for Group Companies of HNB PLC.

APRIL

Re-constitution of the Related Party Transaction Review Committee as prescribed by the Code of Best Practices on Related Party Transactions issued by the Securities and Exchange Commission of Sri Lanka

AUGUST

Reformulation of the Corporate Communication Policy of the Bank.

Good Corporate Governance Practices are not just a matter for the Board but are at the heart of everything we do within the Bank.

Corporate Governance is the system, by which an organisation is directed, controlled and managed. The Corporate Governance Framework guides the Bank and drives towards progress by way of developing and implementing appropriate corporate strategies. In pursuing the corporate objectives, we have committed to the highest level of governance and strive to foster a culture that values and rewards exemplary ethical standards, personal and corporate integrity and mutual respect.

The Bank has formulated a well-structured integrated Governance Framework going beyond minimum regulatory requirements to ensure that the Board of Directors uphold the principles of accountability, fairness, and transparency in all the Bank's dealings with its stakeholders.

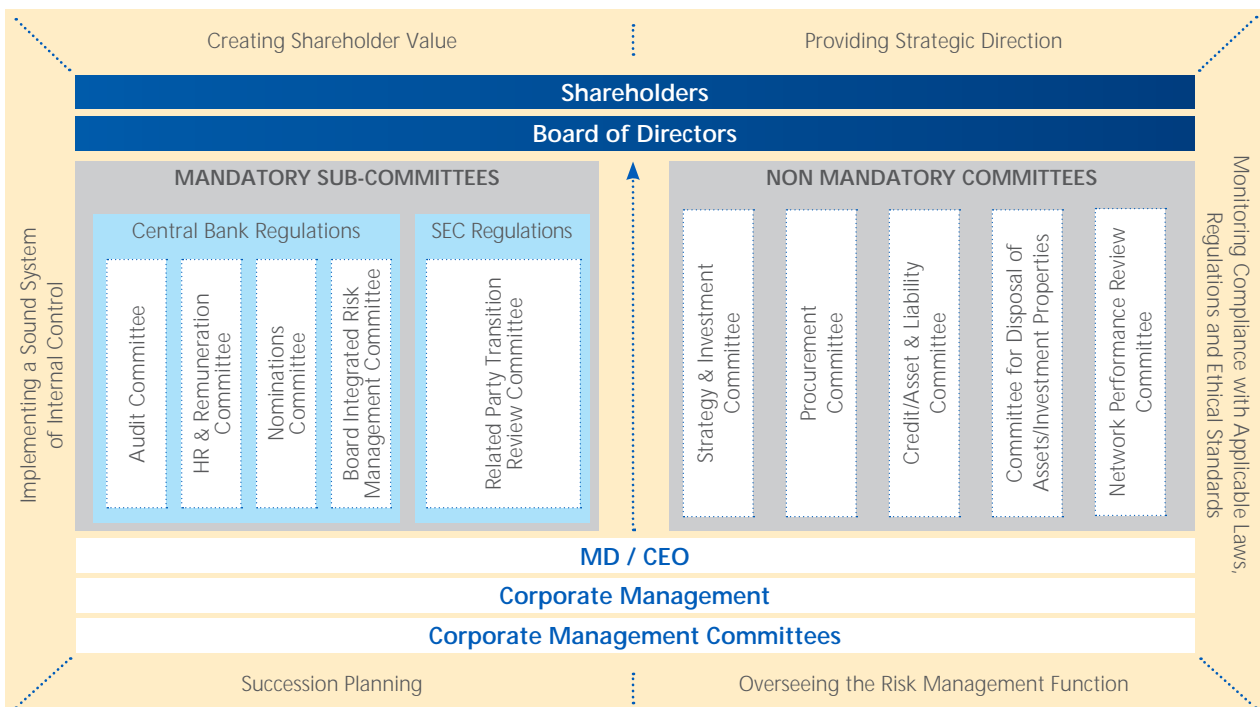
With the view of elevating the level of Corporate Governance practices within

the HNB's subsidiaries and joint ventures, a Group Corporate Governance Policy was formulated during the year 2016.

The Board of Directors, led by the Chairman, is responsible for the governance of the Bank and developing an effective Governance Framework to meet challenges, both short and long term. The Board is committed to reviewing and improving our systems to provide transparency, accountability, and to initiate transformational changes whenever necessary to ensure the adoption of national and international best practice.

We continually review our systems and procedures to provide transparency & accountability whilst updating our Corporate Governance policies to keep in line with the stipulated guidelines.

This report demonstrates the extent of the Bank's compliance with guidelines prescribed in the Banking Act Direction No 11 of 2007 (as amended) on Corporate Governance for Licensed Commercial Banks in Sri Lanka and the Code of Best Practice on Corporate Governance jointly issued by the Securities and Exchange Commission of Sri Lanka and the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka), for the year ended 31st December 2016. The compliance with CSE listing rules on Corporate Governance has not been disclosed as Listed Banks are exempted from complying with the said rules from 2010 onwards. This is because such governance requirements had been adequately covered in the Banking Act Direction No 11 of 2007 (as amended) on Corporate Governance for Licensed Commercial Banks in Sri Lanka.



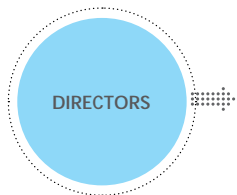



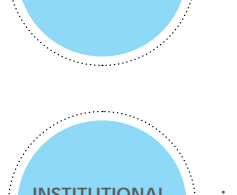


Your Board Room Governance Report

SECTION ONE

CODE OF BEST PRACTICE ON CORPORATE GOVERNANCE ISSUED BY THE SECURITIES AND EXCHANGE COMMISSION OF SRI LANKA (SEC) AND THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA (CA SRI LANKA)

Statement of Compliance

The disclosures below reflect HNB's level of conformance with the above Code which is promulgated around seven (7) key areas and HNB's conformance with the said governance principles in summary is given below.

 <p>DIRECTORS</p>	<p>The Bank is directed, lead and controlled by a Board of Directors who possess the skills, experience and knowledge complemented with a high sense of integrity and independent judgment. The Board is equipped with members having sufficient financial acumen and knowledge. At HNB, there is a clear division of responsibilities between the Chairman and Chief Executive Officer to ensure a balance of power and authority, in such a way that any individual has no unfettered powers of decisions. Ms Sanjivani Jayawardena, Mr Rusi Captain and Mr Amal Cabraal will retire by rotation at the AGM. They have offered themselves for re-election by shareholders at the next AGM, with the support of the Board.</p>
 <p>DIRECTORS' REMUNERATION</p>	<p>HNB has a formal and transparent procedure for executive remuneration and fixing the remuneration packages of individual Directors. The level of remuneration of both Executive and Non-Executive Directors is sufficient to attract and retain the Directors needed to run the Bank successfully. The Bank's remuneration framework for the CEO is designed to create and enhance value for all HNB's stakeholders and to ensure there is strong alignment between the short term and long term interest of the Bank.</p>
 <p>RELATIONSHIP WITH SHAREHOLDERS</p>	<p>The Bank focuses on open communication and fair disclosure, with emphasis on the integrity, timeliness and relevance of the information provided. The Annual General Meeting is mainly used to communicate with shareholders and encourage their active participation.</p> <p>The Bank has ensured that information is communicated accurately and in such a way as to avoid the creation of a false market. Further during 2016, the Bank had not engaged in or committed to any major related party transaction which materially affected HNB's net asset base.</p>
 <p>ACCOUNTABILITY & AUDIT</p>	<p>The Board has presented a balanced and an understandable assessment of the Bank's financial position, performance and prospects during 2016.. The Board has established a sound framework of risk management and internal controls. Through such an effective framework, HNB manages business risks and ensures that the financial information on which business decisions are made and published are reliable, and also ensures that the Bank's assets are safeguarded against unauthorised use or disposition. The Bank has developed a Code of Conduct & Ethics, a Policy on Anti-Bribery & Corruption and a Whistle Blowing Policy applicable for all employees, which addresses conflict of interest, corporate opportunities, confidentiality of information, fair dealing, protecting & proper use of the Bank's assets, compliance with applicable laws & regulations, encouraging the reporting of any illegal or unethical behaviour, financial integrity, insider trading, accurate accounting & record keeping, receiving gifts & entertainment etc.</p>
 <p>INSTITUTIONAL INVESTORS</p>	<p>The Annual General Meeting is used to have an effective dialogue with the shareholders on matters which are relevant and concern to the general membership. The Investor Relations team headed by the MD / CEO has regular discussions with key institutional shareholders to share highlights of the Bank's performance and also with the view are of obtaining constructive feedback. The feedback obtained from institutional shareholders is communicated to the entire Board by the MD / CEO for necessary action.</p>
 <p>OTHER INVESTORS</p>	<p>Individual shareholders are encouraged to carry out adequate analysis or seek independent advice on their investing, holding or divesting decisions. Further, they are encouraged to participate at Annual General Meetings and exercise their voting rights.</p>
 <p>SUSTAINABILITY REPORTING</p>	<p>Sustainability is a business approach that creates long term stakeholder value by embracing opportunities and managing risks derived from economic, environmental and social developments and their potential implications and impacts on the business activities of the entity.</p> <p>Sustainability reporting is the practice of recognising, measuring, disclosing and being accountable to internal and external stakeholders for organisational performance towards the goals of sustainable development in the context of the overall business activities and strategy of the entity and directed to the target stakeholders, usually shareholders, employees, customers, society and government.</p> <p>For details of sustainability endeavours undertaken by the Bank, please refer to the Management discussion and Analysis on pages 36 to 101.</p>

A. DIRECTORS

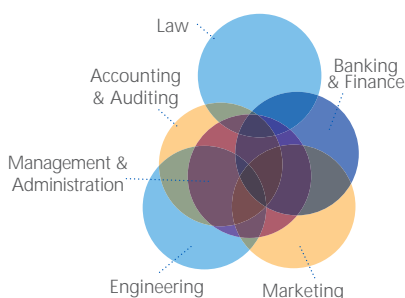
A.1 The Board

The Bank should be headed by a Board, which should direct, lead and control the Bank.

All Directors with the exception of the MD / CEO serve the Bank in a Non-Executive capacity. The Board consists of professionals in the fields of Banking, Law, Accounting, Management, Economics, Engineering, Marketing, Public Administration and Business. All Directors possess the skills, experience and knowledge complemented with a high sense of integrity and independent judgment. The Board gives leadership in setting the strategic direction and establishing a sound control framework for the successful functioning of the Bank. The Board's composition reflects sound balance of independence and anchors shareholder commitment.

The profiles of the Directors are provided on pages 26 to 29.

The charts below demonstrates the diversity of HNB's Board.



A.1.1 The Board Meetings- Adopted

The Board usually meets on monthly intervals, but meets more frequently whenever it is necessary.

The Board met fifteen (15) times during the year. Scheduled Board and Sub-Committee meetings were arranged well in advance and all Directors were expected to attend each meeting. Any instance of non-attendance at Board meetings were generally related to prior business, personal commitments or illness.

The below chart illustrate a summary of attendance at Board meetings during 2016. Refer page 131 for more details.

A.1.2 Board Responsibilities - Adopted

The Board Charter sets out the responsibility of the Board. The Board is responsible to the shareholders for creating and delivering long term sustainable shareholder value through the oversight of business.

The Board has provided strategic direction to the development of short, medium and long term strategy which is aimed at promoting the long term success of the Bank. The business strategy is reviewed by the Board at least on a quarterly basis with updates at each Board meeting on execution of the agreed strategy by the management.

The Board has put in place a Corporate Management team led by the MD / CEO with the required skills, experience and knowledge necessary to implement the business strategy of the Bank. The names and the qualifications of the Corporate Management team are provided on pages 30 and 31. The Board has also implemented a structured approach towards Succession

Planning of the Corporate Management and Senior Management team during the past couple of years.

The Board recognises its responsibility for the Bank's system of internal control and for reviewing its effectiveness on a continuous basis. These systems manage the risk of the Bank's business and ensure that the financial information on which business decisions are made and published is reliable. It also ensures that the Bank's assets are safeguarded against unauthorised use or disposition.

The Board is satisfied with the integrity of financial information and the robustness of the financial controls and systems of risk management of the Bank.

A.1.3 Compliance with laws and access to independent professional advice - Adopted

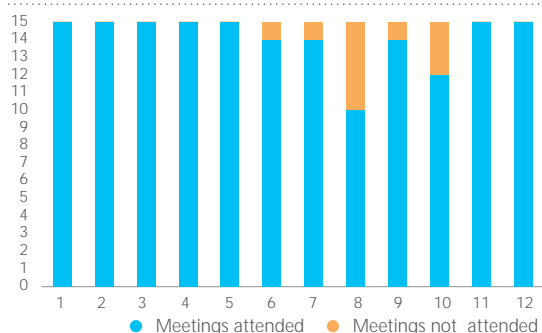
The Board collectively as well the Directors individually, recognize their duty to comply with laws of the country which are applicable to the Bank. The Board of Directors ensures that procedures and processes are in place to ensure that the Bank complies with all applicable laws and regulations.

A procedure has been put in place for Directors to seek independent professional advice, in furtherance of their duties, at the Bank's expense. This will be coordinated through the Board Secretary, as and when it is requested.

A.1.4 Board Secretary - Adopted

All Directors have access to the Board Secretary, who is an Attorney-at-Law by profession. Her services were available to all Directors, particularly the Non-Executive

Attendance at Board meetings during 2016



1. Mr Rienzie Arseculeratne
2. Mr Jonathan Alles
3. Ms Rose Cooray
4. Dr Rohan Karunaratne*
5. Mr Damien Fernando
6. Mr Sujeewa Mudalige
7. Ms Sanjivani Jayawardena
8. Mr Rusi Captain**
9. Mr Amal Cabraal
10. Mr Paliitha Pelpola
11. Mr Duliksha Soosaipillai
12. Mr Nilanth de Silva

* Includes one (01) meeting attended by an alternate director

** Includes two (02) meetings attended by alternate director/s

Your Board Room Governance Report

Directors who needed additional support to ensure they receive timely and accurate information to fulfil their duties. The Board Secretary had provided the Board with support and advice relating to corporate governance matters, Board procedures and applicable rules and regulations during the year. Further, she assisted the Chairman and MD / CEO in determining the annual Board plan.

A.1.5 Independent Judgment - Adopted

Non-Executive Directors are responsible for bringing independent and objective judgment and scrutinising the recommendations/ proposals made by the Corporate Management led by the MD / CEO, on issues of strategy, performance, resources utilisation and business conduct.

The Board promotes an environment whereby challenging contribution from the Non-Executive Directors is welcomed and encouraged, combined with full support for and empowerment of the MD / CEO in implementing decisions.

A.1.6 Dedication of adequate time and effort by the Board and Board Committees- Adopted

The Chairman and members of the Board have dedicated adequate time for the fulfilment of their duties as Directors of the Bank. In addition to attending Board meetings, they have attended Sub-Committee meetings and also have contributed to decision making via circular resolution where necessary. The Board Sub-Committees together with the respective Chairmans are tabulated below.

A.1.7 Training for Directors - Adopted

The Board of Directors recognises the need for continuous training & expansion of knowledge and undertakes such professional development as they consider necessary in assisting them to carry out their duties as Directors.

The Training & Continuous professional Development undertaken by directors in 2016 includes attending seminars / workshops / conferences / formal training programme, participating as speakers at events, using web based learning resources and reading regulatory updates etc.

Membership of Sub-committees

Name of Director	Audit Committee	Board Integrated Risk Management Committee	Human Resources & Remuneration Committee	Nomination Committee	Related Party Transaction Review Committee	Strategy & Investment Review Committee	Credit / Asset & Liability Committee	Procurement Committee	Committee for Disposal of Asset / Investment Properties	Network Performance Review Committee
Mr Rienzie Arseculeratne			•	•						
Mr Jonathan Alles		•			•				•	
Ms Rose Cooray		•		•		•			•	
Dr Rohan Karunaratne	•				•		•	•	•	•
Mr Damien Fernando		•	•						•	
Mr Sujeewa Mudalige	•		•			•				
Ms Sanjivani Jayawardena		•						•	•	•
Mr Rusi Captain				•						•
Mr Amal Cabraal	•		•			•				
Mr Palitha Pelpola				•	•		•			
Mr Duliksha Soosaipillai		•				•		•		
Mr Nilanth de Silva	•				•		•			•

• Chairman/ Chairperson • Member

A.2 Chairman and Chief Executive Officer

There should be a clear division of responsibilities between the Chairman and Chief Executive Officer to ensure a balance of power and authority, in such a way that any individual has no unfettered powers of decisions.

The roles of the Chairman and the Chief Executive Officer are segregated at HNB as envisaged in the board charter. The Chairman's main responsibility is to lead, direct and manage the Board to ensure that it operates effectively and fully discharges its legal and regulatory responsibilities. MD / CEO is responsible for the day-to-day operations of the Bank.

A.2.1 Division of responsibilities of the Chairman and MD / CEO - Adopted

The roles of the Chairman and the Chief Executive Officer are separate. The role of

the Chief Executive Officer is to manage the day-to-day running of the Bank. The Board has delegated this responsibility to the Chief Executive Officer and he then leads the

Corporate Management team in making and executing operational decisions. The Chief Executive Officer is also responsible for recommending the strategy to the Board.

A.3 Chairman's Role

The Chairman should lead and manage the Board, ensuring that it discharges its legal and regulatory responsibilities effectively and fully and preserves order and facilitates the effective discharge of the Board function.

The profile of the Chairman is given on page 26.

A.3.1 Role of the Chairman- Adopted

The Chairman is responsible for leadership of the Board and ensuring effectiveness in all aspects of its role. The Chairman of HNB is an Independent Non-Executive Director, elected by the Board. The Chairman's role encompasses:

- Ensuring that the new Board Members are given appropriate induction, covering terms of appointment, duties and responsibilities.
- Leading the Board and managing the business of the Board while taking full account of the issues and concerns of the Board.
- Approving the agenda for each meeting prepared by the Board Secretary.
- Ensuring that the Board members receive accurate, timely and clear information, in particular about the Bank's performance to enable the Board to take sound decisions, monitor efficiently and provide advice to promote success of the Bank.
- Ensuring regular meetings, the minutes of which are accurately recorded and where appropriate include the individual and collective views of the Directors.
- Facilitates and encourages discussions amongst all Directors where decisions are needed on matters of risk and strategy.
- Encouraging effective participation of all Directors in the decision making process to optimise contribution.
- Representing the views of the Board to the public.
- Initiates the process for self-assessment of the Board from its members and uses the meaningful feedback to further improve the effectiveness of the Board.

A.4. Financial Acumen

The Board should ensure the availability within it of those with sufficient financial acumen and knowledge to offer guidance on matters of finance.

The Board is equipped with members having sufficient financial acumen and knowledge.

A.4.1 Availability of sufficient financial acumen and knowledge - Adopted

All Directors possess financial acumen and knowledge through the experience gained from leading large private and public enterprises coupled with their academic and professional background.

The details of their qualifications and experience have been set out on pages 26 to 29.

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A.5. Board Balance

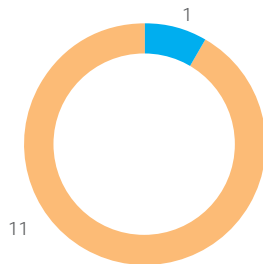
There should be balance of Executive and Non-Executive Directors so that no individual or small group of individuals can dominate the Board's decision-taking.

All Directors are Non-Executive Directors except for the MD / CEO. Each of them bring to the Board, wide experience and the ability to exercise independence and judgment when taking informed decisions.

A.5.1 Presence of Non-Executive Directors- Adopted

All Directors are Non-Executive Directors except for the MD / CEO. The requirement as per the Code has been complied with throughout 2016.

Executive Vs Non-Executive Directors

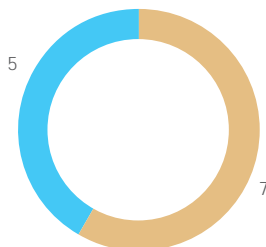


- Executive Directors
- Non-Executive Directors

A.5.2 Independent Directors - Adopted

Seven (7) Non-Executive Directors are independent as defined by the Code as at 31st December 2016. The requirement as per the Code has been complied with throughout 2016.

Independent Vs Non Independent Directors



- Independent Directors
- Non Independent Directors

A.5.3. Criteria to evaluate Independence of Non-Executive Directors - Adopted

Please refer Section A.5.5 below.

The Board considers Non-Executive Director's independence on an annual basis, as part of each Director's performance evaluation. The Board reviewed the independence of each Non-Executive Director in 2016 and concluded that each of them continues to demonstrate this essential behaviour.

A.5.4. Signed declaration of independence by the Non-Executive Directors- Adopted

All Non-Executive Directors of the Bank have made written submissions as to their independence against the specified criteria set out by the Bank, which is in line with the requirements of Schedule J of the Code.

A.5.5 Determination of independence of the Directors by the Board- Adopted

The Board has determined that the submission of declaration/s by the Non-Executive Directors, as to their independence, as fair representation and will continue to evaluate their submission annually. Circumstances have not arisen for the determination of independence by the Board, beyond the criteria set out in the Code. The following Directors are Independent as at 31st December 2016;

- Mr Rienzie Arseculeratne
- Dr Rohan Karunaratne
- Mr Sujeewa Mudalige
- Mr Amal Cabraal
- Mr Palitha Pelpola
- Mr Duliksha Soosaipillai
- Mr Nilanth de Silva

A.5.6 Alternate Director- Adopted

The requirement as per the Code has been met at the time of appointing of Alternate Directors during 2016.

A.5.7 Senior Independent Director- Not Applicable

The requirement to appoint a Senior Independent Director does not arise under this Code, since the Chairman and CEO is not the same person.

A.5.8 Confidential discussion with the Senior Independent Director - Not Applicable

Please refer above comment.

A.5.9 Meeting of Non-Executive Directors- Adopted

The Chairman meets with the Non-Executive Directors without the presence of the Executive Director, on a need basis. The Non-Executive Directors met twice (02) without the presence of the Executive Director during 2016.

A.5.10 Recording of concerns in Board Minutes- Adopted

All concerns raised and wished to be recorded have been documented in sufficient detail.

A.6 Supply of Information

Management should provide time bound information in a form and of quality appropriate to enable the Board to discharge its duties.

Financial and non-financial information are analysed and presented to the Board to make informed and accurate decisions.

A.6.1 Information to the Board by the Management- Adopted

The Board was provided with timely and appropriate information by the Management by way of Board papers and proposals. The Board sought additional information as and when necessary. Members of the Corporate and Senior Management team made presentations to Directors on important

issues relating to strategy, risk management, recoveries endeavours, new legal developments and tax management. The Chairman ensured that all Directors were briefed on issues arising at Board meetings. The Directors have free and open contact with the Corporate and Senior Management of the Bank.

A.6.2 Adequate time for effective Board meetings - Adopted

Board papers are usually sent to the Directors at least a week before the respective Board meetings giving adequate time for Directors to study the related papers and prepare for a meaningful discussion at the respective meetings.

A.7 Appointments to the Board

A formal and transparent procedure should be followed for the appointment of new Directors to the Board.

The Nomination Committee assesses the suitability of the prospective nominees to the Board and recommends persons found to be "fit and proper" for consideration of the entire Board. Upon completion of this process, names are referred to the Director of the Bank Supervision Department of the Central Bank of Sri Lanka for approval as a "fit and proper" person, prior to the appointment.

A.7.1 Nomination Committee- Adopted

The Terms of Reference for the members of the Nomination Committee are similar to the one set out in Schedule A to the Code. The following Directors served on the Nomination Committee during 2016. The MD / CEO attends these meetings by invitation.

A Board approved procedure to appoint MD/CEO, KMPs and Directors is in place.

Job descriptions of the newly appointed KMPs of the Bank was reviewed by the Nomination Committee.

The Nomination Committee report is given on pages 133 and 134.

A.7.2 Assessment of Board Composition by the Nomination Committee - Adopted

The Nomination Committee carries out continuous review of the structure, size and composition (including the skills, knowledge, experience and independence required of Directors) of the Board to address and challenge adequately key risks and decisions that confront, or may confront, the Board and makes recommendations to the Board with regard to any changes.

A.7.3 Disclosure of details of new Directors to shareholders - Adopted

Details of new Directors are disclosed to the shareholders at the time of their appointment by way of public

announcements as well as in the Annual Report. Prior approval for appointment of new Directors is obtained from the Director of Bank Supervision of CBSL and notification is sent to Colombo Stock Exchange. All new appointments as well as continuing Directorships are reviewed by the Nomination Committee. The Directors are required to report any substantial changes in their professional responsibilities and business associations to the Nomination Committee, which will examine the facts and circumstances and make recommendations to the Board.

There were no new appointments to the Board during 2016.

Membership- Nomination Committee

Name of Director	Chairman/ Member	Directorship status	Date of appointment to the Sub Committee
Mr Rienzie Arseculeratne	•	•	04th June 2015
Ms Rose Cooray	•	•	01st January 2012
Mr Rusi Captain	•	•	31st October 2014
Mr Palitha Pelpola	•	•	04th June 2015

• Chairman • Member • Independent Non-Executive Director • Non-Executive Director

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A.8 Re - election

All Directors should submit themselves for re-election at regular intervals and at least once every three years, and all Non-Executive Directors should be appointed for a specific term and subject to re-election.

A.8.1 Appointment of Non-Executive Directors - Adopted

Articles of Association of the Bank require 1/3 of the Directors (other than the MD / CEO) to retire from office at each Annual General Meeting. These Directors are eligible to stand for re-election by the shareholders

at the Annual General Meeting. The proposed re-election of Directors is subject to prior recommendation by the full Board.

Ms Sanjivani Jayawardena, Mr Rusi Captain and Mr Amal Cabraal will retire by rotation at the AGM under the Articles of Association of the Bank. Ms Sanjivani Jayawardena, Mr

Rusi Captain and Mr Amal Cabraal have offered themselves for re-election, with the support of the Board.

A.8.2 Election of Directors by the shareholders - Adopted

Please refer to comments above.

A.9 Appraisal of Board Performance

The Board should periodically appraise its own performance against the pre-set targets in order to ensure that the Board responsibilities are satisfactorily discharged.

A.9.1 Appraisal of Board performance - Adopted

Goals and targets of the Board of Directors have been clearly set out and evaluated at the end of the year by the members.

Further each member of the Board carried out a self-assessment of his / her own effectiveness as an individual as well as effectiveness of the Board as a team for the year 2016. The outcome of the assessment was tabled at a meeting of the Board in January 2017. The Sub-Committees, except

for the Audit Committee, carries out a self-assessment process annually, in accordance with the pre-set criteria, to ensure they function effectively and efficiently with the objective of facilitating continuous improvement individually and collectively in the performance of the Board.

The Audit Committee evaluation was conducted by the Independent Non-Executive Chairman, with individual assessments from the members of the Audit Committee, MD / CEO, COO,

AGM-Finance and the Chief Internal Auditor, in accordance with international best practices.

A.9.2 Annual self-evaluation of the Board and its Committees - Adopted

Refer to comments given for Section A.9.1.

A.9.3 Disclosure of the method of appraisal of Board and Board Sub Committee performance - Adopted

Refer to comments given for Section A.9.1.

A.10 Disclosure of Information in respect of Directors

Details in respect of each Director should be disclosed in the Annual Report for the benefit of the shareholders.

A.10.1 Details in respect of Directors - Adopted

Details of the Directors are given on pages 24 to 29 Directors' attendance at the Board and Board Sub-committee meetings are given on page 131.

The total number of Board seats (excluding directorship in HNB) held by each director as at 31st December 2016, can be summarised as follows;

Directorships in other companies

Name of Director	Directorship Status	No of Board seats held in listed companies		No of Board seats held in unlisted companies	
		Executive Capacity	Non-Executive Capacity	Executive Capacity	Non-Executive Capacity
Mr Rienzie Arseculeratne	•	-	-	-	2
Mr Jonathan Alles	•	-	1	-	4
Ms Rose Cooray	•	-	4	-	3
Dr Rohan Karunaratne	•	-	1	1	5
Mr Damien Fernando	•	-	-	-	-
Mr Sujeewa Mudalige	•	-	-	-	-
Ms Sanjivani Jayawardena	•	-	1	-	13
Mr Rusi Captain	•	-	1	15	1
Mr Amal Cabraal	•	-	3	-	5
Mr Palitha Pelpola	•	-	1	-	-
Mr Duliksha Soosaipillai	•	-	1	-	-
Mr Nilanth de Silva	•	-	1	-	1

• Executive Director • Independent Non-Executive Director • Non-Executive Director

A.11 Appraisal of the CEO

The Board of Directors should at least annually assess the performance of the Chief Executive Officer.

A.11.1 Targets for MD / CEO - Adopted

The MD / CEO's performance objectives are aligned with business sustainability of the Bank. The performance targets for the MD / CEO are set at the commencement of every year by the full Board which are in line with

the short, medium and long term objectives of the Bank.

financial and non-financial targets set as described above, which is followed by a formal annual review by the Board at the end of each financial year.

A.11.2 Evaluation of the performance of the MD / CEO- Adopted

There is an on-going process to evaluate the performance of MD / CEO against the

B.1 Remuneration Procedures

The Bank should have a formal and transparent procedure for developing policy on executive remuneration and fixing the remuneration packages of individual Directors. No Director should be involved in deciding his / her remuneration in order to avoid the self-review threat.

B.1.1 HR & Remuneration Committee - Adopted

The HR & Remuneration Committee is responsible for assisting the Board with regard to the remuneration policy for the Executive Director and the Corporate Management.

The Committee determines and agrees with the Board, the broad policy framework for the remuneration of the MD / CEO. The MD / CEO participates at meetings when deciding the remuneration of the Corporate Management in order to recruit, retain and motivate the Corporate Management team.

B.1.2 Composition of the HR & Remuneration Committee B.1.3 - Adopted

The following Non-Executive Directors served on the HR & Remuneration Committee during 2016.

Membership- HR & Remuneration Committee

Name of Director	Chairman/Member	Directorship status	Date of appointment to the Sub Committee
Mr Rienzie Arseculeratne	•	•	04th June 2015
Mr Damien Fernando	•	•	15th January 2013
Mr Sujeewa Mudalige	•	•	15th January 2013
Mr Amal Cabraal	•	•	31st October 2014

• Chairman • Member • Independent Non-Executive Director • Non-Executive Director

A Board approved Terms of Reference of the Committee and a Remuneration Policy for the Board of Directors is in place.

The HR & Remuneration Committee report is given on page 132.

B.1.4 Remuneration of the Non-Executive Directors - Adopted

The Board as a whole decides the remuneration of the Non-Executive Directors. The Non-Executive Directors receive a fee for being a Director of the Board and additional fee for being a

member of a statutory committee. They do not receive any performance related / incentive payments.

B.1.5 Consultation of the Chairman and access to professional advice- Adopted

Input of the Chairman is obtained by his involvement as a member (Chairman) of the said Sub - Committee. External professional advice is sought by the HR & Remuneration Committee, on a need basis through the Board Secretary.

B.2 Level and make up of Remuneration

The level of remuneration of both Executive and Non-Executive Directors should be sufficient to attract and retain the Directors needed to run the Bank successfully. A proportion of Executive Directors remuneration should be structured to link rewards to the corporate and individual performance.

B.2.1 Level and make-up of the remuneration of MD / CEO - Adopted

The Board is mindful of the fact that the remuneration of Executive and the Non-Executive Directors should reflect the market

expectations and is sufficient enough to attract and retain the quality of Directors needed to run the Bank. The remuneration package of the MD / CEO is structured to link rewards to corporate and individual performance.

The Bank's remuneration framework for the MD / CEO is designed to create and enhance value for all HNB's stakeholders and to ensure there is strong alignment between the short term and long term interest of the Bank.

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B.2.2 Comparison of remuneration with other companies - Adopted

The HR & Remuneration Committee in deciding the remuneration of the Directors (including the compensation package of the MD / CEO) takes into consideration the level of remuneration paid by the other comparable companies, performance and risk factors entailed in his job.

B.2.3 Comparison of remuneration with other companies in the Group – Not Applicable

The size and scale of the Bank is not comparable with any other Group companies.

B.2.4 Performance related payment to MD / CEO - Adopted

Please refer to Section B.2.1.

B.2.5 Executive share options - Adopted

Share options have been offered to the Executive Director as part of the scheme offered to Senior and Corporate Management which was approved by the shareholders of the Bank.

B.2.6 Deciding the Executive Directors remuneration- Adopted

In deciding the remuneration of the MD / CEO, the Bank takes note of the provisions set out in Schedule E.

B.2.7 Early termination of Directors - Not Applicable

Not applicable to the Board except for the MD / CEO who is an employee of the Bank and his terms of employment is governed by the contract of service

B.2.8 Early termination not included in the initial contract - Not Applicable

Refer to comments above.

B.2.9 Remuneration of the Non-Executive Directors - Adopted

The Non-Executive Directors receive a fee in line with the market practices. Non-Executive Directors do not participate in the current share option plans of the Bank and / or other performance related incentive schemes.

B.3 Disclosure of Remuneration

The Bank should disclose the remuneration policy and the details of remuneration of the Board as a whole.

B.3.1 Disclosure of remuneration - Adopted

Please refer to Section B.1.2 on page 111 for the details on the composition of the

HR & Remunerations Committee. The Committee's report setting out the policy of the Committee is given on page 132. The

remuneration paid to the Board of Directors is disclosed in aggregate in note No 17 to the Financial Statements on page 242.

C. RELATIONS WITH SHAREHOLDERS

C.1 Constructive use of the Annual General Meeting and Conduct of General Meetings

The Board should use the Annual General Meeting to communicate with shareholders and encourage their active participation.

C.1.1 Use of proxy votes - Adopted

The Bank has a mechanism to record all proxy votes and proxy votes lodged for each resolution prior to the General Meeting.

C.1.2 Separate resolution for all separate issues - Adopted

The Board, remains mindful of being accountable to the shareholders and the need for transparency at all levels, striving to maintain its value framework in all shareholder dealings and communications.

HNB proposes a separate resolution for each item of business, giving shareholders the opportunity to vote on each such issue, separately.

C.1.3 Availability of all Board Sub-Committee Chairmen at the AGM - Adopted

The Board, which includes the Chairman of the HR & Remuneration and Nomination Committees, was present at the AGM to answer any questions.

Chairman/ Chairperson of the Board Audit Committee and Board Integrated Risk Management Committee were not present at the 2015 AGM held in March 2016, due to prior personal commitments. However, other members of the Board Audit Committee and Board Integrated Risk Management Committee were present at the AGM to answer any questions raised by the shareholders in relation the activities of these two Sub-Committees.

C.1.4 Adequate notice of the AGM - Adopted

The Annual Report including Financial Statements and the notice of the meeting are sent to shareholders at least 15 working days prior to the date of the AGM.

All shareholders irrespective of their voting status are encouraged to attend the AGM

C.1.5 Procedures of voting at General Meetings - Adopted

Voting procedures at General Meetings are circulated to the shareholders.

C.2 Communication with Shareholders

The Board should implement effective communication with shareholders.

C.2.1 Channel to reach all shareholders of the company - Adopted

The primary modes of communication between HNB and the shareholders are the Annual Report and Annual General Meeting (AGM) or other General Meetings. Information is provided to the shareholders prior to the AGM to give them an opportunity to exercise the prerogative to raise any issues relating to the business of HNB, either verbally or in writing prior to the AGM.

The Bank will post on its website (www.hnb.net) copies of annual reports, interim reports, stock information, stock exchange announcements, shareholder circular etc. These will be posted on the website as soon as practicable after they have been released to the stock exchange.

C.2.2 Policy and methodology for communication with shareholders - Adopted

The Bank will focus on open communication and fair disclosure, with emphasis on the integrity, timeliness and relevance of the information provided. The Bank will ensure information is communicated accurately and

in such a way as to avoid the creation of a false market.

C.2.3 Implementation of the policy and methodology for communication with shareholders - Adopted

With a view of formulating clear and precious communication with all stakeholders and general public, the Corporate Communication Policy was reformulated during the year 2016. The Corporate Communication Policy is guided by the principles of efficiency, transparency, proactivity, clarity and feedback. This policy has been communicated to all staff members.

Shareholders are consulted on their preference to receive the Annual Report from the Bank either by means of a CD or in hardcopy form. Shareholders may at any time elect to receive the Annual Report from the Bank in printed form. Printed copies will be provided without charge.

C.2.4 Contact person in relation to and shareholders' matters - Adopted C.2.6

Shareholders may, at any time, direct questions, request for publicly available information and provide comments and suggestions to Directors or Management of the Bank. Such questions, requests and comments should be addressed to the Company Secretary.

C.2.5 Process to make all Directors aware of major issues and concerns of shareholders - Adopted

The Company Secretary shall maintain a record of all correspondence received and will deliver as soon as practicable such correspondence to the Board or individual director/s as applicable.

The Board or individual director/s, as applicable, will generate an appropriate response to all validly received shareholder correspondence and will direct the Company Secretary to send the response to the particular shareholder.

C.2.7 The process responding to shareholder matters - Adopted

Refer to comments given for Section C.2.5

C.3 Major and Material Transactions

Directors should disclose to shareholders all proposed material transactions which would materially alter the net asset position of the Bank, if entered into.

C.3.1 Major Transactions - Adopted

During 2016, the Bank had not engaged in or committed to any major related party

transaction which materially affected HNB's net asset base.

D. ACCOUNTABILITY AND AUDIT

D.1 Financial Reporting

The Board should present a balanced and understandable assessment of the company's financial position, performance and prospects.

D.1.1 Statutory and Regulatory Reporting - Adopted

HNB has reported a true and fair view of its financial position and performance for the

year ended 31st December 2016 and at the end of each quarter of 2016.

In the preparation of quarterly and annual Financial Statements, HNB had complied with the requirements of the Companies Act No 07 of 2007, the Banking Act No 30

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of 1988 and amendments thereto, and are prepared and presented in conformity with Sri Lanka Accounting Standards. HNB has complied with the reporting requirements prescribed by the regulatory authorities such as the Central Bank of Sri Lanka, and the Securities and Exchange Commission.

D.1.2 Directors' report in the Annual Report - Adopted

The "Annual Report of the Board of Directors on the Affairs of the Company" which is given on pages 140 to 149 covers all areas of this Section.

D.1.3 Statement of Directors', and Auditor's responsibility for the Financial Statements - Adopted

The statement of "Directors' Responsibility for Financial Reporting" is given on page 196. Auditor's reporting responsibility is given in their report on the Financial Statements on page 197. The Directors'

Statement on Internal Control is given on pages 150 and 151.

D.1.4 Management Discussion and Analysis - Adopted

The Management Discussion and Analysis is given on pages 36 to 101.

D.1.5 Declaration by the Board that the business as a Going Concern- Adopted

This is given in the "Annual Report of the Board of Directors on the Affairs of the Company" on pages 140 to 149.

D.1.6 Summoning an EGM to notify serious loss of capital - Not Applicable

Likelihood of such occurrence is remote. However, should the situation arise, an EGM will be called for and shareholders will be notified.

D.1.7 Related Party Transactions - Adopted

The Directors have instituted an effective and comprehensive system of Internal Controls for identifying, recording and disclosure of related party transactions.

Steps have been taken by the Board to avoid any conflict of interest that may arise, in transacting with related parties. Further, the Board ensures that no related party benefits from favourable treatment. The pricing applicable to such transactions are based on the assessment of risk and pricing model of the Bank and is comparable with that what is applied to transactions between the Bank and its unrelated customers.

All related party transactions as defined in Sri Lanka Accounting Standard - 24 (LKAS 24) on "Related Party Transactions" is disclosed in note No 60 to the Financial Statements on pages 318 to 322

D.2 Internal Control

The Board should have a sound system of internal controls to safeguard shareholders' investments and the Bank's assets.

D.2.1 Annual evaluation of the risks facing the Bank and the effectiveness of the system of internal controls - Adopted

The Board is responsible for establishing a sound framework of risk management & internal controls and monitoring its effectiveness on a continuous basis. Through such an effective framework, HNB manages business risks and ensures that the financial information on which business decisions are made and published is reliable, and also ensures that the Bank's assets are safeguarded against unauthorized use or disposition.

D.2.2 Internal Audit Function - Adopted

The Bank has its in-house Internal Audit Function.

D.2.3 Review of the process and effectiveness of risk management and internal controls by the Audit Committee - Adopted

The Internal Audit Division of the Bank carries out regular reviews on the internal control system including Internal Control over Financial Reporting.

The Audit Committee monitors, reviews and evaluates the effectiveness of the risk management and internal control system including the Internal Controls over Financial Reporting.

In the year 2016, the Board of Directors was satisfied with the effectiveness of the system of internal controls of the Bank. Refer the Directors' Statement on Internal Control on pages 150 and 151 for details.

The External Auditors of the Bank have independently reviewed the report of the Directors referred to above and have issued a report which is given on page 152.

D.2.4 Responsibilities of Directors in maintaining a sound system of internal Control - Adopted

The Directors' responsibility for maintaining a sound system of internal control is given in the Directors' Statement on Internal Control on pages 150 and 151.

D.3 Audit Committee

The Board should have formal and transparent arrangements in selecting and applying the accounting policies, financial reporting and internal control principles and maintaining an appropriate relationship with the Bank's External Auditor.

Membership- Audit Committee

Name of Director	Chairman/ Member	Directorship status	Date of appointment to the Sub Committee
Mr Sujeewa Mudalige	•	•	01st May 2012
Dr Rohan Karunaratne	•	•	30th May 2013
Mr Amal Cabraal	•	•	31st October 2014
Mr Nilanth de Silva	•	•	04th June 2015

• Chairman/ Chairperson • Member • Independent Non-Executive Director

D.3.1 Composition of the Audit Committee- Adopted

The above Directors served on the Audit Committee during 2016.

The said Committee met eight (08) times during the year.

The Board Secretary functions as the Secretary to the Audit Committee. The Directors, MD/CEO, COO, AGM - Finance, Chief Risk Officer/AGM - Risk, Chief Internal Auditor, Senior Manager - Internal Audit, Compliance Officer and the External Auditor attend meetings on invitation.

D.3.2 Review of Objectivity of the External Auditor - Adopted

The Audit Committee monitors and reviews the External Auditor's independence, objectivity and the effectiveness of the audit process taking into account relevant professional and regulatory requirements.

The Committee sets out the policy for the engagement of the External Auditor to provide non-audit services, taking into account:

- Relevant regulations with regard to the provision of non-audit services and the guidelines issued by the Central Bank of Sri Lanka.
- The External Auditor's skills and experience for providing the particular non-audit service.

- The nature of non-audit services, the related fee levels individually and in aggregate relative to the audit firm.

A formal board approved policy for engagement of the external auditor to provide non audit services is in place.

The Audit Committee has the primary responsibility for making recommendations on the appointment, re-appointment or removal of the External Auditor in-line with professional standards and regulatory requirements.

D.3.3 Terms of reference of the Audit Committee- Adopted

The Audit Committee is guided by the Committee Charter which sets out authority and responsibility of the said Committee. The Charter was reviewed in December 2016. The Board also considered the Code of Best Practice on Audit Committees of CA Sri Lanka in defining the terms of reference for the Audit Committee.

Duties of the Committee encompasses:

- Assisting the Board in the preparation and presentation of Financial Statements
- Bank's compliance with applicable regulations
- Assess the processes to ensure internal controls are adequate, especially in relation to financial reporting

- Assess the Bank's ability to continue as a going concern.

The Audit Committee monitors and reviews the effectiveness of HNB's Internal Audit function. The Chief Internal Auditor reports to the Audit Committee. The Audit Committee reviews and approves the Internal Audit plan and resource requirements. It ensures that the Internal Audit plan adequately covers the significant risks of the Bank, reviews the important Internal Audit findings and follow-up procedures.

The Audit Committee is authorised to obtain external professional advice and to invite outsiders with relevant experience to attend if necessary. The Committee also has full access to information in order to investigate into matters relating to any matter within its terms of reference.

D.3.4 Disclosures of the Audit Committee - Adopted

The External Auditor, has provided a confirmation of Independence in compliance with the "Guidelines for Appointment of Auditors of Listed Companies" issued by SEC.

In order to safeguard the objectivity and independence of the External Auditor, the Audit Committee reviewed the nature and scope taking account of the regulations guidelines stated in Section D.3.2 on page 115.

The names of the members of the Audit Committee are given in the above table.

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D.4 Code of Business Conduct and Ethics

The Bank should develop a Code of Business Conduct and Ethics for Directors and members of the Senior Management team.

D.4.1 Code of Business Conduct and Ethics - Adopted

The Bank has developed a Code of Conduct & Ethics, a Policy on Anti-Bribery & Corruption and a Whistle Blowing Policy applicable for all employees, which addresses conflict of interest, corporate opportunities, confidentiality of information, fair dealing, protecting & proper use of the Bank's assets, compliance with

applicable laws & regulations, encouraging the reporting of any illegal or unethical behaviour, financial integrity, insider trading, accurate accounting & record keeping, receiving gifts & entertainment etc. The Code of Conduct and Ethics for Directors is embodied in the Board Charter.

The Board is not aware of any material violations of any of the provisions of the

Code of Conduct and Ethics by any Director or Corporate Management member of the Bank.

D.4.2 Affirmation by the Chairman that there is no violation of the code of conduct & ethics - Adopted

Please refer to Chairman's statement on page 102 for details.

D.5 Corporate Governance Disclosures

The Bank should disclose the extent of adoption of best practice in Corporate Governance.

D.5.1 Disclosure of Corporate Governance - Adopted

This requirement is met through the presentation of this report.

E. INSTITUTIONAL INVESTORS

E.1 Shareholders voting

Institutional shareholders are required to make considered use of their votes and encouraged to ensure their voting intentions are translated into practice.

E.1.1 Institutional shareholders - Adopted

The Annual General Meeting is used to have an effective dialogue with the shareholders on matters which are relevant and of concern to the general membership. The Investor Relations team headed by the MD / CEO has regular discussions with key

institutional shareholders to share highlights of the Bank's performance and also with the view to obtaining constructive feedback. The feedback obtained from institutional shareholders is communicated to the entire Board by the MD / CEO.

E.2 Evaluation of Corporate Governance initiatives - Adopted

Institutional investors are encouraged to give due weight to all relevant factors in Board structure and composition.

F. OTHER INVESTORS

F.1 Investing / Divesting decision

F.1.1 Individual Shareholders - Adopted

Individual shareholders are encouraged to carry out adequate analysis or seek

independent advice on their investing, holding or divesting decisions.

F.2 Shareholder Voting

F.2.1 Individual shareholders voting - Adopted

Individual shareholders are encouraged to participate at Annual General Meetings and exercise their voting rights.

G. SUSTAINABILITY REPORTING

G.1 Principles of Sustainability Reporting

Sustainability is a business approach that creates long term stakeholder value by embracing opportunities and managing risks derived from economic, environmental and social developments and their potential implications and impacts on the business activities of the entity.

Sustainability reporting is the practice of recognising, measuring, disclosing and being accountable to internal and external stakeholders for organisational performance towards the goals of sustainable development in the context of the overall business activities and strategy of the entity and directed to the target stakeholders, usually shareholders, employees, customers, society and government.

Please refer to the Management Discussion and Analysis on pages 36 to 101 for details.



Your Board Room Governance Report

SECTION TWO

The Statement of Compliance

The Central Bank of Sri Lanka issued the Direction on Corporate Governance (Banking Act Direction No 11 of 2007 and subsequent amendments thereto), in order to improve and sustain the Corporate Governance processes and practices of the Licensed Commercial Banks in Sri Lanka. The disclosures below reflect HNB's level of conformance to the above Direction which comprises of eight (8) fundamental principles, namely:

1. The responsibilities of the Board
2. The Board's composition
3. Criteria for the assessment of the fitness and propriety of Directors
4. Management functions delegated by the Board
5. The Chairman and Chief Executive Officer
6. Board appointed Sub-committees
7. Related Party Transactions and
8. Disclosures

The structures in place and the conformance to the requirement and expectations are tabulated below, under the said eight fundamental principles.

Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2016
3 (1) The Responsibilities of the Board			
1. Strengthening the safety and soundness of the Bank	Rule 3 (1) (i)	Compliant	<p>The Board Charter sets out the responsibility of the Board.</p> <p>The Board is responsible for formulating strategy, ensuring the adequacy of the risk management processes, review of the internal control system and defining the responsibility of the Corporate Management.</p> <p>The Board has strengthened the safety and soundness of the Bank through the implementation of the following:</p> <p>(a) Strategic Objectives and Corporate Values</p> <p>The Bank's strategic objectives and corporate values which are derived from our vision and mission statement have been communicated to all staff members throughout the Bank. Further, the Bank has developed a Code of Conduct and Ethics for all employees, which is in line with our strategic objectives and corporate values. This Code was communicated to all staff members throughout the Bank.</p> <p>(b) Overall Business Strategy</p> <p>The Board has provided direction in the development of short, medium and long term strategy of the Bank with the objective of promoting sustainability and profitable growth of the Bank.</p> <p>A Board approved strategic plan, which contains measurable goals covering the period 2017-2020 is in place. The business strategy is reviewed usually on a quarterly basis by the Board with updates at Board meetings on execution of the agreed strategy. The Board approves and monitors the annual budget which is derived from Bank's strategic plan.</p> <p>Separate risk management policies for Credit Risk, Market Risk, Treasury Risk and Operational Risk are in place.</p> <p>Further, the risk management procedures and mechanisms with time bound implementation milestones was approved and monitored by the Board Integrated Risk Management Committee on a regular basis.</p>

(c) Risk Management

The Board takes responsibility for the overall risk framework of the Bank. The Board Integrated Risk Management Committee ensures that the risks taken in Credit, Operational, Market, Strategic and other areas are within the approved risk appetite set out by the Board.

The findings of the Board Integrated Risk Management Committee are submitted to the main Board for their review and further action if required.

(d) Communication with Stakeholders

With a view of formulating clear and precious communication with all stakeholders and general public, the Corporate Communication Policy had been reformulated in August 2016. The Corporate Communication Policy is guided by the principles of efficiency, transparency, proactivity, clarity and feedback.

The Board is responsible for ensuring timely and effective communication with shareholders and other stakeholders.

The Bank substantially implemented the provisions of Banking Act Direction No 8 of 2011 "Customer Charter of Licensed Banks" which became effective in 2012. This Charter sets key standards of fair banking practices envisaged by customers when they undertake transactions with the Bank and provides guidelines to adopt a "Code of Conduct" on customer protection. The Charter also includes a set of customer obligations towards the Bank in the interest of a stable relationship.

(e) Bank's Internal Control System and Management Information System

The Board takes responsibility for the adequacy and integrity of the overall internal control framework of the Bank.

The Board Audit Committee has reviewed adequacy and integrity of the Internal Control System and the Management Information of the Bank and reported to the Board.

The Board has reviewed the adequacy and integrity of the Internal Control System and the Management Information of the Bank and is satisfied with same.

(f) Key Management Personnel (KMP)

Members of the Corporate Management (MD/ CEO, COO, DGMs and AGMs) and the Head of Compliance have been classified as Key Management Personnel (KMP) as per the guideline on "Key Management Personnel in Banking Act Direction for Corporate Governance" issued by the Banking Supervision Department of CBSL.

(g) Authority and Responsibility of Directors and Key Management Personnel

Duties and responsibilities of the Board of Directors are included in the Board Charter. The duties and responsibilities of Key Management Personnel are formally documented through their respective job descriptions which have been approved by the Nomination Committee and the Board.

The delegated authority limits for KMPs in the respective areas of operations have been approved by the Board.

Your Board Room Governance Report

Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2016
			<p>(h) Oversight of the affairs of the Bank by Key Management Personnel</p> <p>The Board of Directors formulates policies and exercises oversight of the affairs of the Bank through the MD / CEO.</p> <p>(i) Board's own Governance Practices</p> <p>The effectiveness of the Board's own governance practices, including the process for selection, nomination and election of Directors (which is explained in detail under Rule 3 (2) (ix)) and the process for management of conflict of interest (which is explained in detail under Rule 3 (1) (xii)) are reviewed by the Board on a periodic basis. Implementation of changes required are being discussed and determined by the Board at the year-end through, the submission of the summary of annual self-evaluations.</p> <p>(j) Succession Plan for Key Management Personnel</p> <p>A Board approved succession plan for Key Management Personnel is available.</p> <p>In April 2016, the Nomination Committee reviewed the roll-out / implementation of the approved succession plan.</p> <p>A comprehensive policy on succession planning for KMPs and Directors had been approved by the Board in February 2016.</p> <p>(k) Regular Meetings with Key Management Personnel</p> <p>The Directors have free and open contact with the Key Management Personnel of the Bank. Key Management Personnel have made presentations to Directors on important issues relating to strategy, risk management, recovery endeavours and new legal developments. Further, Non-Executive Directors have the option to attend important management meetings at the invitation of MD / CEO.</p> <p>(l) Regulatory Environment</p> <p>The Board Secretary furnishes the Directors with a set of rules with regard to all regulatory directions and requirements including Corporate Governance, on their appointment.</p> <p>The Chairman, MD/CEO and Directors regularly meet CBSL Officials with regard to specific strategic matters of the Bank.</p> <p>(m) Hiring and Oversight of the External Auditor</p> <p>Article 53 (iv) of Bank's Articles of Association states the general procedure for appointment of the External Auditor by the Bank.</p> <p>The Audit Committee has the primary responsibility for making recommendations to the Board on the appointment, re-appointment or removal of the External Auditor in-line with professional standards and regulatory requirements.</p> <p>On the recommendation of the Board, the shareholders have approved the re-appointment of Messrs Ernest & Young (Chartered Accountants) as the External Auditor of the Bank.</p> <p>The Audit Committee sets out the policy for the engagement of the External Auditor to provide non-audit services. A policy for engagement of the external auditor to provide non-audit services is in place.</p>
2.	Chairman and CEO	Rule 3 (1) (ii)	Compliant
			The Board has appointed the Chairman and the Chief Executive Officer. The roles of the Chairman and the Chief Executive Officer are separate and are in line with Rule 3 (5).

Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2016
3. Board Meetings	Rule 3 (1) (iii)	Compliant	<p>The Board usually meets on monthly intervals, but meets more frequently whenever it is necessary.</p> <p>The Board met fifteen (15) times during the year.</p> <p>The attendance at Board meetings held in 2016 is set out on page 131.</p>
4. Board's procedure for inclusion of proposals by all Directors in the agenda	Rule 3 (1) (iv)	Compliant	<p>The Board approved procedure is in place to enable all Directors to include matters and proposals in the agenda on promotion of business, management of risk and other areas relevant to the progress of the Bank for regular board meetings.</p>
5. Notice of Meetings	Rule 3 (1) (v)	Compliant	<p>The Directors are given adequate time, and usually at least seven (7) days of notice is given for regular Board meetings. For all other meetings, a reasonable notice period is given.</p>
6. Non-attendance of Directors	Rule 3 (1) (vi)	Compliant	<p>All Directors have attended at least two thirds (2/3) of the meetings held during 2016. Further no Director has been absent from three consecutive regular Board meetings during 2016.</p>
7. Board Secretary	Rule 3 (1) (vii)	Compliant	<p>The Board has appointed a Company Secretary who is an Attorney at Law by profession and satisfies the provisions of Section 43 of the Banking Act No.30 of 1988.</p> <p>All Directors have access to the Board Secretary. The Board Secretary had provided the Board with support and advice relating to corporate governance matters, Board procedures and applicable rules and regulations during the year.</p>
8. Directors access to Board secretary	Rule 3 (1) (viii)	Compliant	<p>All Directors have access to the Board Secretary. The Board Secretary had provided the Board with support and advice relating to corporate governance matters, Board procedures and applicable rules and regulations during the year.</p>
9. Minutes of the Meetings	Rule 3 (1) (ix) Rule 3 (1) (x)	Compliant	<p>The minutes of the Board meetings are maintained in sufficient detail by the Board Secretary, and are open for inspection by any Director.</p>
10. Independent professional advice	Rule 3 (1) (xi)	Compliant	<p>A Board approved procedure has been put in place for Directors to seek independent professional advice, in furtherance of their duties, at the Bank's expense. This will be coordinated through the Board Secretary, as and when it is requested.</p>
11. Conflicts of Interest	Rule 3 (1) (xii)	Compliant	<p>Article 40 of Articles of Association addresses the provision with regard to this requirement. The Board is conscious of its obligations to ensure that Directors avoid conflicts of interest (both real and apparent) between their duty to HNB and their other interests. The Board has taken steps to ensure that conflicts and potential conflicts of interest of Directors are disclosed to the Board. Any Director with a material personal interest in a matter being considered by the Board, declares his / her interest and unless the Board resolves otherwise, he / she does not participate in discussions or vote on that specific matter.</p> <p>During the year, the Bank had re-constituted the Related Party Transaction Review Committee (RPTRC).</p> <p>The Following Directors serve on the Related Party Transactions Review Committee</p> <p>Mr Nilanth de Silva - Chairman / Independent Non-Executive Director</p> <p>Mr Jonathan Alles - Executive Director</p> <p>Mr Palitha Pelpola - Independent Non-Executive Director</p> <p>Dr Rohan Karunaratne - Independent Non-Executive Director</p>
12. Formal schedule of matters	Rule 3(1) (xiii)	Compliant	<p>The Board reserves for itself a formal schedule of matters on which it takes the ultimate decision.</p>

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Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2016
13. Situation of Insolvency	Rule 3(1) (xiv)	N/A	This situation has not arisen during the year 2016.
14. Capital adequacy	Rule 3 (1) (xv)	Compliant	The Bank has been fully compliant with the capital adequacy requirements issued by the Monetary Board during 2016.
15. Corporate Governance Report	Rule 3 (1) (xvi)	Compliant	This requirement is met through the publishing of the Corporate Governance report in the annual report.
16. Annual self-assessment by the Directors	Rule 3 (1) (xvii)	Compliant	Individual Directors carried out an annual self-assessment of their own performance and the effectiveness of the Board as a whole. The summary findings together with areas for future improvement has been tabled at the Board meeting for discussion and endorsement by the full Board in January 2017.

3 (2) The Board's Composition

17. Number of Directors	Rule 3 (2) (i)	Compliant	The Board comprised of twelve (12) Directors as 31st December 2016.
18. Period of service of a Director	Rule 3 (2) (ii)	Compliant	The total period of service of all Non-Executive Directors does not exceed nine (9) years.
19. Appointment of an employee as a Director	Rule 3 (2) (iii)	Compliant	Mr Jonathan Alles (MD / CEO) is the only employee appointed to the Board as at date, and as such, the number of Executive Directors does not exceed one third (1/3) of the number of Directors of the Board throughout the year.
20. Independent Non-Executive Director	Rule 3 (2) (iv)	Compliant	The Board includes seven (7) Independent Non-Executive Directors as per the definition of this Direction, which is more than one third (1/3) of the Board. The Board considers Non-Executive Directors' independence on an annual basis, based on the self-declaration and as part of each Director's self-assessment.
21. Alternative Director	Rule 3 (2) (v)	Compliant	During the year, all alternate directors appointed to represent Independent Non-Executive directors were independent.
22. Credibility, skills and experience of Non-Executive Directors	Rule 3 (2) (vi)	Compliant	The Board consists of professionals in the fields of Banking, Law, Accounting, Management, Economics, Engineering, Marketing, Public Administration and Business. All Directors possess the skills, experience and knowledge complemented with a high sense of integrity and independent judgment. The Board gives leadership in setting the strategic direction and establishing a sound control framework for the successful functioning of the Bank. The Board's composition reflects sound balance of independence and anchors shareholder commitment. Please refer pages 26 to 29 for the profiles of the Non-Executive Directors.
23. Presence of Non-Executive Directors in Board Meetings	Rule 3 (2) (vii)	Compliant	At all Board meetings convened during the year, more than one half (1/2) of the Directors present were Non-Executive Directors.
24. Details of Directors	Rule 3 (2) (viii)	Compliant	Please refer page 131 for the details of the Directors and their categories.
25. Appointment of new Directors	Rule 3 (2) (ix)	Compliant	The Nomination Committee assesses the suitability of the prospective nominees to the Board and recommends persons found to be "fit and proper" for consideration of the entire Board. Upon completion of this process, names are referred to the Director of the Bank Supervision Department of the Central Bank of Sri Lanka for approval as a "fit and proper" person, prior to the appointment. There were no new Directors appointed to the Board during 2016.
26. Appointment to fill a casual vacancy	Rule 3 (2) (x)	Compliant	As per Article 36 of Bank's Articles of Association all members elected to fill casual vacancies of the Board shall hold office till the next AGM, and then be eligible for re-election. There were no casual vacancies during 2016.

Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2016
27. Resignation / removal of a Director	Rule 3 (2) (xi)	Compliant	There were no resignations or removal of Directors during 2016.
28. Appointments to other Banks	Rule 3 (2) (xii)	Compliant	None of the Directors are either employees or Directors of other Banks.
3 (3) Criteria to assess the fitness and propriety of Directors.			
29. Directors over 70 years of age	Rule 3 (3) (i)	Compliant	All Directors are below the age of Seventy (70) years as at 31st December 2016.
30. Holding of office in more than 20 companies	Rule 3 (3) (ii)	Compliant	No Director holds office as a Director in more than 20 companies.
3 (4) The Management function delegated by the Board			
31. Delegation of work to the management	Rule 3 (4) (i)	Compliant	<p>As per Article 38(iii) of the Articles of Association of the Bank the Board may delegate to, entrust to and confer upon a committee of Directors or to a Director, or to any officer/employee of the company any of the powers exercisable by which it is permitted to delegate.</p> <p>The Board annually evaluates the delegated authority process to ensure that the delegation of work does not materially affect the ability of the Board as a whole in discharging its' duties.</p> <p>The Financial Authority Manual and the Credit Delegation Authority are reviewed annually by the Board as part of its delegation of authority to the Management through the MD / CEO</p>
32. Extent of Delegation	Rule 3 (4) (ii)	Compliant	Please refer comments above.
33. Evaluation of the delegated process	Rule 3 (4) (iii)	Compliant	Please refer comments on rule 3(4) (i) above.
3 (5) The Chairman and Chief Executive Officer			
34. Division of Responsibilities of the Chairman and MD / CEO	Rule 3 (5) (i)	Compliant	The roles of the Chairman and Chief Executive Officer are separate.
35. Chairman preferably be an Independent Director and if not designate a Senior Director	Rule 3 (5) (ii)	Compliant	The Chairman of the Board of Directors (Mr Rienzie Arseculeratne) is an Independent Non-Executive Director.
36. Relationship between Chairman, CEO and other Directors	Rule 3 (5) (iii)	Compliant	As declared by the Directors, there are no material relationship between the Chairman / CEO and / or other members of the Board which will impair their respective roles.
37. Role of the Chairman	3 (5) (iv)	Compliant	The Chairman's main responsibility is to lead, direct and manage the Board to ensure that it operates effectively and fully discharges its legal and regulatory responsibilities.
38. Approval Agenda for Board meetings by the Chairman	3 (5) (v)	Compliant	The Chairman approves the agenda for each Board meeting which is prepared by the Board Secretary.

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Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2016
39. Accurate, timely and clear information to Directors.	3 (5) (vi)	Compliant	<p>The Chairman ensured that the Board was provided with timely and appropriate information by the Management by way of Board papers and proposals. The Board sought additional information as and when necessary. The Chairman ensured that all Directors were briefed on issues arising at Board meetings.</p> <p>The Board papers are usually sent to the Directors at least a week before the respective Board meetings giving adequate time for Directors to study the related papers and prepare for a meaningful discussion at the respective meetings.</p>
40. Contribution of all Directors to the Board's affairs	3 (5) (vii) and 3 (5) (viii)	Compliant	The Chairman has encouraged effective participation of all Directors in the decision making process in order to optimise contribution. The Chairman also encouraged constructive relations between the MD /CEO and the Non-Executive Directors.
41. Supervision of KMP's by Chairman	3 (5) (ix)	Compliant	The Chairman does not engage in activities involving the direct supervision of KMPs or any other executive duties. The MD/ CEO is empowered by the Board to carry out all operational duties of the Bank who in turn reports to the Board.
42. Communication with Shareholders	3 (5) (x)	Compliant	The Annual General Meeting is used to have an effective dialogue with the shareholders on matters which are relevant to them.
43. The Chief Executive Officer to be the apex executive in-charge of day to day Operations and Business	3 (5) (xi)	Compliant	As per the Board approved organization structure the MD / CEO is responsible for the day-to-day operations and business of the Bank.

3 (6) Board appointed Committees

44. Board appointed four Sub - Committees	Rule 3 (6) (i)	Compliant	<p>There are four (4) Board appointed Sub-committees including the Audit Committee, Board Integrated Risk Management Committee, Human Resources & Remuneration Committee and Nomination Committee, which are prescribed by the CBSL. Direction (mandatory Sub-Committees).</p> <p>A Related Party Transaction Review Committee as prescribed by the Code of Best Practices on Related Party Transactions issued SEC is also in place.</p> <p>In addition, the Bank has established five (05) committees to assist the Bank's operations/ decision making process. These committees include the Related Party Transaction Review Committee, Credit / Asset & Liability Committee, Procurement Committee, Committee for Disposal of Asset / Investment Properties, Strategy & Investment Review Committee and Network Performance Review Committee.</p> <p>Meeting minutes and recommendations of the Sub - Committees are submitted to the Board by the respective secretaries of the Sub-Committees.</p>
45. Audit Committee			
45.01 Chairman of the Audit Committee	Rule 3 (6) (ii) (a)	Compliant	Mr Sujeewa Mudalige (Independent Non-Executive Director) is the Chairman of the Audit Committee. Mr Mudalige is a fellow member of the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka), the Chartered Institute of Management Accountants (CIMA - UK), Fellow of the Association of Chartered Certified Accountants (ACCA - UK) and Fellow of the Certified Public Accountants (CPA - Australia). He is a past president of the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka).
45.02 Composition of the Audit Committee	Rule 3 (6) (ii) (b)	Compliant	All the members of the Audit Committee are Independent Non-Executive Directors.

Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2016
45.03 Recommendation to the Board	Rule 3 (6) (ii) (c)	Compliant	<p>The Audit Committee has the primary responsibility for making recommendations to the Board on the appointment, re-appointment or removal of the External Auditor in-line with professional standards and regulatory requirements. The Committee also evaluates and makes recommendations to Board with regard to the audit fee.</p> <p>On the recommendation of the Board, the shareholders have approved the re-appointment of Messrs Ernest & Young (Chartered Accountants) as the External Auditor of the Bank for the year 2016.</p> <p>The Committee also reviews the accounting policies to determine the most appropriate accounting policies after considering all options available.</p>
45.04 Monitoring and review of the External Auditor's independence, objectivity and the effectiveness	Rule 3 (6) (ii) (d)	Compliant	<p>The Audit Committee monitors and reviews the External Auditor's independence, objectivity and the effectiveness of the audit process taking into account relevant professional and regulatory requirements.</p>
45.05 Policy for the engagement of the External Auditor to provide non-audit services	Rule 3 (6) (ii) (e)		<p>The Committee sets out the policy for the engagement of the External Auditor to provide non-audit services.</p> <p>A Board approved policy for engagement of the external auditor to provide non audit services is in place.</p> <p>Please refer Section D.3.2 of the SEC & CA Sri Lanka Code table on pages 115 for further details.</p>
45.06 Nature and Scope of External Audit	Rule 3 (6) (ii) (f)	Compliant	<p>The Committee met with the External Auditor during the year to discuss their audit approach and procedures including matters relating to the scope of the audit and auditor's independence.</p>
45.07 Review of Financial Information of the Bank	Rule 3 (6) (ii) (g)	Compliant	<p>The Audit Committee has a process to review financial information of the Bank, in order to monitor the integrity of the Financial Statements of the Bank. The Audit Committee reviewed the Bank's Annual Report and quarterly Financial Statements before the submission to the Board for approval.</p>
45.08 Meeting with External Auditors	Rule 3 (6) (ii) (h) and (l)	Compliant	<p>The Committee met the External Auditor twice (02) without the presence of the Executive Director and the Management, during 2016.</p>
45.09 External Auditor's Management Letter	Rule 3 (6) (ii) (i)	Compliant	<p>During the year, the Audit Committee reviewed the year end Management Letter for 2015, and the responses thereto with the External Auditor and the Management team.</p>
45.10 Internal Audit	Rule 3 (6) (ii) (j) and (k)	Compliant	<p>During the year, the Audit Committee reviewed the independence, objectivity and performance of the Internal Audit Function. The findings of the internal audits completed during the year and the internal audit department's evaluation of the Bank's internal controls were reviewed by the Audit Committee.</p> <p>The Audit Committee also reviewed the adequacy of coverage of the internal audit plan and approved the same. It also assessed the Department's resource requirements including succession planning. The Committee reviewed the performance appraisal of the Chief Internal Auditor and other senior staff members of the Internal Audit Department. Committee has also considered major findings of internal investigations and management's responses thereto.</p> <p>The Chief Internal Auditor directly reports to the Board Audit Committee thus ensuring the independence of the Internal Audit Department.</p>

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Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2016
45.11 Terms of Reference	Rule 3 (6) (ii) (m)	Compliant	The Board Audit Committee is guided by the Committee Charter which sets out authority and responsibility of the said Committee. The Charter was reviewed in December 2016. The Audit Committee is authorized to obtain external professional advice and to invite outsiders with relevant experience to attend as and when necessary. The Committee also has full access to information in order to investigate into matters relating to any matter within its terms of reference.
45.12 Meetings	Rule 3 (6) (ii) (n) and (o)	Compliant	The Board Audit Committee met eight (08) times for 2016. The attendance at Audit Committee meetings held in 2016 is set out on page 131. The Board Audit Committee report is given on pages 137 and 138 sets out the activities of the Committee during 2016.
45.13 Secretary	Rule 3 (6) (ii) (p)	Compliant	The Company Secretary also acts as secretary to the Audit Committee.
45.14 Process by which employees raise concerns in confidence	Rule 3 (6) (ii) (q)	Compliant	A Board approved whistle blowing policy is in place. The whistle blowing policy and the mechanism had been communicated to all staff members. The Audit Committee reviews issues relating to breach of ethics if any and the arrangements by which the staff of the Bank may in confidence raise concerns about possible improprieties. The Committee also ensured that the procedures for the independent investigations of such matters are appropriate and are in place. The Board Charter addresses the Boards responsibility to encourage any communication regarding non compliances and unethical behaviour within the Bank.
46. Human Resources & Remuneration Committee			
46.01 Remuneration Policy	Rule 3 (6) (iii) (a)	Compliant	The Committee reviews all significant human resource policies and initiatives, salary structures, promotions and terms and conditions relating to staff at senior management level with information and recommendations from the MD / CEO and the Chief Human Resource Officer. A Remuneration Policy for the Board of Directors is in place. The HR & Remuneration Committee had also put in place a remuneration policy for all employees of the Bank. Further the Committee has approved a specific Remuneration Policy for Key Management Personnel of the Bank in February 2017. In addition a specific remuneration policy for the MD / CEO is currently in place.
46.02 Goals and Targets	Rule 3 (6) (iii) (b)	Compliant	The goals and targets of the Board of Directors have been clearly set out and evaluated at the end of the year. The goals and targets for the MD/CEO and the senior leadership team are documented under the Balance Score Card system.
46.03 Performance Evaluation	Rule 3 (6) (iii) (c)	Compliant	The Directors are evaluated at the end of the year based on the goals and targets set out. The Committee deliberates upon and recommends to the Board of Directors the remuneration packages, annual increments and bonuses of the MD/CEO, COO, members of the Corporate Management and senior management staff, having evaluated their performance against the set goals and targets.
46.04 Meetings	Rule 3 (6) (iii) (d)	Compliant	The Committee met seven (07) times during the year. The MD/CEO attends Human Resources & Remuneration Committee by invitation. The MD/CEO is not present at the time his performance is being discussed.

Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2016
47. Nomination Committee			
47.01 Procedure to select/ appoint MD / CEO, KMPs and Directors	Rule 3 (6) (iv) (a)	Compliant	A formal procedure to appoint MD/CEO, KMPs and Directors is in place.
47.02 Re- election of Directors	Rule 3 (6) (iv) (b)	Compliant	The Committee considers and recommends the re-election of the Directors to the Board. The Committee also set criteria of the succession of the MD/CEO.
47.03 Criteria such as qualifications, experience and key attributes for eligibility to be considered for appointment or promotion to the post of CEO, and Key Management Personnel	Rule 3 (6) (iv) (c)	Compliant	A Board approved procedure to appoint MD / CEO, KMPs and Directors is in place. Job descriptions of the newly appointed KMPs of the Bank were reviewed by Nomination Committee during the year.
47.03 Fit and proper person to hold office	Rule 3 (6) (iv) (d)	Compliant	Each Director including the MD / CEO carries out an assessment of " fitness and propriety" to serve as a Director of the Bank. These declarations reviewed by the Nomination Committee prior to onward transmission to the Director Bank Supervision of the Central Bank of Sri Lanka.
47.04 Formal Succession plan for the retiring directors and KMPs	Rule 3 (6) (iv) (e)	Compliant	A comprehensive policy on Succession Planning for KMPs and Directors had been approved by the Board in February 2016. During the year, the Nomination Committee reviewed the additional/ new expertise requirements and succession arrangements for the Senior leadership team of the Bank , in line with Bank's strategic objectives
47.05 Chairman of the Committee	Rule 3 (6) (iv) (f)	Compliant	The following Directors served on the Nomination Committee during 2016. Mr Rienzie Arseculeratne - Chairman / Independent Non-Executive Director Ms Rose Cooray - Non Executive Director Mr Rusi Captain - Non Executive Director Mr Palitha Pelpola - Independent Non Executive Director
48. Integrated Risk Management Committee			
48.01 Composition of the Committee	Rule 3 (6) (v) (a)	Compliant	The following personnel served on the Board Integrated Risk Management Committee during 2016. Ms Rose Cooray - Chairperson / Non Executive Director Mr Jonathan Alles - Managing Director / CEO Ms Sanjivani Jayawardena - Non Executive Director Mr Damien Fernando- Non Executive Director Mr Duliksha Soosaipillai - Independent Non Executive Director Mr Damith Pallewatte - Chief Risk Officer / AGM - Risk Mr Bhanu Wijyaratne - Chief Compliance Officer (resigned w.e.f 27th May 2016) Ms Mohini Seneviratne - Head of Compliance (appointed 28th May 2016) The COO, CFO/AGM- Finance, Chief Digital Officer and Chief Internal Auditor attend meetings on invitation.

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Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2016
48.02 Process to assess all risks	Rule 3 (6) (v) (b)	Compliant	<p>The Bank's Risk Management function assesses, risks in credit, market, liquidity, and operational areas and reports are submitted to the BIRMC through the Chief Risk Officer.</p> <p>Risk dashboard consisting of credit, recoveries, operational and market risks are reviewed periodically by the BIRMC. The Committee has set up limits wherever required.</p> <p>The risk management process followed by the subsidiary companies has also been reviewed by the BIRMC during 2016.</p>
48.03 Review of specific qualitative and quantitative risk limits for management level Committees	Rule 3 (6) (v) (c)	Compliant	The BIRMC has reviewed specific qualitative and quantitative risk limits for important management committees including the Asset and Liability Committee (ALCO) and the Credit Policy Committee.
48.04 Review of risk indicators which have gone beyond the specified risk limits	Rule 3 (6) (v) (d)	Compliant	The Committee has reviewed and considered a number of risk indicators which have gone beyond the specific qualitative and quantitative risk limits through the dash boards.
48.05 Meetings	Rule 3 (6) (v) (e)	Compliant	The BIRMC met nine (09) times during 2016. The Sub-Committee had kept the Board informed of their risk assessment of the Bank continuously during the year.
48.06 Action against officers responsible for failure to identify and take prompt corrective action	Rule 3 (6) (v) (f)	Compliant	This process will be coordinated through the Bank's Human Resources Division when deemed necessary by the BIRMC.
48.07 Submission of risk assessment report to the Board	Rule 3 (6) (v) (g)	Compliant	Detailed reports of the BIRMC meetings is submitted to the Board at the subsequent Board meeting.
48.08 The Compliance Function	Rule 3 (6) (v) (h)	Compliant	<p>The Board Integrated Risk Management Committee also oversees the compliance function. The Head of Compliance reports directly to the BIRMC.</p> <p>The compliance function assesses the Bank's compliance with laws and regulations and reports to the BIRMC on a periodic basis.</p> <p>A process for the assessment of the Bank's compliance with internal controls and approved policies is in place.</p>

3 (7) Related Party Transactions

49. Avoiding conflicts of interest in related party transaction and favourable treatment	Rule 3 (7) (i) Rule 3 (7) (ii) Rule 3 (7) (iii)	Compliant	<p>A formal policy to enhance the transparency of Related Party Transactions had been put in place by the Board of Directors.</p> <p>Steps have been taken by the Board to avoid any conflicts of interest, that may arise, in transacting with related parties as per the definition of this Direction and Sri Lanka Accounting Standard - 24 (LKAS 24) on "Related Party Transactions". Further, the Board ensures that no related party benefits from favourable treatment. The pricing applicable to such transactions is based on the assessment of risk and pricing model of the Bank and is comparable with that what is applied to transactions between the Bank and its unrelated customers.</p> <p>The net accommodation granted to each category of related parties as a percentage of the Bank's regulatory capital is given under Rule 3 (8) (ii) (e).</p>
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Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2016
50. Accommodation to Directors and / or their close relatives	Rule 3 (7) (iv)	Compliant	All accommodations to Directors and / or their close relatives are approved by at least 2/3 of the Board. The Director concerned is not a part of the approval process. All accommodations to Directors and / or their close relatives are secured by security which is prescribed by the Monetary Board.
51. Appointment of Director subsequent to approval of facilities to him / her	Rule 3 (7) (v)	Compliant	The accommodations granted to the Director prior to his appointment as a Director of the Bank has been secured by security which is prescribed by the Monetary Board before the expiration of an exemption period of one year allowed by CBSL.
52. Accommodation to employees	Rule 3 (7) (vi) Rule 3 (7) (vii)	Compliant	Accommodation has not been given to employees on a favourable basis other than the general schemes applicable to all employees of the Bank.

3 (8) Disclosures

53. Financial reporting, statutory and regulatory reporting	Rule 3 (8) (i)	Compliant	The Financial Statements for the year ended 31st December 2016, are in conformity with all rules and regulatory requirements and for the quarters then ended have been published in the newspapers in all three languages.
54. Minimum disclosure in the Annual Report	Rule 3 (8) (ii)	Compliant	<p>(a) Compliance with applicable accounting standards and regulatory requirements has been reported under the "Directors' Responsibility for Financial Reporting" on page 196, the "CEO's and CFO's Responsibility Statement" on page 195 and note No 2.1.1 (Statement of Compliance) to the Financial Statements on page 206.</p> <p>(b) Directors' report on the effectiveness of the internal control system over financial reporting is given under the Directors' Statement on Internal Control on pages 150 and 151.</p> <p>(c) The Assurance Report issued by the External Auditor on the Internal Control over Financial Reporting based on "SLSAE 3050 – Assurance Reports for Banks on Directors' Statement on Internal Controls" issued by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) is given on page 152. The recommendations made by the Auditors where relevant, will be dealt with in 2017.</p> <p>(d) Details of the Directors are given on pages 24 to 29. The Directors' transactions with the Bank have been disclosed in note No. 60 to the Financial Statements on pages 318 to 322. The remuneration paid to the Board of Directors (which include the Executive Director Remuneration) is disclosed in aggregate in note No. 17 to the Financial Statements on page 242.</p> <p>(e) The net accommodation granted to each category of related parties is given below as a percentage of the Bank's regulatory capital.</p>

Category of Related Party Transactions	Rs Mn	%
Non-Executive Directors and their close family Members	32.24	0.04%
Key Management Personnel (KMP)* and their close family Members	110.03	0.12%
Subsidiaries	486.73	0.54%
Joint Venture	5,357.20	5.98%
Entities controlled by Directors and their close family members	6,009.94	6.71%
Government of Sri Lanka/ Entities Controlled, Jointly Controlled, Significantly Influenced by the Government of Sri Lanka	28,202.73	31.48%

*includes the Executive Director

Your Board Room Governance Report

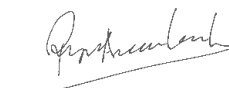
Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2016										
			<p>(f) The aggregate amount of remuneration paid during 2016 to Key Management Personnel and the transaction with Key Management Personnel are given below</p> <table border="1"> <thead> <tr> <th></th> <th>Rs Mn</th> </tr> </thead> <tbody> <tr> <td>Remuneration Paid</td> <td>348.61</td> </tr> <tr> <td>Loans and Advances</td> <td>300.71</td> </tr> <tr> <td>Deposits</td> <td>366.89</td> </tr> <tr> <td>Investments</td> <td>111.27</td> </tr> </tbody> </table> <p>(g) The external auditors have performed procedures set out in Sri Lanka Standards on Related Service 4400 issued by the Institute of Chartered Accountants of Sri Lanka (SLSRS 4400), to meet the compliance requirement of the Corporate Governance directive. Their findings presented in their report addressed to the Board are consistent with the matters disclosed above and did not identify any inconsistencies to those reported above by the Board. The recommendations made by the Auditors where relevant will be dealt with in 2017.</p> <p>(h) There were no material non - compliance to prudential requirements, regulations, laws and internal controls affecting the Bank.</p> <p>(i) There were no supervisory concerns regarding lapses in the Bank's risk management system or non-compliance with this Direction that have been pointed out by the Director of the Bank Supervision Department of the CBSL and requiring disclosure to the public.</p>		Rs Mn	Remuneration Paid	348.61	Loans and Advances	300.71	Deposits	366.89	Investments	111.27
	Rs Mn												
Remuneration Paid	348.61												
Loans and Advances	300.71												
Deposits	366.89												
Investments	111.27												
55. Transitional and other general provisions	Rule 3 (9)	Compliant	The Bank has complied with the transitional and other general provisions.										

Report from External Auditors

The external auditors have performed procedures set out in Sri Lanka Standards on Related Service 4400 (SLSRS 4400) issued by the Institute of Chartered Accountants of Sri Lanka to meet the compliance requirement of the Corporate Governance directive. Their findings presented in their report addressed to the Board are consistent with the matters disclosed above and did not identify any inconsistencies to those reported above by the Board.



Jonathan Alles
Managing Director / Chief Executive Officer



Rienzie Arseculeratne
Chairman

Board and the Committee Attendance

The number of meetings of the Board, Board appointed Sub - committees and individual attendance by members is shown below.

Name of Director	Directorship Status	Date of Appointment to the Board	Board	Audit Committee	HR & Remuneration Committee	Nomination Committee	Board Integrated Risk Management Committee	Related Party Transaction Review Committee	Strategy & Investment Committee	Procurement Committee	Credit/Assets & Liability Committee	Network Performance Review Committee
Total No. Meetings			15	8	7	5	9	4	6	12	7	4
Mr Rienzie Arseculeratne	Independent Non-Executive Chairman	30th April 2015	•15/15		• 7/7	• 5/5						
Mr Jonathan Alles	Managing Director / CEO	01st May 2013	15/15	7a	6a	5a	4/9	3/4	6a		6a	
Ms Rose Cooray	Non-Executive Director	15th February 2010	15/15	5a		5/5	• 9/9		6/6			
Dr Rohan Karunaratne	Independent Non-Executive Director	06th October 2011	*15/15	*7/8				1/4		*11/12	4/7	
Mr Damien Fernando	Non-Executive Director	02nd April 2012	15/15		4/7		9/9					2/4
Mr Sujeewa Mudalige	Independent Non-Executive Director	02nd April 2012	14/15	• 8/8	7/7		6a		6/6			
Ms Sanjivani Jayawardena	Non-Executive Director	02nd April 2012	14/15				8/9			12/12		4/4
Mr Rusi Captain	Non-Executive Director	02nd April 2012	**10/15			*3/5						0/4
Mr Amal Cabraal	Independent Non-Executive Director	01st April 2014	14/15	7/8	7/7				• 6/6			
Mr Palitha Pelpola	Independent Non-Executive Director	30th April 2015	12/15			5/5		4/4			5/7	
Mr Duliksha Soosaipillai	Independent Non-Executive Director	30th April 2015	15/15				9/9		6/6	12/12		
Mr Nilanth de Silva	Independent Non-Executive Director	30th April 2015	15/15	8/8				• 4/4			• 7/7	• 4/4

* Includes one (01) meeting attended by an alternate director

** Includes two (02) meetings attended by alternate director/s

a Meetings attended by Invitation

• Chairman/Chairperson of the Board/ Sub-committee as at 31st December 2016

The papers relating to Credit are circulated to the members of the respective Board appointed Sub-committees set out below. If a Director has an interest in the relevant subject matter under consideration, he / she declares his / her interest to the respective Committee and withdraws from the approval process.

Name of Director	Total No of Credit papers approved in 2016
Total No. of credit papers approved in 2016	406
Mr Rienzie Arseculeratne	403
Mr Jonathan Alles	371
Ms Rose Cooray	120
Dr Rohan Karunaratne	155
Mr Damien Fernando	8
Mr Sujeewa Mudalige	42
Ms Sanjivani Jayawardena	17
Mr Rusi Captain	25
Mr Amal Cabraal	28
Mr Palitha Pelpola	200
Mr Duliksha Soosaipillai	27
Mr Nilanth de Silva	368

HR and Remuneration Committee Report

Composition of the Committee

The Human Resources & Remuneration Committee ("the Committee"), appointed by the Board of Directors comprises four Non-Executive Directors, of whom three including the Chairman are Independent Directors. One member is Non-Independent. The following Directors serve on the HR & Remuneration Committee:

Mr Rienzie Arseculeratne (IND / NED) - Chairman

Mr Sujeewa Mudalige (IND / NED)

Mr Damien Fernando (NIND / NED)

Mr Amal Cabraal (IND / NED)

(IND - Independent Director, NIND – Non-Independent Director and NED - Non Executive Director)

Brief profiles of the Directors are given on pages 26 to 29 of the Annual Report.

The Managing Director / Chief Executive Officer (MD / CEO) who is responsible for the overall management of the Bank, attends meetings and participates in the Committee meetings by invitation. The MD / CEO takes part in all deliberations except when his own performance and remuneration is discussed.

The Chief Human Resource Officer/ DGM (Human Resources) functions as the Secretary to the Committee.

Policy

The Bank's remuneration policy aims to attract, motivate and retain talent in a competitive environment with the appropriate professional, managerial and operational expertise necessary to achieve the objectives of the Bank.

The focus of the Committee is to ensure that the total remuneration packages of the Bank are competitive to attract the best available talent to the Bank.

The remuneration of the MD / CEO, COO and corporate management is designed to create and enhance value for all stakeholders of the Bank and to ensure alignment between the short and long term interests of the Bank and its management.

Scope

The Committee is vested with power to examine, evaluate and recommend to the Board of Directors on any matter that may affect the human resources management of the Bank within its Terms of Reference (TOR) and any other matters as may be referred to it by the Board.

The Committee sets targets and goals for the Directors, MD/CEO and the Key Management Personnel annually. It reviews all significant Human Resource policies and initiatives, salary structures and terms and conditions relating to staff at senior management level. In this process, necessary information and recommendations are obtained from the MD/CEO and Chief Human Resource Officer/DGM (Human Resources). The Committee deliberates upon and recommends to the Board of Directors the remuneration packages, annual increments and bonuses of the MD/CEO, COO, members of the corporate management and senior management staff, having evaluated their performance against the set goals and targets.

The organisational structure is also reviewed periodically and adjustments are made according to the focus of the strategic plan. An on going priority is to ensure proper succession for key positions. In doing so, the aspirations of the staff for career progression are taken into account.

Recruitments and promotions of staff at management level are also considered and approved based on proposals submitted by the MD/CEO and Chief Human Resource Officer/DGM (Human Resources) following a formal process of evaluation.

Reports of meetings of the Committee with its recommendations are referred to the Board for information and follow up action where necessary.

During the year under review, terms of reference for this Committee together with certain other HR policies were ratified by the Board.

Meetings

The Committee met six (06) times during 2016.

Attendance at the meetings is given in the table on page 131 of the Annual Report.

Fees

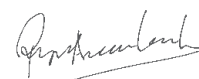
All Non-Executive Directors receive a monthly fee for participation in the deliberations of the Board including attendance at meetings as per the Director's Remuneration Policy. They may also receive fees for attending sub-committee meetings, and/or meetings of subsidiary boards. They do not receive any performance or incentive payments.

Professional Advice

The Committee has the authority to seek external professional advice on matters within its purview.

Committee Evaluation

The Committee completed the evaluation process with self-assessment in 2016, which was conducted by the Chairman and Committee Members and was deemed to be satisfactory.



Rienzie Arseculeratne
Chairman

*Human Resources & Remuneration
Committee*

Colombo, Sri Lanka
23rd February 2017

Nomination Committee Report

Composition of the Nomination Committee

The Nomination Committee ("the Committee") comprises of four Non-Executive Directors appointed by the Board of Directors of the Bank. The following Directors serve / served on the Nomination Committee during the year under reference:

Mr Rienze Arseculeratne - Chairman (IND/NED)

Ms Rose Cooray (NIND/NED)

Mr Rusi Captain (NIND/NED)

Mr Palitha Pelpola (IND/NED)

(IND - Independent Director, NIND – Non Independent Director and NED - Non Executive Director)

Brief profiles of the members of the Committee are given at pages 26 to 29 of the Annual Report.

The Board Secretary functions as the Secretary to the Nomination Committee.

Committee Responsibilities

The Nomination Committee is responsible for reviewing the composition of the Board and Board Sub - Committees to ensure that they are properly constituted and balanced in terms of skills, experience and diversity. In addition, the Committee is entrusted with the responsibility of:

1. Recommending to the Board on appointments of new Directors and Key Management Personnel (KMP) and ensuring the implementation of the approved procedure in selecting such Directors and Key Management Personnel;
2. Recommending the re-election of current Directors to the Board of Directors, taking into account the performance and contribution made by such Directors towards the overall discharge of responsibilities of the Board;
3. Reviewing criteria such as qualifications, experience and key attributes required for eligibility to be considered for appointment or promotion to the post

of Managing Director/CEO and/or the Key Management positions;

4. Ensuring that the Directors, Managing Director/CEO and the Key Management Personnel are fit and proper persons to hold office as required by the Banking Act and other applicable statutes;
5. Assessing from time to time the requirements of additional/new expertise and the succession arrangements for retiring Directors and Key Management Personnel with a view to providing advice and recommendations to the Board on any such appointment;
6. Monitoring Corporate Governance Issues

The Terms of Reference

The Terms of Reference (TOR) of the Nomination Committee, which was adopted by the Board of Directors in 2012, was further refined in 2013 and 2014.

Thereafter, it was reviewed and amended by the members at their meeting held on 19th January 2015 as per the latest intimation by the regulator on improvement of Corporate Governance for the banking industry. Thereafter, the necessity for any further amendments to the TOR was considered at its meetings held on 23rd November 2015 and 21st November 2016, but the Committee was of the view that the TOR could remain unchanged for the time being.

Committee Meetings and how it discharged its duties

The Nomination Committee met five (05) times during the year under review, and its main focus was on the following:

Board Composition

- Identified skill gaps and vacancies created at Board level and made recommendations for certain appointments to be made;
- Evaluated the Board statutory and non-statutory Sub-Committees thrice during the year and set out clear guidelines/

principles on the constitution of such Committees;

- Assessed the fitness and propriety of the Directors holding office in terms of the provisions of the Banking Act and the directions of the Monetary Board relating to Corporate Governance;
- Recommended the re-appointment of Directors who retired by rotation after considering their respective contributions during the previous year;

Succession Planning

- Continuously assessed the adequacy of the expertise available at the Senior Management level;
- Reviewed and discussed the processes, overall methodology and contingency plans in place for senior strategic roles;
- Reviewed the Bank's succession and talent management programme below Board level;
- Specifically discussed succession planning for the positions of Key Management Personnel of the Bank and reviewed potential candidates for those roles;

Board Effectiveness

- Reviewed and recommended all new appointments to the Boards of subsidiary and associate companies of the Bank.
- Reviewed and recommended all strategic recruitments to the Senior Management cadre of the Bank;
- Job Descriptions (the JDs) of the Key Management Personnel were analysed in detail and the Committee was satisfied that the JDs are in line with the respective qualifications, experience and key attributes set forth by the Committee pertaining to each office of KMP;

Group Governance/ Management Principles

- The Committee deliberated on recommending the adoption of a Charter by the Board for the management and

Nomination Committee Report

implementation of good governance practices of the joint ventures, subsidiaries and associates (hereafter collectively called the "Group" or "Group Companies"). This was a further step in the direction of improving efficiencies and transparency within the Group.

- This policy is reflective of the fact that good Governance is a part of the business philosophy of the HNB Group Companies and provides a framework that is conducive to carrying out business of the group based on the highest professional standards, integrity and ethics.
- On 21st November 2016, the Committee assessed the level of compliance by the Group Companies of the requirements envisaged in the Charter and further recommended that the Compliance Department should validate the level of implementation of the governance principles prescribed in the Charter in accordance with the returns submitted by the respective Group Companies.

Committee Attendance

Attendance by the Committee members at the meetings is given in the table on page 131 of the Annual Report. The Chief Executive Officer also attended Five (05) meetings by invitation.


Re-election / Re-appointment of Directors at the 48th Annual General Meeting

Three Directors namely, Ms Sanjivani Jayawardena, Mr Rusi Captain and Mr Amal Cabraal, representing not more than 1/3rd of the Board, are to retire by rotation and are eligible to be re-elected / re-appointed at the 48th Annual General Meeting to be held on 30th March 2017. The Committee, taking into account their contribution and the manner in which they have discharged their responsibilities, decided to recommend the aforesaid names to be formally approved by the Board of Directors. Accordingly, the Board at its meeting held on 23rd February 2017, decided that Ms Sanjivani Jayawardena, Mr Rusi Captain and Mr Amal Cabraal, should be re-elected / re-appointed at the next Annual General Meeting.

Committee Effectiveness

The performance of the Committee is reviewed each year as part of the Board effectiveness review.

The Committee completed the self-assessment for the year 2016, which was conducted by the Chairman and Committee Members and the review concluded that the Committee continues to operate effectively.



Rienzie Arseculeratne
Chairman
Nomination Committee

Colombo, Sri Lanka
23rd February 2017

Board Integrated Risk Management Committee Report

At the end of 2016, the Board Integrated Risk Management Committee (BIRMC) comprised seven (7) members, of which four (4) members were Non-Executive Directors.

Members

Ms Rose Cooray, Chairperson (NIND / NED)

Mr Damien Fernando (NIND / NED)

Ms Sanjivani Jayawardena (NIND / NED)

Mr Duliksha Soosaipillai (IND / NED)

Mr Jonathan Alles, Managing Director / CEO

Mr Damith Pallewatte, Chief Risk Officer / AGM-Risk

Ms Mohini Seneviratne - Head of Compliance
Appointed w.e.f. 28th May 2016

Invitees from the Management

Mr Dilshan Rodrigo, Chief Operating Officer

Mr Sidath Wijeratne, Chief Information Officer / DGM-IT

Mr Nirosana Seneviratne, AGM - Internal Audit

Ms Anusha Gallage, AGM - Finance
Appointed w.e.f. 5th September 2016

Other Invitees

Mr Sujeewa Mudalige (IND/NED) was invited to participate at the meetings as an observer.

Brief profiles of the Directors representing the Committee are given on pages 26 to 29 of the Annual Report.

(IND - Independent Director, NIND - Non Independent Director, NED - Non Executive Director)

Compliance

The BIRMC was established as a Committee of the Board, in compliance with Section 3 (6) of the Banking Act Direction No. 11 of 2007, on "Corporate Governance for Licensed Commercial Banks in Sri Lanka".

The composition and the scope of work of the Committee are in conformity with the provisions of the aforementioned Direction.

The Bank has adopted an Integrated Risk Management (IRM) framework in line with the Central Bank of Sri Lanka Banking Act Direction No. 7 of 2011.

The Primary Responsibilities of the Committee

The terms of reference set out by the Board of Directors, include the following:

- To ensure that the Bank has a comprehensive risk management framework, appropriate compliance policies and systems in place.
- To assess all risk types, including but not limited to: credit, market, liquidity, operational and strategic/reputational risks to the Bank through appropriate risk indicators and management information.
- To ensure risk decisions are taken in accordance with established delegated authorities and corrective actions are taken to mitigate risks taken beyond the risk tolerance set by the committee, on the basis of the Bank's policies and regulatory and supervisory requirements.
- To monitor and assess the effectiveness of the Bank's risk management system and the robustness of the risk management function.
- Periodically assess performance against internally defined risk appetite.
- Review issues raised by Internal Audit that impact upon the risk management framework.
- To review progress on the Basel II and Basel III Roadmap implementations.

Other Responsibilities of the Committee

The BIRMC also assists the Board of Directors in fulfilling its oversight responsibilities relating to compliance matters. In this capacity, the committee reviews the implementation of compliance programs, policies and procedures that are designed to respond to the various compliance and regulatory risks face by the Bank. The committee also reviews the Bank's compliance report on money laundering and action taken in relation to report.

The Year in Retrospect

- Strengthening of "Loan Review Mechanism" - The process has been streamlined and brought under the Chief Risk officer's purview to ensure an independent assessment of quality of credit approvals and related processes.
- Credit approval structure was reorganised to provide an independent assessment and risk to play an advisory role on credit proposals/appraisals, instead granting approvals.
- Establishment of "Centralised Credit Risk Monitoring Unit" - Processes have since been strengthened on monitoring stressed credit, watch-listed customers, frequent TODs on a daily, weekly, fortnightly and monthly basis. This has promoted and inculcated a culture of active engagement of risk management division with business units/relationship managers enabling early identification of warning signals and proactively remedying those stressed credits.
- Establishment "Operational Risk Steering Committee" (ORSC) - In order to manage matters related to operational risk management and to foster a risk awareness culture within the Bank that emphasizes and demonstrates the benefits of a risk-based approach to internal control and management of Operational Risks, The committee is the main interaction point between all operational functions of the bank encompassing end to end process coverage. Thus the primary purpose of this committee is to critically assess operational processes and internal controls with a view of eliminating loopholes thus minimizing possible operational losses.
- Introduction of "Risk and Control Self-Assessment Process" (RCSA) - This dynamic operational risk management tool was introduced to identify and reduce operational/internal control lapses within the Bank. Building up of a "Risk Registry" would support a strong and robust internal control structure and better control over managing any operational risk.

Board Integrated Risk Management Committee Report

- Introduction of an “Enterprise Risk Assessment Methodology” - Key strategic risk are identified and presented to the Board through BIRMC. This process assess the key risks faced by the bank in an objective and proactive manner.
- Development of the overall risk management policy - This would strengthen integrated enterprise-wide risk management framework which encompasses the risk culture, processes and structure.
- Improvement of risk management tools and dashboards expanding the coverage.
 - Introduced cyber risk security dashboard covering assessment of threat levels, and cyber incidents, whilst providing comparative measurement of awareness culture against a target environment.
- Assessment of capital requirements under Pillar 2 has been improved and ICAAP document of the bank was reviewed and strengthened.

Future Plans

Key initiative will be to strengthen credit under writing standards. Emphasis is placed on introducing non-judgemental scorecards to asses consumer credit and implement an improved loan originating system. Strengthen credit risk assessment

by validating and re-calibrating the internal risk rating system also one item that will receive a greater consideration. In order to support management of distressed credit plans afloat to strengthen collection and recoveries by establishing a “Centralised Collections Shop”, with the state-of-the-art system support. With a view of combating cyber/information security threats, plans are underway to bring management of information security risk within the purview of the Chief Risk Officer and implement the cyber security risk management policy.

Meetings

Nine (09) meetings were held and at least one in each quarter. Attendances at the meetings are given in table on page 131 of the Annual Report. The discussions and conclusions reached at the meeting are recorded in minutes and circulated to the Board of Directors for information and advice. The Chairperson of the Committee also briefs the Board of Directors on the main findings of the committee at each Board meeting.

Professional Advice

The committee has the authority to seek external professional advice on matters within its purview.

Appreciation

The committee wishes to thank the following members who resigned from the committee in 2015 and invitees from the management who participated regularly at the BIRMC meetings for their valuable contributions over the years:

Mr C B Wijeyaratne
- Chief Compliance Officer

Mr Ashok Goonesekere
- Chief Financial Officer

Committee Evaluation

The committee completed the evaluation process with self-assessment in December 2016 which was deemed to be satisfactory.



Rose Cooray
Chairperson
Board Integrated Risk Management Committee

Colombo, Sri Lanka
23rd February 2017

Board Audit Committee Report

Composition of the Committee

The Audit Committee ("the Committee"), appointed by and responsible to the Board of Directors comprises of four Non Executive/Independent Directors.

The following members serve / served on the Audit Committee:

Mr Sujeewa Mudalige (IND / NED) - Chairman

Dr Rohan Karunaratne (IND / NED)

Mr Amal Cabraal (IND/NED)

Mr Nilanth de Silva (IND / NED)

(IND - Independent Director, NIND - Non Independent Director and NED - Non Executive Director)

Other management officers who attended meetings on invitation;

Mr Jonathan Alles - Managing Director/CEO

Mr Dilshan Rodrigo - Chief Operating Officer

Mr Ashok Goonesekere - Chief Financial Officer (retired w.e.f 2nd September 2016)

Ms Anusha Gallage - AGM (Finance) (appointed w.e.f 1st January 2016)

Mr Niroskana Seneviratne - Chief Internal Auditor/ AGM (Internal Audit)

Mr Damith Pallewatte - Chief Risk Officer/ AGM (Risk)

Ms Mohini Seneviratne - Head of Compliance (appointed w.e.f 28th May 2016)

Each of the members of the Committee has a depth of financial expertise and collectively, the Committee has considerable financial experience on which to draw. More information on experience of and brief profiles of the members are given on pages 26 to 29 of the Annual Report.

The Board Secretary functions as the Secretary to the Audit Committee.

Audit Committee Charter

The Audit Committee Charter was reviewed on 2nd December 2016 and relevant amendments were made.

Audit Committee Responsibilities

The Committee is mainly responsible for:

- (i) Monitoring the integrity of the Bank's financial reporting and satisfying itself

that any significant financial judgements by the management are sound.

- (ii) Monitoring the Bank's internal controls including controls relating to financial statement reporting; and
- (iii) Monitoring and reviewing the activities and performance of the internal, external and outsourced auditor/s, including monitoring their independence and objectivity.

Meetings

For the purpose of discharging the above duties, the Audit Committee met eight (08) times during the year. Attendance by the Committee members at each of these meetings is given in the table on page 131 of the Annual Report. Other Management Officers as mentioned under "Composition of the Committee" also attended these meetings on invitation. On the invitation of the Committee, the Engagement Partner of the Bank's external auditors, Messrs Ernst & Young attended four (04) Committee meetings during the year.

The Committee is conscious of the need to keep its knowledge up to date and Committee members participated at presentations and workshops conducted internally and externally on relevant topics.

Any individual member of the Committee had the opportunity to raise specific issue at the meetings. The undersigned was in regular contact with the management including the Chief Financial Officer (who retired on 2nd September 2016), AGM - Finance and Chief Internal Auditor during 2016 on matters coming under the purview of the Committee.

Financial Reporting

The Committee, as part of its responsibility to oversee the Bank's financial reporting process on behalf of the Board of Directors, has reviewed and discussed with the management, the annual and the quarterly financial statements prior to their release. The review included the extent of compliance with the Sri Lanka Accounting Standards, the Companies Act No 7 of 2007, the Banking Act No 30

of 1988 and amendments thereto. The Committee also reviews the effectiveness of the Financial Reporting Systems in place to ensure reliability of the information provided and the accounting policies to determine the most appropriate accounting policies after considering all choices available. The committee assessed, whether the disclosures made under the financial reporting is appropriate and fair. Matters of special interest in the current environment and the processes that support certification of the financial statements by the Bank's Chief Executive Officer, CFO and AGM - Finance were also brought up for discussion.

Risks and Internal Controls

Additionally, the Committee also assessed the effectiveness of the Bank's internal control over financial reporting as of 31st December 2016, as required by the Banking Act Direction No 11 of 2007, Corporate Governance for Licensed Commercial Banks in Sri Lanka, Subsection 3(8) (ii)(b), based on the "Guidance for Directors of Banks on the Directors' Statement on Internal Control" issued by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka). The result of the assessment is given on pages 150 and 151, "Directors' Statement on Internal Control" of the Annual Report.

The external auditors have issued an Assurance Report on Directors' Statement on Internal Controls. The report is given on page 152 of the Annual Report.

The Committee has reviewed the processes for identification, recording, evaluation and management of all significant risks throughout the Bank and other Group entities.

Corporate Governance Report

As required by the Banking Act Direction No 11 of 2007, Corporate Governance for Licensed Commercial Banks in Sri Lanka, Annual Corporate Governance Report for 2016 is provided on pages 102 to 131. The external auditors have performed procedures set out in Sri Lanka Standards on Related Service 4400 (SLSRS 4400) issued by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka), to meet the

Board Audit Committee Report

compliance requirement of the Corporate Governance Directive. The recommendations made by the Auditors where relevant will be dealt with in 2017.

External Audit

Messrs Ernst & Young were re-appointed as the external auditor at the last Annual General Meeting held on 30th March 2016.

The Audit Committee undertook the annual evaluation of the independence and objectivity of the external auditor and the effectiveness of the audit process. The Committee also evaluated the external audit fee and made recommendations to the Board.

The Committee met the external auditor during the year to discuss their audit approach and procedures, including matters relating to the scope of the audit and auditor's independence. The Committee reviewed the audited financial statements with the external auditor who is responsible for expressing an opinion on its conformity with the Sri Lanka Accounting Standards.

The Committee reviewed the Interim Management Letters issued by the external auditor together with the management responses thereto, in the presence of relevant business heads and senior management along with the external auditor. The Committee also followed up action points taken by the Management in improving the financial reporting based on the 2015 Management Letter by the external auditor Messrs Ernst & Young.

The Committee met the external auditors two (02) times during the year without the presence of MD/CEO and the corporate management to ensure that there was no limitation of scope in relation to the audit and to allow for full disclosure of any incidents which could have had a negative impact on the effectiveness of the external audit, and concluded that there was no cause for concern.

The Committee sets out the policy for the engagement of the external auditor to provide non - audit services. The Audit Committee reviewed the policy for

engagement of the external auditor to provide non-audit services. The revised policy was approved by the Board on 19th January 2016. Further, the Audit Committee was of the view that such services were not within the category of services identified as prohibited under:

1. The guidelines issued by the Central Bank of Sri Lanka, for external auditors, relating to their statutory duties in terms of Section 39 of Banking Act No 30 of 1988 and amendments thereto.
2. The Guidelines for Listed Companies on Audit and Audit Committees issued by the Securities and Exchange Commission of Sri Lanka.

The Letter of Representation issued to the external auditor by the Board and Letter of Independence Confirmation issued by the external auditor was tabled at the Audit Committee Meeting held on 23rd February 2017.

Messrs Ernst & Young also acts as the Tax Advisor of the Bank and assists the Bank in managing its taxes effectively.

Internal Audit

To fulfil its responsibility to monitor the effectiveness of internal audit function, the Committee received regular reports from the Chief Internal Auditor setting out the internal audit function's view of the control environment and performance against any key indicators. During the year, the Audit Committee reviewed the independence, objectivity & performance of the internal audit function, the findings of the internal audits completed and their evaluation of the Bank's internal control system including internal controls over Financial Reporting.

The annual audit plan for the year was made on a risk based planning methodology. Adequacy and the frequency of the coverage of the internal audit plan has been evaluated and approved. It also assessed the Internal Audit Department's resource requirements including succession planning.

As per the international best practices, the Committee also had an independent discussion with the Chief Internal Auditor

without the management team to ensure independence of the Internal Audit Department's operations.

Regulatory Compliance

The Committee reviewed the procedures established by management for compliance with the requirements of regulatory authorities. The Compliance Officer of the Bank who has oversight of the compliance function, submitted quarterly reports to the Audit Committee on the extent to which the Bank was in compliance with the regulatory requirements.

Whistle-blowing Policy

The whistle blowing policy was reviewed in October 2015 by the Audit Committee with a view to further strengthen the process by which employees raise concerns in confidence. The revised policy was approved by the Board in October 2015. Ms Rose Cooray, Director to the Board was appointed as the new reporting authority.

Professional Advice

The Committee has the authority to seek external professional advice on matters within its purview.

Committee Evaluation

The annual evaluation of the Committee was conducted by the Non-Executive Chairman, with contributions from the individual assessments by the members of the Audit Committee, Managing Director / CEO, Chief Operating Officer, AGM - Finance, Chief Internal Auditor and the external auditor in accordance with international best practices and was deemed to be satisfactory.



Sujeewa Mudalige
Chairman
Audit Committee

Colombo, Sri Lanka
23rd February 2017

Related Party Transactions Review Committee Report

Adoption of The Code of Best Practices on Related Party Transactions

The Committee & its Composition

The Bank re-constituted the Related Party Transactions Review Committee (the "Committee") as a Board Sub-Committee with effect from 1st January 2016, to review "Related Party Transactions". The scope of the Committee covers the requirements of the Code of Best Practices on Related Party Transactions ("the Code") issued by the Securities and Exchange Commission of Sri Lanka (SEC).

The Composition of the Committee is as follows :

Mr Nilanth de Silva - Chairman (IND/NED)

Dr Rohan Karunaratne - (IND/NED)

Mr Palitha Pelpola - ((IND/NED))

Mr Jonathan Alles - (MD/CEO)

The Committee is assisted by the following Key Management Personnel (KMPs) of the Bank who attend sittings on a regular basis.

Mr Dilshan Rodrigo - Chief Operating Officer

Ms Ruvini Thenabadu - DGM - Credit & Transaction Banking

Ms K A L Thushari Ranaweera - DGM – Legal / Board Secretary

Ms Anusha Gallage - AGM - Finance

In addition, the Committee summoned other relevant officials of the Bank to participate in the committee proceedings on a need basis.

Terms of Reference and Scope of Operations

The Committee operates in accordance with the Terms of Reference of a Policy document on monitoring Related Party Transactions, which has been approved by the Board of Directors.

The principal functions of the Committee are the scrutiny of all Related Party Transactions with Directors, Key Management Personnel (KMPs), substantial shareholders, Subsidiaries and Associate Companies of the Bank and such other related parties

as defined in the Code with a view to determining that they have not received any favourable nor preferential consideration vis a vis the other shareholders and customers of the Bank as well as to ascertain that their transactions and dealings are in strict conformity with Statutory and Regulatory requirements which the Bank is obliged to adhere to.

The Committee relies on the integrity of periodically reportable Related Party Transactions data sourced via a comprehensive list of Related Parties based on latest available Declarations, signed off by the responsible Directors/KMPs, which in turn is further reviewed by the Assistant General Manager – Finance who is the ultimate reporting authority. This review is carried out by comparing Related Party Transactions with benchmarked criteria applicable for comparable Non Related Party Transactions, to determine that Related Parties have not received any favourable nor preferential consideration.

The Bank's Internal Audit Division is also mandated to verify the integrity of reported data, to ensure greater transparency.

Wherever necessary, the Committee resorts to obtaining legal, financial & technical advice from competent authorities in such fields, to review transactions. Further the Committee has the right of access as well as the power to call for clarification and explanation from Management & Auditors (External & Internal).

In addition, the Committee will share information with the Board Audit Committee as necessary and appropriate to facilitate the Audit Committee to conduct its Statutory & Regulatory responsibilities with regard to Related Party Transactions

Meetings

Meetings are held mandatorily, at least once a quarter. During 2016, 4 such meetings were held and the minutes were circulated to the Board of Directors for their information and review. In the opinion of the Committee there were no transactions

with the related parties that were more favourable or preferential during the period under review and the Bank had been compliant with the Code.

Self Appraisal of Committee Functions

A self-evaluation of the effectiveness of the Committee was conducted by the Chairman of the Committee with contributions from the individual assessments by the members of the committee, Managing Director/CEO, participating KMPs referred to at the outset of this Report and the review concluded that the Committee continues to operate effectively.

Review of TOR

The TOR/Policy on "Related Party" Transactions is subject to periodic review based on Regulatory as well as operational requirements and during the year the TOR was amended twice.



Nilanth de Silva
Chairman

Related Party Transaction Review Committee

Colombo, Sri Lanka
23rd February 2017

Annual Report of the Board of Directors on the Affairs of the Company

1. General

The Board of Directors of Hatton National Bank PLC has pleasure in presenting its Annual Report to the shareholders for the financial year ended 31st December 2016, together with the audited financial statements of the Bank, consolidated financial statements of the Group for the said year and the Auditor's Report on those financial statements, conforming to the requirements of the Companies Act No 7 of 2007 and the Banking Act No 30 of 1988. The financial statements were reviewed and approved by the Board of Directors on 23rd February 2017.

This Report includes the information as required by the Companies Act No 7 of 2007, Banking Act Direction No 11 of 2007 (Corporate Governance for Licensed

Commercial Banks and subsequent amendments thereto) and Listing Rules of the Colombo Stock Exchange (CSE). The Report is also guided by the recommended best practices on Corporate Governance.

Hatton National Bank PLC ("the Bank") is a Licensed Commercial Bank registered under the Banking Act No 30 of 1988 and was incorporated as a public limited liability company in Sri Lanka on 5th March 1970 under the Companies Ordinance No 51 of 1938. The Bank was re-registered as required under the provisions of the Companies Act No 7 of 2007 on 27th September 2007. The re-registration number of the Bank is PQ 82.

The ordinary shares (both voting and non-voting) and unsecured subordinated/senior

redeemable debentures of the Bank are listed on the main board of the Colombo Stock Exchange in Sri Lanka.

The Bank has been assigned a National Long Term Rating of AA- (Ika) with a Stable Outlook by Fitch Ratings Lanka Ltd and a foreign currency issuer rating of B1 by Moody's Investors Service which is on par with the sovereign rating of B1 of Sri Lanka. This is the first ever international rating obtained by a Sri Lankan Bank.

The registered office as well as the Head Office of the Bank is at No 479, T B Jayah Mawatha, Colombo 10, Sri Lanka.

Section 168 of the Companies Act No. 07 of 2007, requires the following information to be published in the Annual Report prepared for the year under review.

Information required to be disclosed as per the companies act no. 07 Of 2007	Reference to the Companies Act	Level of compliance by the Bank
The nature of the business of the Bank and the Group	Section 168 (1) (a)	Refer section 3 on page 140
Signed financial statements of the Bank and the Group for the accounting period completed	Section 168 (1) (b)	Refer section 7 on page 141
Auditor's Report on financial statements of the Bank and the Group	Section 168 (1) (c)	Refer section 9 on page 141
Changes in accounting policies made during the accounting period	Section 168 (1) (d)	Refer section 10 on page 141
Particulars of entries in the interests register made during the accounting period	Section 168 (1) (e)	Refer section 36 on page 146
Remuneration and other benefits paid to the Directors during the accounting period	Section 168 (1) (f)	Refer section 40 on page 147
Total amount of donations made by the Bank during the accounting period	Section 168 (1) (g)	Refer section 15 on page 143
Information on Directorate of the Bank and its subsidiaries/joint ventures during and at the end of the accounting period	Section 168 (1) (h)	Refer section 28 and 32 on page 144
Amounts payable to the auditor as audit fees and fees for other services rendered during the accounting period as a separate disclosure	Section 168 (1) (i)	Refer section 53 on page 149
Auditor's relationship or any interest with the Bank and its subsidiaries	Section 168 (1) (j)	Refer section 53 on page 149
Annual Report of the Board signed on behalf of the Board by two Directors and the Company Secretary	Section 168 (1) (k)	Refer section 56 on page 149

2. Vision, Mission and Corporate Conduct

The Bank's Vision and Mission statements are given on page 13 of the report. The business activities of the Bank are conducted in keeping with the highest level of ethical standards in achieving its Vision and Mission.

Bank's Codes of Ethics and Conduct reflect our commitment to high standards of business conduct and ethics. The said Codes have been disseminated to staff via electronic and visual mediums and made

accessible to all staff in the Bank. It is our desire and commitment, that all staff embrace these best practices in their day to day work and uphold ethics, good conduct and governance in the workplace at all times.

3. Principal Activities

The principal activities of the Bank and the Group during the year were general banking, development banking, offshore banking, mortgage financing, leasing,

corporate banking, dealing in government securities and listed equities, pawn broking, e - banking facilities, Islamic banking, custodian banking for mobile banking, stockbroking, providing life and general insurance services, micro financing, custodian banking business, payments and cash management, other financial services and property development. There were no significant changes in the nature of the principal activities of the Bank and the Group during the financial year under review.

The names of the Bank's subsidiaries and their nature of principal activities are given in Note 1.3 to the financial statements and are found on page 206.

4. Changes to the Group Structure

During the year, there were no changes to the Group structure.

5. Review of Operations

A review of the operations of the Bank during the financial year 2016 and results of its operations are contained in the Chairman's Message (pages 17 to 19), the Managing Director's Review (pages 21 to 23) and the Integrated Management Discussion & Analysis (pages 36 to 100). These reports form an integral part of the Annual Report of the Board of Directors.

6. Future Developments

An overview of the future developments of the Bank is given in the Chairman's Message (pages 17 to 19), the Managing Director's Review (pages 21 to 23) and the Integrated Management Discussion & Analysis (pages 36 to 100).

7. Financial Statements

The financial statements of the Bank and the Group have been prepared in accordance with Sri Lanka Accounting Standards laid down by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) and they comply with the requirements of Companies Act No 7 of 2007 and Banking Act No 30 of 1988.

The financial statements of the Bank and the Group for the year ended 31st December 2016 duly signed by AGM - Finance, two Directors of the Bank and the Company Secretary are given in pages 198 to 327, which form an integral part of the Annual Report of the Board of Directors.

8. Directors' Responsibility for Financial Reporting

The Directors are responsible for the preparation of the financial statements of the Bank to present a true and fair view of its state of affairs. The Directors are of the view that these financial statements have been prepared in conformity with the requirements of the Sri Lanka Accounting Standards, (SLFRSs and LKASs), Companies Act No 7 of 2007, Sri Lanka Accounting and Auditing Standards Act No 15 of 1995, Banking Act No 30 of 1988 (as amended), Banking Act Direction No 11 of 2007 (Corporate Governance for Commercial Banks in Sri Lanka as amended) and the Listing Rules of the CSE. The Statement of Directors' Responsibility for Financial Reporting is given on page 196 and forms an integral part of the Annual Report of the Board of Directors.

9. Auditors' Report

The Bank's auditors, Messrs. Ernst & Young, carried out the audit on the financial statements of the Bank and the consolidated financial statements of the Group for the year ended 31st December 2016 and their report on those financial statements is given on page 197 of this Annual Report.

10. Significant Accounting Policies

The significant accounting policies adopted in the preparation of the financial statements are given on pages 206 to 327.

11. Going Concern

The Board is satisfied that the Bank has adequate resources to continue its operations in the foreseeable future. Therefore, the Bank continues to adopt the "going concern" basis in preparing these financial statements.

12. Income

The income of the Group for 2016 was Rs 95,990,771,000/- (2015: Rs 70,026,698,000/-) while the Bank's income was Rs 84,350,823,000/- (2015: Rs 61,153,466,000/-). An analysis of the income is given in Note 7 to the financial statements on page 235.

13. Financial Results and Appropriations

The Bank has recorded a growth in profit before tax of 33.9% and a growth in profit after tax of 35.4% in 2016. The Group's profit before tax recorded a growth of 39.2% and a growth in profit after tax of 41.2% in 2016.

The Bank's total other comprehensive income for the year was Rs 13,970,939,000/- (2015: Rs 9,242,064,000/-) while the Group has recorded a total other comprehensive income of Rs 18,856,962,000/- for the year (2015: Rs 13,388,312,000/-).

Annual Report of the Board of Directors on the Affairs of the Company

	2016 Rs 000	2015 Rs 000
The Group profit for the year ended 31st December after payment of all operating expenses and provision for depreciation and contingencies	22,498,647	16,160,268
Less: taxation	(6,833,685)	(5,064,424)
Group net profit after taxation	15,664,962	11,095,844
Other comprehensive income net of income tax		
Gains and losses on re-measuring available-for-sale financial assets		
Change in fair value on available-for-sale financial assets, net of tax	(3,312,113)	(2,538,159)
Transfer to life policy holder reserve fund	134,781	97,098
Net amount transferred to profit or loss (available-for-sale financial assets)	14,466	(19,242)
Share of other comprehensive income of equity accounted Joint Venture	(21,154)	17,041
Re-measurement gains/losses on defined benefit plans	377,525	(909,543)
Revaluation of Freehold land and buildings, net of tax	5,748,917	5,597,137
Total Group comprehensive income for the year	18,856,962	13,388,312
Non - controlling interests	(991,142)	(532,707)
	17,865,820	12,855,605
Other comprehensive income net of tax relating to:		
Available for sale reserve	2,776,906	2,287,750
Capital Reserve	(5,518,506)	(5,493,000)
	15,124,220	9,650,355
Unappropriated profit brought forward from previous year	7,949,848	10,396,517
Balance available before appropriation / adjustments	23,074,068	20,046,872
Deemed disposal gain	-	9,830
	23,074,068	20,056,702
Appropriations		
Transfer to general reserve	(6,000,000)	(6,000,000)
Transfer to reserve fund	(800,000)	(600,000)
Dividends		
Final dividend paid (Cash) 2014	-	(2,827,776)
Interim dividend paid (Cash) 2015	-	(608,548)
Final dividend paid (Cash) 2015	(1,421,200)	-
Final dividend paid (Scrip) 2015	(1,421,200)	-
Interim dividend paid (Cash) 2016	(620,387)	-
Others		
Super gain tax	-	(2,093,074)
Transfer of revaluation reserve	9,835	22,544
Balance carried forward as at 31st December	12,821,116	7,949,848

14. Reserves

The Group reserves consist of:

	31.12.2016 Rs 000	31.12.2015 Rs 000
Capital reserve	19,771,905	14,263,234
Statutory reserve fund	4,560,000	3,760,000
Available for sale reserve	1,741,535	4,518,441
Life policy holder reserve fund	(191,131)	(56,350)
ESOP reserve	147,092	202,356
Revenue reserve	49,921,116	39,049,848
	75,950,517	61,737,529

The movement in these reserves is shown in the Statement of Changes in Equity on pages 201 to 203 of the Annual Report.

Further, the Directors propose to transfer Rs 800,000,000/- (2015: Rs 600,000,000/-) to the statutory reserve fund, and Rs 6,000,000,000/- (2015: Rs 6,000,000,000/-) to the general reserve account.

15. Corporate Donations

During the year, the Bank made donations amounting to Rs 20,451,000/- (2015: Rs 12,819,000/-) in terms of the resolution passed at the last Annual General Meeting. Donations made by the Group during the year amounted to Rs 24,751,000/- (2015: Rs 19,110,000/-). The Bank did not make any donations to Government approved charities.

16. Taxation

The income tax rate applicable on the Bank's domestic operations and FCBU on-shore & off-shore banking operations is 28% (2015: 28%). It is the Bank's policy to provide for deferred taxation on all known temporary differences under the liability method.

The Bank is also liable for Financial Services VAT at 15% (2015: 11%) and NBT on Financial Services at 2% from (2015: 2%).

The Bank is liable to pay Crop Insurance Levy on a quarterly basis at 1% (2015: 1%) on after tax profit to the National Insurance Trust Fund Board.

17. Statutory Payments

The Directors, to the best of their knowledge and belief, are satisfied that all statutory payments in relation to the Government and the employees have been made up to date.

18. Dividends on Ordinary Shares

An interim dividend of Rs 1.50 per share (2015: Rs 1.50 per share) was paid on 16th December 2016 to the holders of the ordinary shares (both voting and non-voting) for the financial year 2016. A part of the interim dividend paid for the year represents a redistribution of the exempt dividends received by the Bank and will therefore be free of income tax in the hands of the

shareholders. On this basis 17.3% of the interim dividend paid for 2016 is subject to income tax.

The Directors recommend that a final dividend of Rs 7.00 per share by way of Rs 3.50 in cash and Rs 3.50 in the form of script (2015: Rs 3.50 per share in cash and Rs 3.50 in the form of script) on both voting and non-voting shares of the Bank, be paid for the financial year ended 31st December 2016.

The Board of Directors was satisfied that the Bank would meet the solvency test immediately after the interim dividend was paid on 16th December 2016 and the final dividend proposed which will be paid in April 2017 in terms of the provisions of the Companies Act No 7 of 2007 and Listing Rules of the CSE. The Board provided the Statements of Solvency to the auditors and obtained Certificates of Solvency from the auditors in respect of each dividend payment conforming to the statutory provision.

19. Capital Expenditure

The total capital expenditure on acquisition of investment property, property, plant and equipment and intangible assets of the Bank and the Group amounted to Rs 1,348,462,000/- and Rs 1,749,220,000/- respectively (2015 Bank: Rs 959,997,000/- and Group: Rs 1,251,847,000/-). Details are given in Note 37, 38 and 39 to the financial statements. The capital expenditure approved and contracted for and not contracted for as at Balance Sheet date are given in Note 59(b) to the financial statements on page 317.

20. Property, Plant and Equipment (PPE)

Details of property, plant and equipment are given in Note 38 to the financial statements on page 282.

21. Net Book Value of Freehold Properties

The net book values of freehold properties owned by the Bank and the Group as at 31st December 2016 are included in the accounts at Rs 11,413,989,000/- and Rs 25,374,381,000/- respectively (2015

Bank: Rs 9,138,545,000/- and Group: Rs 19,729,723,000/-).

A panel of Chartered Valuers / Licensed Surveyors carried out a revaluation of the Bank's freehold properties in 2016. The details of freehold properties owned by the Bank are given in Note 38(a) to the financial statements on page 285.

22. Outstanding Litigation

In the opinion of the Directors and the Bank's Lawyers, pending litigation against the Bank disclosed in Note 59(d) of the financial statements on page 317, will not have a material impact on the financial position of the Bank or its future operations.

23. Events after the Reporting Date

No circumstances have arisen since the Statement of Financial Position date which would require adjustments to, or disclosure in, the accounts, except those disclosed in Note 64 to the financial statements on page 327.

24. Stated Capital and Debentures

The stated capital of the Bank as at 31st December 2016 was Rs 15,340,158,000/- consisting of 413,815,474 ordinary shares, which is the aggregate of 330,756,782 (voting shares) and 83,058,692 (non-voting shares). (2015: Rs 13,826,873,000/- consisting of 405,821,370 ordinary shares, which is the aggregate of 324,405,445 - voting shares and 81,415,925 - non-voting shares.)

The Bank issued 1,314,043 ordinary shares during the year, 1,088,993 shares (voting) at a consideration of Rs 157,128,000/- and 225,050 shares (non-voting) at a consideration of Rs 21,813,000/- under the approved Employee Share Option Plan (ESOP). Therefore, the Stated Capital increase of the Bank due to employees exercising their options under ESOP amounted to Rs 178,941,000/- (2015: Rs 420,898,000/). During the year, Rs 55,264,000/- got transferred from ESOP reserve to stated capital on account of share options exercised till date. The total increase in the stated capital during the year is Rs 1,513,285,000/- (2015: Rs 536,881,000/-).

Annual Report of the Board of Directors on the Affairs of the Company

The Bank had issued unsecured, subordinated, redeemable debentures to the value of Rs 22,409,926,000/- as at 31st December 2016. (2015: Rs 8,471,740,000/-). The details of unsecured, subordinated, redeemable debentures issued and redeemed during the year 2015 and those outstanding as at 31st December 2016 are given in Note 47(a) to the financial statements on page 302.

Further, the Bank had issued unsecured, senior, redeemable debentures to the value of Rs 4,653,057,000/- as at 31st December 2016 (2015: Rs 4,490,742,000/-). Increase is due to capitalization of interest. The details of this debenture are given in Note 46 to the financial statements on page 301.

25. Share Information

Information relating to earnings, dividend, net assets and market price per share is given on page 343 of the Annual Report. Information on share trading is given on page 342 of the Annual Report.

26. Shareholdings

As at 31st December 2016, there were 4,593 and 10,329 registered voting and non-voting shareholders respectively (2015: voting 4,619 and non-voting 10,660). Information on the distribution of shareholding and the respective percentages is indicated on pages 341 and 342 of the Annual Report. The twenty largest voting and non-voting shareholders of the Bank as at 31st December 2016, together with an analysis are given on pages 345 to 346 of the Annual Report.

27. Equitable Treatment to Shareholders

The Bank has at all times ensured that all shareholders (both voting and non-voting) are treated equitably except for the right to vote.

28. The Board of Directors

The Board of Directors of the Bank consists of 12 (2015: 12) Directors with wide financial and commercial knowledge and experience. The following Directors held office as at the Statement of Financial Position date and their brief profiles appear on pages 26 to 29 of the Annual Report.

Name of the Director	Status
Mr Rienze Arseculeratne – Chairman	IND / NED
Ms Rose Cooray	NIND / NED
Dr Rohan Karunaratne	IND / NED
Mr Damien Fernando	NIND / NED
Mr Sujeewa Mudallige	IND / NED
Ms Sanjivani Jayawardena	NIND / NED
Mr Rusi Captain	NIND / NED
Mr Amal Cabraal	IND / NED
Mr Palitha Pelpola	IND / NED
Mr Duliksha Soosaipillai	IND / NED
Mr Nilanth de Silva	IND / NED
Mr Jonathan Alles (MD/CEO)	ED

(IND - Independent Director, NIND - Non Independent Director, NED - Non Executive Director and ED - Executive Director)

29. Retirement / Resignation of Directors

There were no retirements or resignations of Directors during the year under reference.

30. Appointment of Directors

There were no new appointments of Directors during the year under reference.

31. Retirement by rotation / re-appointment of Directors

Directors - Ms Sanjivani Jayawardena, Mr Rusi Captain and Mr Amal Cabraal who are subject to retirement by rotation in terms of Article 34 of the Articles of Association of the Bank, will offer themselves for re-election under the said Article.

32. List of Directors of Subsidiaries and Joint Ventures of the Bank

Subsidiaries

HNB Assurance PLC

Ms Rose Cooray - Chairperson
Mr S C Ratwatte
Mr Dilshan Rodrigo
Ms S N Wickramasinghe
Dr S Selliah
Mr J A P M Jayasekera
Mr K Balasundaram
Mr Thimal Perera

Sithma Development (Pvt) Ltd

Ms Rose Cooray - Chairperson
Mr Janaka Epasinghe - Director/CEO
Mr Dilshan Rodrigo
Ms Anusha Gallage

HNB Grameen Finance Limited

Mr Jonathan Alles - Chairman
Mr B Premalal – Deputy Chairman
Mr B M D C Prabath – MD/CEO
Ms H K S R Perera
Ms Rose Cooray
Mr Thimal Perera
Ms L L C C Thambiah
Mr A S Wijesinha
Mr S U H Fernando
Mr P A H D Wijesundara

Joint Ventures

Acuity Partners (Pvt) Ltd

Mr A R Fernando - Chairman
Mr M R Abeywardena - MD
Mr T W de Silva
Mr D A B Ellepola
Mr Jonathan Alles
Ms Ruvini Thenabadu
Mr Dilshan Rodrigo

Other Group Companies

HNB General Insurance Ltd

Ms Rose Cooray - Chairperson
Ms M Tharmaratnam
Mr M O F Salieh
Mr Dilshan Rodrigo
Mr Thimal Perera

Lanka Ventures PLC

Mr Jonathan Alles - Chairman
Mr M R Abeywardena
Mr A R Fernando
Mr S E de Silva
Mr A R Munasinghe
Ms Ruvini Thenabadu
Mr T W de Silva

LVL Energy Fund Ltd (Subsidiary of Lanka Ventures PLC)

Mr Jonathan Alles - Chairman
Mr A R Fernando
Mr M R Abeywardena
Mr D S Arangala
Mr S E de Silva
Mr T W de Silva
Mr M Wijetunge
Mr A R Munasinghe

Acuity Stockbrokers Ltd

Mr M R Abeywardena – Chairman
Mr D A B Ellepola
Mr Prashan Fernando
Ms Ruvini Thenabadu
Mr Ruwan Manatunga
Mr Arjun Fernando

Acuity Securities Ltd

Mr M R Abeywardena – Chairman
Mr Dilshan Rodrigo
Mr I A S D Fernando
Ms Ruvini Thenabadu
Mr L H A L Silva

33. Register of Directors and Secretaries

As required under Section 223 (1) of the Companies Act No 7 of 2007, the Bank maintains a Register of Directors and Secretaries which contains the name,

surname, former name (if any), residential address, business, occupation, dates of appointment and dates of resignation (if applicable) of each Director and the Secretary.

34. Board Sub-Committees

The Board while assuming the overall responsibility and accountability for the management oversight of the Bank has also appointed Board Sub-Committees to ensure oversight and control over certain affairs of the Bank, conforming to the Banking Act Direction No 11 of 2007 issued by the Monetary Board of the Central Bank of Sri Lanka, on "Corporate Governance for Licensed Commercial Banks of Sri Lanka". Accordingly, the following mandatory Sub-Committees have been constituted by the Board:

Audit Committee comprises:

Mr Sujeewa Mudalige - Chairman
Dr Rohan Karunaratne
Mr Amal Cabraal
Mr Nilanth de Silva

The Report of the Audit Committee is given on pages 137 to 138 and forms part of the Annual Report of the Board of Directors.

Nomination Committee comprises:

Mr Rienzie Arseculeratne – Chairman
Ms Rose Cooray
Mr Rusi Captain
Mr Palitha Pelpola

The Report of the Nomination Committee is given on pages 133 to 134 and forms part of the Annual Report of the Board of Directors.

Human Resources & Remuneration Committee comprises:

Mr Rienzie Arseculeratne - Chairman
Mr Damien Fernando
Mr Sujeewa Mudalige
Mr Amal Cabraal

The Report of the Human Resources & Remuneration Committee is given on page

132 and forms part of the Annual Report of the Board of Directors.

Board Integrated Risk Management Committee comprises:

Ms Rose Cooray - Chairperson
Mr Damien Fernando
Ms Sanjivani Jayawardena
Mr Duliksha Soosaipillai
Mr Jonathan Alles - MD/CEO
Mr Damith Pallewatte - Chief Risk Officer/ AGM (Risk)
Ms Mohini Seneviratne – Head of Compliance

Invitees from the Management are as follows:

Mr Dilshan Rodrigo - Chief Operating Officer
Mr Sidath Wijeratne - Chief Digital Officer / DGM (IT)
Ms Anusha Gallage – AGM (Finance)
Mr Niroshana Seneviratne - Chief Internal Auditor/ AGM (Internal Audit)

The Report of the Integrated Risk Management Committee is given on pages 135 to 136 and forms part of the Annual Report of the Board of Directors.

Apart from the mandatory Board Sub-Committees, the Board has appointed five other non-mandatory Sub-Committees namely the Board Credit Committee, Strategy & Investment Review Committee, Procurement Committee, Committee for Disposal of Assets/Investment Properties and Network Performance Review Committee to ensure effective discharge of its duties. The composition of these Committees was as follows:-

Credit Committee:

Mr Nilanth de Silva – Chairman
Mr Palitha Pelpola
Dr Rohan Karunaratne

Management Officers

Mr Jonathan Alles - MD/CEO
Mr Dilshan Rodrigo - Chief Operating Officer
Ms Ruvini Thenabadu - DGM (Credit & Transaction Banking)

Annual Report of the Board of Directors on the Affairs of the Company

Mr Ruwan Manatunga – Head of Corporate Banking/DGM (Corporate Banking)

Mr Damith Pallewatte – Chief Risk Officer/AGM (Risk)

Strategy & Investment Review Committee:

Mr Amal Cabraal – Chairman

Ms Rose Cooray

Mr Sujeewa Mudalige

Mr Duliksha Soosaipillai

Management Officers

Mr Jonathan Alles - MD/CEO

Mr Dilshan Rodrigo - Chief Operating Officer

Mr Rajive Dissanayake - Chief Strategy Officer/AGM (Strategy)

Procurement Committee:

Dr Rohan Karunaratne – Chairman

Ms Sanjivani Jayawardena

Mr Duliksha Soosaipillai

Management Officers

Mr Dilshan Rodrigo - Chief Operating Officer

Committee for Disposal of Assets/ Investment Properties

Up to Rs. 10.0 Mn

Ms Rose Cooray

Mr Jonathan Alles - MD/CEO

Over Rs. 10.0 Mn

(Any two of the following)

Dr Rohan Karunaratne

Mr Damien Fernando

Ms Sanjivani Jayawardena

Network Performance Review Committee:

Mr Nilanth de Silva - Chairman

Mr Damien Fernando

Ms Sanjivani Jayawardena

Mr Rusi Captain

Management Officers

Mr Thimal Perera – DGM (Retail & SME Banking)

Mr Nirosch Perera - AGM (Colombo Region)

Mr Janaka Epasinghe - AGM (Services)

Related Party Transactions Review Committee:

This Committee which was constituted as per SEC regulations and Listing Rules of CSE, was re-constituted on 28th April 2016. The composition of this Committee is as follows:

Mr Nilanth de Silva – Chairman

Mr Jonathan Alles (MD/CEO)

Mr Palitha Pelpola

Dr Rohan Karunaratne

35. Directors' Meetings

The details of the Directors' meetings which comprise Board meetings, Audit Committee meetings, Nomination Committee meetings, Human Resource & Remuneration Committee meetings and Board Integrated Risk Management Committee meetings and the attendance of Directors at these meetings are given on page 131 of the Annual Report. Furthermore, the Directors contributed towards policy advocacy and direction by participating in the deliberations of the Board appointed Sub-Committees on Strategy & Investment Review, Credit, Disposal of Assets/Investment Properties, Network Performance Review, Procurement and Related Party Transactions Review. In furtherance of the deliberations of the

Board, special Committees consisting of Board members were also constituted from time to time to attend to specific tasks.

36. Directors' Interests Register and Directors' Interest in Contracts or Proposed Contracts

The Bank maintains the Directors' Interests Register as required under the provisions of Section 168 (1) (e) of the Companies Act No 7 of 2007. Directors of the Bank have made necessary declarations of their interest in contracts or proposed contracts, in terms of Sections 192 (1) and 192 (2) of the said Companies Act. These interests have been recorded in the Interests Register which is available for inspection in terms of the Act. The particulars of the Directors' Interest in Contracts are given on pages 153 to 156 of the Annual Report and form an integral part of the Annual Report of the Board of Directors. The Directors have no direct or indirect interest in a contract or a proposed contract with the Company other than those disclosed.

In terms of article 40 of the Articles of Association the Directors did not (i) participate at the discussions or in the approving process; (ii) vote on matters or contracts in which they were interested.

37. Directors' Interests in the Ordinary Shares (Voting and Non-Voting)

	As at 31st December 2016 No of Shares	As at 31st December 2015 No of Shares
Mr Rienzie Arseculeratne	-	-
Mr Jonathan Alles	101,959	2,000
Ms Rose Cooray	5,404	5,312
Dr Rohan Karunaratne	1,034	1,018
Mr Damien Fernando	517	509
Mr Sujeewa Mudalige	-	-
Ms Sanjivani Jayawardena	508	500
Mr Rusi Captain	6,104	6,007
Mr Amal Cabraal	-	-
Mr Palitha Pelpola	-	-
Mr Duliksha Soosaipillai	-	-
Mr Nilanth de Silva	100	-

*** There has been no change in the interests in shares of the Directors mentioned above, between 31st December 2016 and 23rd February 2017, being the date of this Report. There are no arrangements enabling the Non Executive Directors of the Bank to acquire shares of the Bank other than via the market.*

38. Directors' Interest in Debentures

There were no debentures registered in the name of any Director as at the beginning and at the end of the year.

39. Related Party Transactions

The Directors have also disclosed transactions if any, that could be classified as related party transactions in terms of LKAS 24 "Related Party Disclosures" which is adopted in the preparation of the financial statements. Those transactions disclosed by the Directors are given in Note 60 to the financial statements on page 318, forming part of the Annual Report of the Board of Directors.

The Related Party Transaction Review Committee set up by the Board as required by the Code of Best Practices on Related Party Transactions (the "Code") issued by the Securities and Exchange Commission of Sri Lanka (SEC) and Listing Rules of CSE is responsible for reviewing the Related Party Transactions of the Bank. The details of the composition of the Committee are disclosed in page no 146. The Bank has complied with the requirements of the Code issued by SEC and Listing Rules of CSE and with all disclosure requirements stipulated thereunder.

40. Directors' Remuneration

Details of Directors' emoluments and other benefits paid in respect of the Group and the Bank during the financial year ended 31st December 2016 are given in Note 17 to the financial statements on page 242.

41. Human Resources

The employment strategies of the Bank are framed to employ, train, develop and retain the best talent available. Towards this end, employment policies are reviewed periodically to be aligned with organisational needs.

Specific measures taken in this regard are detailed on pages 60 to 65.

42. Employee Share Option Plan (ESOP)

In the year 2008, with the approval of the shareholders, the Bank formulated an Employee Share Option Plan (ESOP) for the staff in the management grades, recognising and rewarding them for their contribution. The scheme was aimed at further motivating the management staff. This gives an option to the management staff to acquire ownership in the ordinary shares (both voting and non-voting) of the Bank, provided the Bank has met certain set profit goals. It was operative for 5 years and the management staff has the option to purchase ordinary shares (voting and non-voting) of the Bank each year up to a limit

of 1.25% of the shares issued and up to a maximum of 5% of the total shares issued.

The first option to purchase shares was granted in 2007 and the remaining options from this offer were expired in 2014.

The second option to purchase shares were granted in 2009 and the remaining options from this offer were expired in 2015.

Based on the performance achieved for the year 2010, third option to purchase shares has been offered to 196 management officers.

The option to purchase shares is exercisable up to 29th March 2017. As at 31st December 2016, 157 management officers have exercised the option (some fully and others partially) and purchased shares.

Based on the performance achieved for the year 2012, fourth option to purchase shares has been offered to 192 management officers. The option to purchase shares is exercisable up to 4th June 2018. As at 31st December 2016, 118 management officers have exercised the option (some fully and others partially) and purchased shares.

Having noted that the scheme was to grant share options 1.25% per annum subject to the above ceiling, the Board, on 25th September 2014, granted its approval to resolve the ESOP Scheme, as concluded.

The details of the options offered to the employees under ESOP as at 31st December 2016 are as follows:

	2012 Allocation		2013 Allocation	
	Voting	Non-Voting	Voting	Non-Voting
No of options brought forward	1,120,852	195,408	1,579,169	371,140
No of options granted in 2016	-	-	-	-
No of options exercised during the year	(636,790)	(103,165)	(452,203)	(121,894)
No of options expired during the year	(51,540)	(10,092)	(33,156)	(4,154)
No of options remaining	432,522	82,151	1,093,810	245,092
Allotment price (Rs)	145.79	81.43	142.17	110.04
Funding granted to employees	None	None	None	None

Annual Report of the Board of Directors on the Affairs of the Company

43. Environmental Protection

To the best of knowledge of the Board, the Bank has complied with the relevant environmental laws and regulations.

The Bank has not engaged in any activity that is harmful or hazardous to the environment. Specific measures taken to protect the environment are given on pages 79 to 80.

44. Risk Management and Internal Control

44.1 Risk Management

The Bank has an on going process in place to identify, evaluate and manage the risks that are faced by the Bank. This process is detailed in the Risk Management Report on pages 157 to 189. The Directors on a regular basis review the above mentioned process through the Board Integrated Risk Management Committee (BIRMC).

44.2 Internal Control

The Board considers that strong internal controls are integral to the sound management of the Bank and it is committed to maintain strict financial, operational and risk management controls over all its activities.

The Directors are ultimately responsible for the Bank's system of internal control and for reviewing its effectiveness. Such a system is designed to manage, rather than eliminate, the risk of failure to achieve business objectives and can provide only reasonable and not absolute assurance against material misstatement or loss. There is an on-going process for identifying, recording, evaluating and managing the risks that are faced by the Bank, and the Directors have reviewed this process, through the Board Audit Committee.

The Board of Directors is satisfied with the effectiveness of the system of internal control for the year under review and up to the date of approval of the Annual Report and financial statements.

45. Directors' Statement on Internal Control

The Board has issued a report on the internal control mechanism of the Bank as per Section 3 (8) (ii) (b) of Banking Act Direction No 11 of 2007 on Corporate Governance. The Board has confirmed that the financial reporting system has been designed to provide reasonable assurance regarding the reliability of the financial reporting, and that the preparation of financial statements for external purposes has been done in accordance with relevant accounting principles and regulatory requirements. The above report, which forms an integral part of the Annual Report of the Board of Directors, is given on pages 150 to 151.

The Board has obtained an assurance report from the external auditors on Directors' Statement on Internal Control which is given on page 152 of the Annual Report.

46. Corporate Governance

In the management of the Bank, the Directors have placed emphasis on conforming to the best corporate governance practices and procedures. Accordingly, systems and structures have been introduced / improved from time to time to enhance risk management measures and to improve accountability and transparency. A separate report on Corporate Governance is given on pages 102 to 131.

As required by Section 3(8) (ii) (g) of Direction No 11 of 2007 of the Banking Act on Corporate Governance for Licensed Commercial Banks, issued by the Central Bank of Sri Lanka, the Board of Directors confirms that all the findings of the "Factual Findings Reports" of auditors issued under "Sri Lanka Related Services Practice Statement 4400" have been presented in auditor's report dated 23rd February 2017, addressed to the Board of Directors.

47. Appraisal of Board Performance

The Bank has in place a robust scheme whereby the Directors perform a self-assessment of the Board's conduct annually by answering a self-assessment

questionnaire. The responses to the self-assessment questionnaire are evaluated by the Chairman and any action, recommendations and/or concerns are discussed with the Board and accordingly noted and action taken where deemed appropriate.

48. Insurance and Indemnity

Pursuant to a decision of the Board, the Bank obtained an Insurance Policy to cover Directors' and Officers' liability.

49. Compliance with Laws and Regulations

The Bank has at all times ensured that it complied with the applicable laws and regulations including the Listing Rules of the CSE as a listed company. Compliance Officer who reports to Board Integrated Risk Management Committee, tables a report on compliance at the quarterly meetings of the Board Audit Committee.

50. Material Foreseeable Risk Factors (As per Rule No. 7.6 (VI) of the Listing Rules of the Colombo Stock Exchange)

Information pertaining to the material foreseeable risk factors, that require disclosures as per Rule No. 7.6 (vi) of the Listing Rules of the Colombo Stock Exchange are discussed in the Risk Management Review in pages 157 to 189.

51. Material Issues Pertaining to Employees and Industrial Relations Pertaining to the Bank (As per Rule No. 7.6 (VII) of the Listing Rules of the Colombo Stock Exchange)

There were no material issues pertaining to employees and industrial relations pertaining to the Bank that occurred during the year under review which needs to be disclosed.

52. Operational Excellence

The Bank achieved greater efficiency, service and quality in its banking operations, credit underwriting as well as non-banking

operations through a focused drive of initiatives in operational efficiency, cost optimization, business process re-engineering and optimization of latest technology. In 2015 and 2016, many of these initiatives were completed with greater emphasis placed on enabling the Bank to achieve better focus on sales and services by moving operational tasks to specialized teams where efficiency is derived through economies of scale due to better service, specialization and standardization. Cost to income ratio reduced from 45.9% to 42.5% year on year.

53. Auditors

The Bank's auditors during the period under review were Messrs. Ernst & Young, Chartered Accountants. Audit fees and reimbursement of expenses paid to Messrs. Ernst & Young during the year under review by the Bank and the Group amounted to Rs 10,899,000/- (2015: Rs 10,283,000/-) and Rs 18,410,000/- (2015: Rs 19,709,000/-) respectively. Further Rs 8,007,000/- (2015: Rs 4,510,000/-) and Rs 8,660,000/- (2015: Rs 5,163,000/-) were paid by the Bank and the Group respectively for audit related and non-audit services including reimbursement of expenses.

Based on the declaration provided by Messrs. Ernst & Young, and as far as the Directors are aware, the auditors do not have any relationship or interest with the Bank that in our judgment, may reasonably be thought to have a bearing on their independence within the meaning of the Code of Professional Conduct and Ethics issued by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka), applicable on the date of this Report.

A resolution relating to re-appointment of auditors and authorising the Directors to fix their remuneration, will be proposed at the forthcoming Annual General Meeting.

54. Shareholder Litigation

Pursuant to an action filed by Stassen Exports (Private) Limited - a shareholder of the Bank, interim orders were issued by the Commercial High Court of Colombo, pending the final determination of the case (i) restraining HNB, its Directors and the Company Secretary from taking any action regarding the proposed share issue including issuing of shares to Asian Development Bank (ADB) by way of a private placement; and (ii) restraining the 1st to the 14th Respondents in the case, from holding and/or proceeding with the Extra-Ordinary General Meeting of HNB which was scheduled for Wednesday, 26th October 2016 or any time thereafter for the purpose of obtaining the approval of the shareholders to issue shares to ADB by way of a private placement, in consideration of the proposal made by ADB to make an equity investment in HNB, in any manner whatsoever.

The Bank has filed necessary papers for the vacation of the interim orders referred to above and the case is being heard.

55. Notice of Annual General Meeting

The 48th Annual General Meeting of the Bank is convened on Thursday 30th March 2017, at 10.00 in the forenoon, at the Auditorium on Level 22 of "HNB Towers" (Registered Office), No 479, T B Jayah Mawatha, Colombo 10. The Notice of the 48th Annual General Meeting is enclosed.

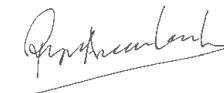
56. Acknowledgement of the Contents of the Report

As required by Section 168 (1) (k) of the Companies Act No. 07 of 2007, the Board of Directors hereby acknowledges the contents of this Annual Report.

For and on behalf of the Board of Directors.



Jonathan Alles
*Managing Director /
Chief Executive Officer*



Rienzie Arseculeratne
Chairman



K A L Thushari Ranaweera
*Deputy General Manager (Legal) /
Company Secretary*

Colombo, Sri Lanka
23rd February 2017

Directors' Statement on Internal Control

Responsibility

As per Section 3 (8) (ii) (b) of Banking Act Direction No: 11 of 2007, the Board of Directors present this report on internal control mechanisms of the Bank.

The Board of Directors ("Board") is responsible for the adequacy and effectiveness of Hatton National Bank PLC's ("the Bank") system of internal controls. However, such a system is designed to manage the Bank's key areas of risk within an acceptable risk profile, rather than eliminate the risk of failure to achieve the business objectives and policies of the Bank. Accordingly, the system of internal controls can only provide a reasonable but not absolute assurance against material misstatement of management and financial information and records against financial losses or fraud.

The Board has established an on-going process for identifying, evaluating and managing the significant risks faced by the Bank and this process includes enhancing the system of internal controls as and when there are changes to business environment or regulatory guidelines.

The process is regularly reviewed by the Board in accordance with the guidance for Directors of Banks on the Directors' Statement on Internal Control issued by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka). As per the said guidance, significant processes affecting significant accounts of the Bank were assessed along with the key risk areas of the Bank.

The management assists the Board in the implementation of the Board's policies and procedures on risk and control by identifying and assessing the risks faced by the Bank, and in the design, operation and monitoring of suitable internal controls to mitigate and control these risks.

The Board is of the view that the system of internal controls in place is sound and adequate to provide a reasonable assurance regarding the reliability of financial reporting, and that the preparation of financial statements for external purposes

is in accordance with relevant accounting principles and regulatory requirements.

Key Internal Control Processes

The key processes that have been established in reviewing the adequacy and integrity of the system of internal controls include the following:

- The Board Sub Committees are established to assist the Board in ensuring:
 - the effectiveness of the Bank's daily operations.
 - that the Bank's operations are in accordance with the corporate objectives and strategies.
 - that the operations of the Bank are in line with the annual budget as well as the policies and business directions that have been approved by the Board.
- The Internal Audit Division of the Bank checks for compliance with policies and procedures and the effectiveness of the internal control systems and highlights significant findings in respect of any non-compliance. Audits are carried out on majority of units and branches, the frequency of which is determined by the level of risk assessed by the internal audit, to provide an independent and objective report on operational and management activities of these units and branches. The annual audit plan is reviewed and approved by the Audit Committee and the findings of the audits are submitted to the Audit Committee for review at their periodic meetings.
- The Audit Committee of the Bank reviews internal control issues identified by the Internal Audit Division, the external auditors, regulatory authorities and management; and evaluates the adequacy and effectiveness of the risk management and internal control systems. They also review the internal audit function with particular emphasis on the scope of audits and quality of the same. The minutes of the Audit Committee meetings are tabled for the information of the Board on a periodic

basis. Further details of the activities undertaken by the Audit Committee of the Bank are set out in the Audit Committee Report on pages 137 to 138.

- The Board Integrated Risk Management Committee (BIRMC) is established to assist the Board to oversee the overall management of principal areas of risk of the Bank. The Executive Risk Management Committee which includes representation from all key business and operating units of the Bank, assists the Board with the implementation of policies advocated at the Board Integrated Risk Management Committee (BIRMC).
- Operational committees have also been established with appropriate empowerment to ensure effective management and supervision of the Bank's core areas of business operations. These committees include the Human Resource Management Committee, Assets and Liability Committee, the Credit Policy Committee, Investment Committee, the Information Technology Steering Committee, Executive Risk Management Committee and the Operational Risk Steering Committee

In assessing the internal control system over financial reporting, identified officers of the Bank collated all procedures and controls that are connected with significant accounts and disclosures of the financial statements of the Bank. These in turn were observed and checked by the internal audit department for suitability of design and effectiveness on an on going basis. The Bank adopted the new Sri Lanka Accounting Standards Comprising LKAS & SLFRS in 2012. Since adoption of such Sri Lanka Accounting Standards, progressive improvements on processes to comply with new requirements of recognition, measurement, classification and disclosure are being made whilst, further strengthening of processes will take place pertaining to impairment of loans and advances and financial statement disclosures. Having recognized the importance of having an automated financial reporting process in place to more effectively comply with the

requirements of recognition, measurement, classification and disclosure of financial instruments, the bank commenced the implementation of an automated solution in 2015 with the assistance of a reputed solution provider who has worldwide experience in implementing such solutions. The project is expected to be completed in second quarter of 2017. The assessment did not include subsidiaries of the Bank.

The recommendations made by the external auditors in connection with the internal control system in previous years were reviewed during the year and appropriate steps have been taken to implement them.

Confirmation

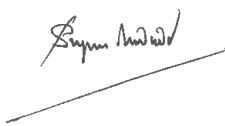
Based on the above processes, the Board confirms that the financial reporting system of the Bank has been designed to provide a reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes has been done in accordance with Sri Lanka Accounting Standards and regulatory requirements of the Central Bank of Sri Lanka.

Review of the Statement by External Auditors

The external auditor, Messrs Ernst & Young, have reviewed the above Directors' Statement on Internal Control for the year ended 31st December 2016 and reported to the Board that nothing has come to their

attention that causes them to believe that the statement is inconsistent with their understanding of the process adopted by the Board in the review of the design and effectiveness of the internal control system of the Bank. Their Report on the Statement of Internal Control is given on page 152 of this Annual Report.

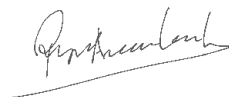
By order of the Board



Sujeewa Mudalige
Chairman
Board Audit Committee



Jonathan Alles
Managing Director /
Chief Executive Officer



Rienzie Arseculeratne
Chairman

Colombo, Sri Lanka
23rd February 2017

Independent Assurance Report



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Chartered Accountants
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INDEPENDENT ASSURANCE REPORT TO THE BOARD OF DIRECTORS OF HATTON NATIONAL BANK PLC

Report on the Directors' Statement on Internal Control over Financial Reporting

We were engaged by the Board of Directors of Hatton National Bank PLC (the "Bank") to provide assurance on the Directors' Statement on Internal Control over Financial Reporting (the "Statement") included in the annual report for the year ended 31 December 2016.

Management's responsibility

Management is responsible for the preparation and presentation of the Statement in accordance with the "Guidance for Directors of Banks on the Directors' Statement on Internal Control" issued in compliance with section 3(8)(ii) (b) of the Banking Act Direction No. 11 of 2007, by the Institute of Chartered Accountants of Sri Lanka.

Our responsibilities and compliance with SLSAE 3050

Our responsibility is to issue a report to the Board on the Statement based on the work performed. We conducted our engagement

in accordance with Sri Lanka Standard on Assurance Engagements (SLSAE) 3050 – Assurance Report for Banks on Directors' Statement on Internal Control issued by the Institute of Chartered Accountants of Sri Lanka.

Summary of work performed

We conducted our engagement to assess whether the Statement is supported by the documentation prepared by or for Directors; and appropriately reflected the process the Directors have adopted in reviewing the system of internal control over financial reporting of the Bank.

The procedures performed were limited primarily to inquiries of Bank personnel and the existence of documentation on a sample basis that supported the process adopted by the Board of Directors.

SLSAE 3050 does not require us to consider whether the Statement covers all risks and controls or to form an opinion on the effectiveness of the Bank's risk and control procedures. SLSAE 3050 also does not require us to consider whether the processes described to deal with material internal control aspects of any significant problems disclosed in the annual report will, in fact, remedy the problems.

Our conclusion

Based on the procedures performed, nothing has come to our attention that causes us to believe that the Statement included in the annual report is inconsistent with our understanding of the process the Board of Directors has adopted in the review of the design and effectiveness of internal control over financial reporting of the Bank.

23rd February 2017
Colombo

Directors' Interest in Contracts with the Bank

Bank carries out transactions in the ordinary course of its business at commercial rates with entities in which a Key Management Personnel (KMP) or one of their Close Family Members (CFM) is the Chairman or a Director of such entity. The details of such transactions are given below. Further this complies with the requirements of section 168 of the Companies Act. No. 07 of 2007 and directions issued under section 47 (3), (4), (5) and (6) of the Banking Act No. 30 of 1988.

1. Lending transactions with the Bank

Director/Company	Name of the Director/Relationship	Nature of Transaction	Aggregate Amount of Accommodation				Security
			As at 31st December 2016		As at 31st December 2015		
			Limit Rs.Mn	Outstanding Rs.Mn	Limit Rs.Mn	Outstanding Rs.Mn	
(A) Ms D S C Jayawardena							
Ambewela Livestock Company Ltd	Director	Overdraft	50.00	31.26	50.00	34.64	Quoted shares
		Letters of Credit	10.00	-	10.00	-	Corporate guarantee
		Total	60.00	31.26	60.00	34.64	
Ambewela Products (Pvt) Ltd	Director	Overdraft	100.00	-	100.00	68.13	Quoted shares
		Letters of Credit	50.00	-	50.00	0.50	Corporate guarantee
		Total	150.00	-	150.00	68.63	
Ceylon Garden Coir (Pvt) Ltd	Director	Letter of Credit	10.00	-	10.00	-	Quoted shares
		Total	10.00	-	10.00	-	Corporate guarantee
Lanka Dairies (Pvt) Ltd	Director	Overdraft	200.00	142.52	200.00	159.30	Quoted shares
		Letters of Credit	196.42	195.40	100.00	-	Corporate guarantee
		Letters of Guarantee	25.00	-	25.00	-	
		Total	421.42	337.92	325.00	159.30	
Lanka Milk Foods (CWE) PLC	Director	Overdraft	300.00	18.00	300.00	221.70	Quoted shares
		Letters of Credit	600.00	269.94	600.00	-	Corporate guarantee
		Letter of Guarantee 1	30.00	-	30.00	-	Clean
		Letter of Guarantee 11	*(70)	33.49	*(70.00)	34.10	
Total	930.00	321.43	930.00	255.80			
Milford Exports (Ceylon) Ltd	Director	Letters of Credit	50.00	-	50.00	-	Quoted shares
		Neg. of Doc bills	200.00	-	200.00	-	Corporate guarantee
		Overdraft	10.00	-	10.00	-	
		Letters of Guarantee	40.00	5.00	40.00	5.35	
Total	300.00	5.00	300.00	5.35			
Pattipola Livestock Company Ltd	Director	Overdraft	50.00	10.37	50.00	16.58	Quoted shares
		Letters of Credit	10.00	-	10.00	-	Corporate guarantee
		Total	60.00	10.37	60.00	16.58	
Stassen Natural Foods (Pvt) Ltd	Director	Overdraft	10.00	-	10.00	4.70	Quoted shares
		Letter of Credit	50.00	0.04	50.00	-	Corporate guarantee
		Letters of Guarantee	15.00	15.00	15.00	15.00	
		Nego.of Doc. Bills	200.00	-	200.00	-	
Total	275.00	15.04	275.00	19.70			
Stassen Int'l (Pvt) Ltd	Director	Overdraft	300.00	14.58	300.00	0.41	Quoted shares
		Letter of Credit	150.00	5.07	150.00	10.42	Corporate guarantee
		Letters of Guarantee	125.00	57.84	125.00	55.00	
		Nego.of Doc. Bills	500.00	-	500.00	-	
Total	1,075.00	77.49	1,075.00	65.83			
Stassen Exports (Pvt) Ltd	Director	Overdraft	3,048.00	507.80	3,048.00	329.41	Quoted shares
		Letter of Credit	265.00	92.24	265.00	146.26	Corporate guarantee
		Letters of Guarantee	100.00	20.30	100.00	5.35	
		Forward Exchange	1,300.00	290.00	1,300.00	-	
		Nego.of Doc. Bills	500.00	-	500.00	431.33	
Total	5,213.00	910.34	5,213.00	912.35			

Directors' Interest in Contracts with the Bank

Director/Company	Name of the Director/Relationship	Nature of Transaction	Aggregate Amount of Accommodation				Security
			As at 31st December 2016		As at 31st December 2015		
			Limit Rs.Mn	Outstanding Rs.Mn	Limit Rs.Mn	Outstanding Rs.Mn	
(B) Spouse of Mr Sujeewa Mudalige							
Capital Maharaja (Pvt) Ltd	Group Director	Term Loan	-	-	0.03	0.03	Corporate guarantee
		Total	-	-	0.03	0.03	
Capital holding Maharaja	Group Director	Lease	12.82	12.82	17.41	17.41	Corporate
		Letter of guarantee	-	-	0.55	0.55	guarantee, absolute
		Overdraft	19.44	-	20.00	-	ownership of vehicles
		Total	32.26	12.82	37.96	17.96	
Harcros Chemicals (Pvt) Ltd	Group Director	Letters of Credit/Import loan	305.00	95.01	305.00	200.96	Immovable Property
		Overdraft	100.00	4.11	100.00	5.71	Corporate guarantee
		Letters of Guarantee**	1.50	13.13	1.50	-	Trade receivables
		Total	406.50	112.25	406.50	206.67	Goods imported
International Cosmetics Ltd	Group Director	Overdraft	40.00	42.90	40.00	30.60	Mortgage over
		Letter of Credit/ Import Loan	245.00	239.05	200.00	98.17	property, titles of the
		Short term loan	-	-	5.00	-	imported goods
		Total	285.00	281.95	245.00	128.77	
M Chem (Pvt) Ltd	Group Director	Overdraft	5.00	-	5.00	-	Corporate guarantee
		Letters of Credit Import Loan	25.00	-	25.00	-	
		Total	30.00	-	30.00	-	
MBC Network (Pvt) Ltd	Group Director	Term Loan	-	-	30.96	-	Immovable property.
		Overdraft	-	-	80.00	-	Leeway available on
		Letters of Credit	-	-	5.00	-	quaternary Mortgage.
		Total	-	-	115.96	-	Corporate Guarantee.
MTV Channel (Pvt) Ltd	Group Director	Letters of Credit Overdraft	45.00	-	15.00	-	Immovable property.
		Import Loan	*(45.00)	-	*(15.00)	-	Goods imported.
		Overdraft	100.00	-	65.00	42.69	Leeway available
		Term Loan	216.30	216.30	304.46	304.46	in the existing
		Letters of Guarantee	5.00	-	5.00	-	immovable property.
		Total	366.30	216.30	389.46	347.15	over imm.prope.
P E Plus (Pvt) Ltd	Group Director	Letter of Credit /OD // Import Loan I	245.00	101.54	242.00	130.46	Corporate guarantee
		Term loan	7.09	7.09	-	-	Immovable Property
		Total	252.09	108.63	242.00	130.46	
S - Lon Lanka (Pvt) Ltd	Group Director	Overdraft	310.00	-	310.00	26.37	Stock in trade
		Letters of Guarantee	(100.00)	-	30.00	22.77	Corporate guarantee
		Letters of Credit/Import loan	735.00	263.75	735.00	219.21	Goods imported
		Total	1,045.00	263.75	1,075.00	268.35	
Tuffline Ltd	Group Director	Letters of Credit/Import Loan	100.00	84.67	100.00	88.33	Trade receivables
		Overdraft	90.00	84.41	65.00	58.49	Mortgage over
		Letters of Guarantee	1.00	-	1.00	-	machinery
		Local Purchase Loan	5.00	-	4.97	4.97	Board Resolution
		Term Loan	66.04	66.04	9.24	-	
		Total	262.04	235.12	180.21	151.79	
Kevilton Electricals	Group Director	Letter of Credit/Import Loan	150.00	139.95	-	-	Corporate Guarantee
		Total	150.00	139.95	-	-	
Harrisons Shipping (Pvt) Ltd	Group Director	Overdraft	10.00	-	-	-	Corporate Guarantee
		Total	10.00	-	-	-	

Director/Company	Name of the Director/Relationship	Nature of Transaction	Aggregate Amount of Accommodation				Security
			As at 31st December 2016		As at 31st December 2015		
			Limit Rs.Mn	Outstanding Rs.Mn	Limit Rs.Mn	Outstanding Rs.Mn	
(C) Mr Amal Cabraal							
John Keells Holdings PLC	Director	Overdraft	200.00	-	200.00	-	Board Resolution
		Commercial paper	*(200.00)	-	*(200.00)	-	Commercial paper agreement
		Overdraft	*(200.00)	-	*(200.00)	-	
		Term loan	*(200.00)	-	*(200.00)	-	
		Total	200.00	-	200.00	-	
S A Silva & Sons Ltd	Director	Packing credit loan	N/A	N/A	57.60	-	Confirmed export orders & Corp. Guarantee
		Export bill	N/A	N/A	*(57.6)	-	
		Overdraft	N/A	N/A	30.00	9.71	Lien over FD
		Total	N/A	N/A	87.60	9.71	
Ceylon Beverage Holding PLC	Director	Overdraft	100.00	95.17	100.00	100.30	Board Resolution
		Term loan	217.80	217.80	317.40	317.40	
		Total	317.80	312.97	417.40	417.70	
Lion Brewery (Ceylon) PLC	Director	Overdraft	100.00	8.06	100.00	85.99	Board Resolution, Demand promissory notes, LG Indemnity, documents of title
		Letter of guarantee	20.00	0.52	20.00	0.75	
		Money market loan	5,000.00	1,950.00	5,000.00	2,300.00	
		Term loan	*(1000.00)	1,000.00	*(1,000.00)	-	
		Letter of credit 1	50.00	50.00	50.00	-	
		Letter of credit 11	*(2,000.00)	166.87	*(50.00)	-	
		Import loan	*(2,050.00)	-	*(50.00)	-	
		Total	5,170.00	3,175.45	5,170.00	2,386.74	
(D) Mr Nilanth de Silva							
Malwatte Valley Plantations PLC	Director	Overdraft	254.00	192.48	254.00	242.77	Stock & book debts
		Refinance loan	-	-	0.38	0.38	Property
		Term loan	-	-	29.23	29.23	Guarantee
		Commercial paper	40.00	-	40.00	-	Board Resolution
		Stand by overdraft	*(40.00)	-	*(40.00)	-	Dollar bond for \$695,000
		packing credit loan	400.00	-	400.00	67.87	Letters of Hypothecation
		Export bill	*(400.00)	72.26	*(400.00)	120.33	vehicles/equipment
		Lease	28.68	28.68	42.40	42.40	
		Total	722.68	293.42	766.01	502.98	
		(E) Mr Duliksha Soosaipillai					
Commercial Credit & Finance PLC	Director	Overdraft	12.00	-	12.00	-	Mortgage over property, securitisation lease/hire purchase
		Securitisation loan	1,031.26	1,031.26	513.53	513.53	Board resolution
		Let of guarantee	2,128.19	2,128.19	2,104.00	2,104.00	Asset backed trust certificates.
		Temp. S/TL loan	193.00	193.00	-	-	
		Investment loan	7.30	7.30	91.00	91.00	
Total	3,371.75	3,359.75	2,720.53	2,708.53			
(F) Ms Rose Cooray							
Ceylon Guardian Investment Trust/Ceylon Investment PLC	Director	Overdraft/Term loan	300.00	-	300.00	0.23	Board resolution
		Overdraft	*(300.00)	-	*(300.00)	-	
		Total	300.00	-	300.00	0.23	
(G) Mr Rusi Caption							
Paints & General Industries Ltd	Director	Overdraft	3,250.00	2,230.18	3,250.00	2,743.21	Board resolution, Quoted Shares
		Letter of Credit	*(100)	15.68	*(100)	9.09	
		Letter of Guarantee**	-	4.07	-	-	
		Total	3,250.00	2,245.86	3,250.00	2,752.30	

Directors' Interest in Contracts with the Bank

Director/Company	Name of the Director/Relationship	Nature of Transaction	Aggregate Amount of Accommodation				Security
			As at 31st December 2016		As at 31st December 2015		
			Limit Rs.Mn	Outstanding Rs.Mn	Limit Rs.Mn	Outstanding Rs.Mn	
(H) Dr Rohan Karunaratne							
AKK Engineers (Pvt) Ltd	Director	Overdraft	31.00	0.99	31.00	1.00	Mortgage over property. Fixed Deposits. Personal Guarantee
		Letter of Guarantee 1	60.80	30.26	65.30	39.80	
		Letter of Guarantee 2	*(10.00)	-	*(10.00)	-	
Total			3,250.00	31.25	96.30	40.80	

* Figures in brackets indicate sub limits granted to respective entities.

** Outstanding consists of a shipping guarantee against 100% cash margin.

2. Other business transactions with the Bank

Company/Director	Name of the Director / Relationship	Nature of Transaction	Amount (RsMn)	
			2016	2015
(A) Ms Sanjivani Jayawardena				
Stassen Exports (Pvt) Ltd	Director	Interest on repurchase agreements	4.93	8.15
		Repo (outstanding as at year end)	-	130.00
(B) Mr Jonathan Alles				
Lanka Financial services Beurea	Director	Interest on repurchase agreements	0.88	-
		Merchant commission	-	4.24
		Other charges	4.47	4.06
(C) Ms Rose Cooray				
Ceylon Guardian Investment Trust PLC	Director	Interest on repurchase agreements	-	4.13
Ceylon Investment PLC	Director	Repo (outstanding as at year end)	-	12.33
(D) Mr Amal Cabral				
Jhon keels Holdings PLC	Director	Repo (outstanding as at year end)	4,261.10	-
		Interest on repurchase agreements	322.60	-
(E) Mr Sujeewa Mudalige				
MBC Networks Pvt Ltd	Spouse-Group Director	Other Charges	12.10	7.24
MTV Channels	Spouse-Group Director	Other Charges	14.14	18.12

The above entities also held customer deposits with the Bank totalling to Rs 13,004.66 Mn and interest paid was Rs 839.2 Mn.

Interest income earned from loans and advances amounted to Rs 747.27 Mn for the year ended 31/12/2016.

Risk Management

Envisaging the unexpected has become more imperative than ever. In order to navigate those unexpected challenges role played by risk management discipline has emerged as a key strength. Risk management has also been intensely subject to endless changes in global and domestic economic integration, technological advances, geopolitical frictions and ever-changing regulation evolving from the historical experience in the sector. Emerging markets and developing economies had an extremely challenging year and as a result, global growth has further tilted downwards emerging markets. Policy buffers have been eroded in many countries creating diminishing confidence in the effectiveness of economic policies to promote growth opportunities.

The banking sector in Sri Lanka plays a vital role in the financial system as it has the capacity to supply credit and liquidity to the entire economy, providing payment services and thereby facilitating financial transactions in the economy. Even though state banks dominate with a majority stake in financial sector performance and contribute substantially to scale-up the banking system, contribution from the private sector too stands significant, especially in re-shaping the banking industry. However, in search of growth amidst emerging risks, evolving risk function, stiff competition and the government reliance on the financial sector as a main revenue source, banks were compelled to expose themselves to a much higher level of risks where systematic management of risks become

the key differentiator. Risks are created and amplified by certain events that occur and such key events took place during year 2016 driving the demand for improved risk management practices, emanating from the global and local developments, have been outlined below. All these developments necessitated the enhancement of risk management techniques, broadening of risk reporting and building a strong risk management culture within the banking and financial sector in Sri Lanka.

Global Outlook

In a global perspective, risks have become more pronounced and economic prospects have weakened during the year 2016. Slow growth has eroded policy buffers to counteract shocks, leaving the global economy less prepared to confront downside risks. Global economy further tumbled with Britain's exit from the European Union. Europe is now in a period facing sensitive political and economic uncertainties as a result of the decision made by Great Britain. In addition, global economy has already felt the impact due to uncertainty in policies with the political changes in USA and it is likely that these changes will take some time to bring stability.

In view of impending and probable uncertainties, we have identified risk drivers, which would pose challenges directly or indirectly to performance of HNB. Further, we have articulated possible impact to HNB and envisaged risk mitigant strategy to ensure bank will not face unexpected volatilities.



Risk Drivers	Impact to HNB	HNB Risk Mitigant Strategy
Easing the monetary policies of the major economies, US, Europe, Japan, China to manage economic slowdown	<p>Moderate</p> <ul style="list-style-type: none"> Major currencies appreciating against rupee resulting in imports becoming more expensive Exchange losses in trading book Cash outflow in foreign investments resulting in liquidity tightness, making fund raising more expensive. 	<ul style="list-style-type: none"> Closely monitor the global emerging markets and reduce the exposure accordingly Mark to market on regular basis Use dynamic risk mitigation techniques such as currency swaps to manage volatility

Risk Management

Risk Drivers	Impact to HNB	HNB Risk Mitigant Strategy
<p>China's financial transition</p> <ul style="list-style-type: none"> - Less on new investments, exports and more on consumption and services. - Tight credit conditions 	<p>Moderate</p> <ul style="list-style-type: none"> • Drop in Financial aid and investments made in major government projects thus, losing lending opportunities. • However, only 18% of the exposure of facilities granted to government projects by HNB are backed by Chinese funding 	<ul style="list-style-type: none"> • Closely monitor financial projects funded by China • Strengthening the underwriting standards and to analyses the financial sponsors from China • Search alternate opportunities
<p>Increasing trends in cyber attacks</p>	<p>Moderate</p> <ul style="list-style-type: none"> • Possibility of breaking down of critical information infrastructure and misuse of bank's customer database • Possible reputational, legal and financial consequences and loss of customer confidence • Heavy investments in software systems increasing the cost: income ratio 	<ul style="list-style-type: none"> • Development of a prevention mechanism by establishing dedicated cyber security risk management unit • Increase awareness among employees • Implementation of cyber security policy • Streamlining mechanism for early detection, response, recovery to mitigate and better manage consequences limiting the damage and ensuring business continuity as mentioned in the local outlook
<p>Rising crude oil price</p>	<p>Low</p> <ul style="list-style-type: none"> • Increase in crude oil import bill moving USD demand fluctuating 	<ul style="list-style-type: none"> • Carrying out stress tests to assess the impact • Expanding the remittance network to western and other markets to explore more opportunities
<p>Drop in commodity prices</p>	<p>Moderate</p> <ul style="list-style-type: none"> • Adverse impact on commodity exporters resulting increased NPA • Speculative importers would stand lose • Deteriorating asset quality 	<ul style="list-style-type: none"> • Lending has been diversified in to many industry sectors to negate the credit concentration risk • Analysing stress scenarios to assess the impact of the portfolio of commodity traders/importers • Analysing stress scenarios to assess the impact of the portfolio • Discourage speculative stocking and imports
<p>Uncertainties associated with Brexit</p>	<p>Low</p> <ul style="list-style-type: none"> • Slowdown in tourism industry performance as result of depreciation of GBP • Lending to exporters will be impacted as exporting to UK will restrain the chance of claiming the benefit of GSP plus. 	<ul style="list-style-type: none"> • Regular analysis of global economic and impact on local industries to review and understand the market trends • Stress testing to gauge the maximum impact
<p>Increasing regulatory breaches due to control lapses</p>	<p>High</p> <ul style="list-style-type: none"> • Potential adverse impact on correspondent banking • Difficulty in raising capital in the international markets 	<ul style="list-style-type: none"> • Monitor market developments • Reduce concentration on single correspondent bank • Test and improve the business continuity plan in the event of crisis situation in a correspondent bank • Strengthening compliance function and increase monitoring • Dedicated two BIRMC meetings to review progress on compliance matters
<p>Change in the political regime in USA</p>	<p>Moderate</p> <ul style="list-style-type: none"> • Notable changes in interest rates/taxes that could hurt Sri Lanka in its borrowings • Potential impact on Asian economies resulting investment cut down/ rupee depreciation • Probable regulatory and policy changes/ uncertainties that would directly impact export industry 	<ul style="list-style-type: none"> • Regular analysis of global economic impact on local economies • Stress testing to gauge the maximum impact • Closely monitor the trading book and mark to market to assess the impact on daily basis

Domestic Outlook

The Sri Lankan economy-gathering pace since third quarter, continued to grow moderately around 5% during the year. Value addition from construction and manufacturing activities, which constituted approximately 30% of lending of HNB, continued to remain low. However, towards the latter part of the year, the economy showed some signs of recovery boosted by the industry sector. The service sector too recorded a moderate growth where financial services sector was the main contributor. Agriculture sector showed a relatively slower growth due to adverse weather conditions that prevailed almost throughout the year. Consumer price inflation, which was maintained at mid-single digit during first half of 2016, was pushed upwards by domestic supply shortage due to bad weather conditions, among other factors during later part of the year.

The Central Bank of Sri Lanka (CBSL), with a view of addressing this situation adopted measures to tighten the monetary policy by raising the Statutory Reserve Ratio (SRR) by 150 basis points to 7.5% and raised policy interest rates by 50 basis points each on two occasions, during 2016. These measures led to a slowing in lending by the commercial banks comparative to a year before.

A notable decline in international commodity prices and lower demand for exports resulted in a drop in external performance to modest levels increased

the deficit in the trade account. However, the current account improved with higher inflows to the service sector. Net inflows to the financial account declined, mainly reflecting outflows in the government securities market and slowdown in foreign direct investments. These economic activities resulted in an overall deficit in the balance of payments during the year 2016.

Consequently several measures implemented by the government to augment revenue including increase in tax rates, government revenue collections showed signs of improvement during the year. However, revenue collection remained below the target due to delays in implementing some of the recovery measures. Hence, achieving the 2016 budget deficit remained challenging. Sri Lanka entered into a 3-year arrangement under the Extended Fund Facility (EFF) of USD 1.5 Bn with the IMF to support its economic program 2016 – 2019 with the intention of strengthening external and fiscal balances of the economy through the implementation of several reform programs. Two tranches of the EFF were drawn down in the year 2016.

Whilst debt to GDP remained around 75%, government debt has increased notably during the year. Significant portion of government revenue is used for debt repayment. The increase in debt accounted for both offshore borrowings and local borrowings. Sri Lanka experienced a sovereign rating downgrade from BB- to B+

during the early part of year 2016 mainly in view of increasing refinancing risks. The Sri Lankan government faced increased refinancing risks on account of high external debt maturities. Rating downgrade coupled with change of outlook to “Negative” by international rating agencies opened up severe challenges. LKR depreciated against USD surpassing Rs. 150/- per USD by end December 2016. Nevertheless depreciation of rupee wasn't as sharp as in 2015. Stock market was volatile during the year with ASPI down approx. 10% compared to end December 2015. Despite a sharp drop of approx. 15% mid-year compared to the beginning of the year, ASPI later recovered to a certain extent.

The real estate market in Sri Lanka has indicated a continuous growth during the last decade and it is attributed to the trend in the up-liftment of living standards in Colombo and suburbs. Condominiums have become popular, especially among the emerging middle class seeking better lifestyles and convenience. However, the fast growth in condominium development projects indicate that in time to come, there could be a stress situation created by an oversupply of condominiums.

Nevertheless, for the banking sector, some of the main risk drivers which created challenges during the year emerged from least expected sources. Following table depicts such risks and how ready HNB is to manage the impact arising out of those.

Risk Drivers	Impact to HNB	HNB Risk Mitigant Strategy
Fin-techs encroaching share of banking business	<p>Low</p> <ul style="list-style-type: none"> Non-interest income streams of the Bank is impacted via introduction of payments modes through smart phone applications 	<ul style="list-style-type: none"> Aggressive promotion of mobile payment mechanism “MOMO” to Retail and SME merchants Launch of state-of the art e-banking platform, FEBA to facilitate on-line transactions. Partnering and collaborating with technology firms to cater higher level of customer experience
Alarming trends in cyber threats	<p>High</p> <ul style="list-style-type: none"> Increasing cost of data security Possible financial losses due to unauthorized transactions Possible reputation damage and loss of customer confidence 	<ul style="list-style-type: none"> Advanced authentication mechanism and secure access mode with multi-layered authentications Continually reviewing and strengthening the internal control system Strong focus on implementing strict cyber security prevention tools Escalating cyber security information to the risk dashboard and reviewed every two months at BIRMC meetings. Introduction of a cyber security policy

Risk Management

Risk Drivers	Impact to HNB	HNB Risk Mitigant Strategy
Tight liquidity	Moderate <ul style="list-style-type: none"> Increased cost of funds Increase in the interest rates More reliance on external/internal borrowings 	<ul style="list-style-type: none"> Maintain a healthy balance of reserves and provide the best interest rates to depositors whilst lending rates are at the lowest Regular review of rate sensitive assets and liabilities of the Bank Aggressive savings campaigns including children's savings along with incentives for canvassing savings Highest interest rate offered to encourage savings Regular testing of liquidity contingency plan
Low economic growth than expected	Low <ul style="list-style-type: none"> Lower disposable income resulting in low savings Increase in credit default 	<ul style="list-style-type: none"> Proactive risk management practices e.g. obligor risk rating, independent credit risk assessment prior to granting loans, strengthening loan review mechanism Conduct stress testing for different stress scenarios Predictive portfolio analytics to manage consumer/retail portfolios
Challenges in implementing Basel III reforms	Moderate <ul style="list-style-type: none"> As a D-SIB, requirement of a higher CAR to be maintained Increase transparency and disclosure requirement 	<ul style="list-style-type: none"> Capital infusion plan is amalgamated in strategic objective 2020 plan Comprehensive qualitative and quantitative assessment of Pillar II risks under ICAAP Capital forecasting and stress testing
Increase in government taxes and direction on lowering LTV	Low <ul style="list-style-type: none"> Increase in corporate tax rates reduces the profitability of the Bank and discourage investments Loss of lending opportunities in key revenue drivers 	<ul style="list-style-type: none"> Regular scenario analysis is carried out understand the impact on investment portfolio Maintaining diversified lending portfolio to mitigate impact on lost opportunities in leasing/vehicle financing
Possible real estate bubble	Moderate <ul style="list-style-type: none"> Possible increase in NPA 	<ul style="list-style-type: none"> Improve underwriting standards Implement tighter sectorial caps and other internal limits Continuous monitoring/reporting of industry trends

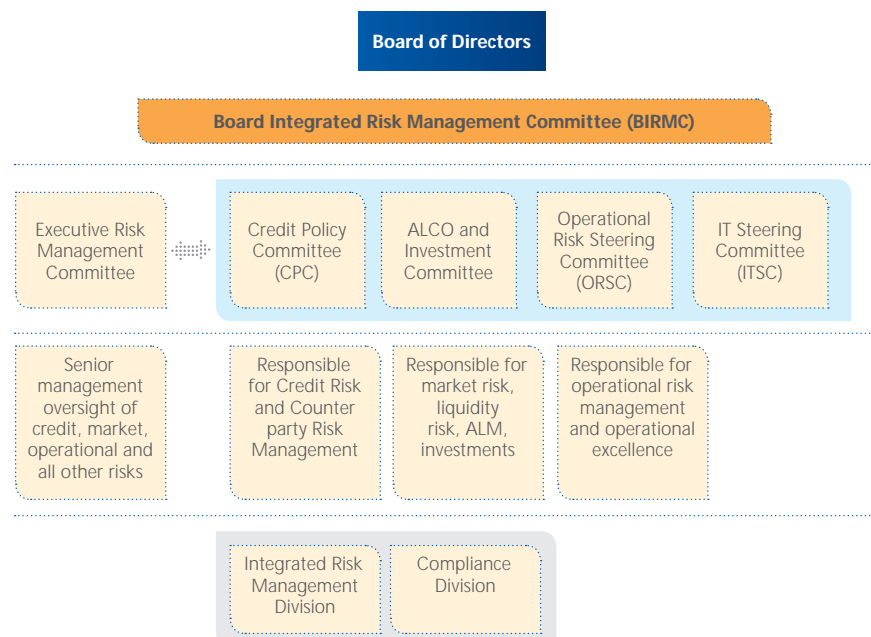
Risk Governance Structure

The risk governance framework of HNB adopts a "Three lines of defense" structure that ensures principal risks are appropriately managed within a well-defined risk management framework of the Bank.

First line of defense is the front line that canvases and brings in new and incremental business. Then the risk management division of the Bank plays an independent risk monitoring, measurement and advisory role as the second line of defense. Apart from conventional risk functions, plans are afloat to connect and integrate monitoring of IT and information security related risks including cyber risk within the purview of integrated risk management function.

Internal audit department of the Bank acts as the third line of defense, by carrying out an objective review on processes, practices and business decisions of the Bank on periodic basis. The BIRMC works very closely with the Board Audit Committee (BAC) to

Risk Governance Structure of HNB



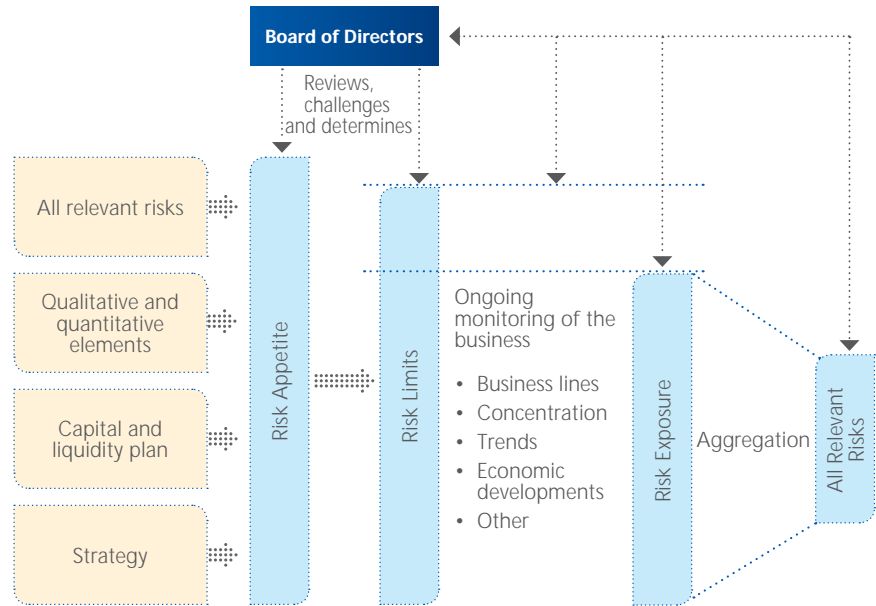
ensure both defense lines are seamlessly integrated. Among the BAC's responsibilities are, oversight of the internal controls of operations and the efficacy of internal audit, both of which have significant implications for risk management. In addition to above, compliance department of the Bank helps to ensure that, all regulatory, internal and external policy guidelines are adhered to minimising the risk of non-compliance.

Risk Appetite

The term "Risk Appetite" refers to the broad types and amounts of risks that HNB is willing to undertake in implementing its business strategy. Setting the risk appetite is an exercise where Bank's risk capital is allocated effectively and risk limits are set within the risk strategy of the Bank. Thus, the risk appetite is set, covering overall group position of the HNB ensuring main business units are in line with the business objectives set by Board of Directors.

Risk appetite statement includes qualitative and quantitative measurements, which are linked with earnings, capital, risk thresholds, liquidity and other relevant measures, as appropriate. The Bank assures a balance

Setting and Monitoring Risk Appetite



between risk goals set and forecasts of short to long-term strategy and capital planning. Thus, preparation of risk appetite statement is based on forward looking assumptions to support achieving the Bank's overall objectives. The Bank ensures to operate within the established risk tolerance level and in this direction, risk goal parameters

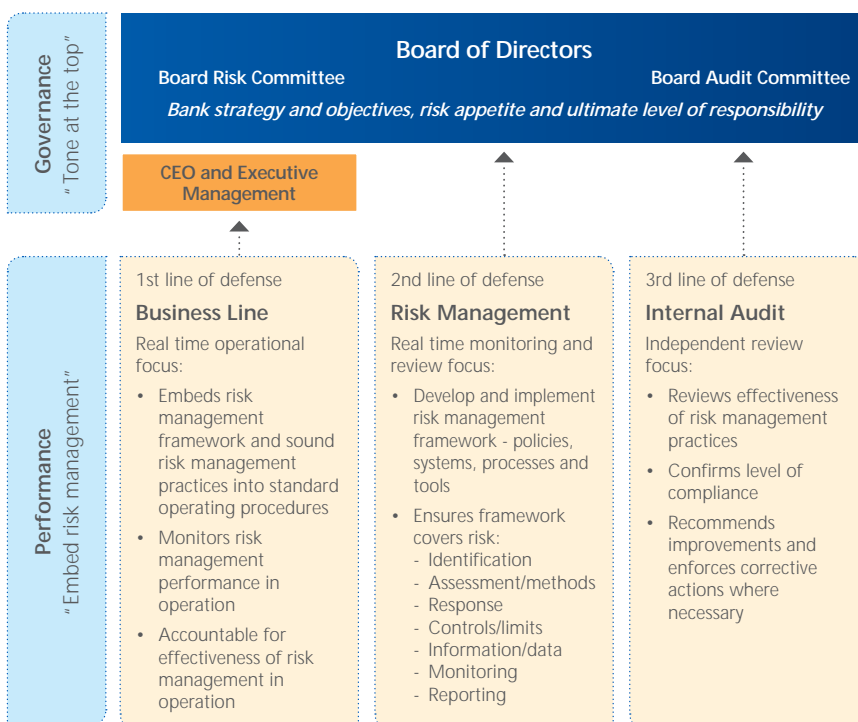
are continuously monitored and reported to Board of Directors and board subcommittees on a monthly basis via risk dashboards. Broad overview of setting and monitoring of risk appetite is outlined above.

Risk Culture of HNB

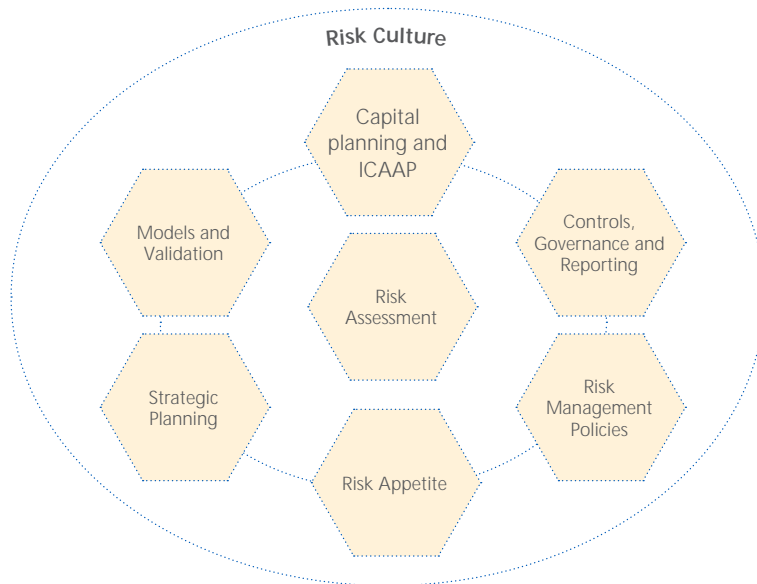
HNB has created a consistent "Risk Culture" throughout the Bank that promotes its business objectives and an environment that enables management to execute the business strategy in a more efficient and sustainable manner. In order to create and maintain a strong risk culture, it is important to manage the "Risk Governance" responsibilities set out by the CBSL. The Board of Directors regularly review the risk profile of the Bank and its subsidiaries and makes every senior leader a responsible stakeholder in developing a strong risk culture within the Bank. Further, the Bank ensures that, every employee has a clear understanding of their responsibilities in terms of risks undertaken by them in every step they take in their regular business activities.

The Bank has developed a risk management framework covering risk governance, which includes, risk management structure comprising different sub committees and clearly defined reporting lines ensuring

Three Lines of Defense at HNB



Risk Management



risk management unit is functioning independently.

Risk governance of the Bank also includes setting the risk appetite statement, risk limits, risk management functions, capital planning, risk management policies, risk infrastructure and MIS and analysis to monitor Bank's risk profile.

Review of 2016

Strengthening of Risk Management.....

With a view of developing a high performing risk function and creating a strong risk management culture, the Bank, during the year 2016 has introduced several initiatives in strengthening its risk management function from top to bottom covering both financial and non-financial risks. Broadly, they can be summarized as expansion of coverage of risk identification and assessment. In addition, a new dashboard covering IT and cyber a security risk was introduced for closer monitoring purposes. Introducing new tools and techniques and making few structural changes to risk functional areas have effectively supported the elevation of overall risk management capability of the Bank.

Following are few such key initiatives rolled-out during the year.

Introduction of an Enterprise Risk

Assessment Methodology - A process has been introduced to identify, assess, manage and mitigate key strategic risks in an objective and proactive manner. The Bank gained the capability to address core structural issues through a structured assessment methodology. Findings have been deliberated at corporate management meetings and were presented to the Board of Directors through the Board Integrated Risk Management Committee (BIRMC). During the process the level of risks the Bank has undertaken are being assessed under different headline risks such as external environment including economic/political environment, business strategies and processes, organisation and people including good governance and chain of command and technology and data. Key strategic risks are identified in a forward-looking manner by the top management and those are then presented to the BIRMC. This is a strategic level initiative where the top management of the Bank is committed to maneuver the Bank with appropriate risk mitigating action implemented. Every quarter, these dashboards are presented to the Board of Directors at its monthly meetings and the chairperson of the BIRMC brings to the notice of the Board of Directors the salient features and the developing trend paving the way for discussions.

Advisory/Observer Role in Credit

Approval Structure - The practice of risk department approving credit facilities, which was hitherto adopted, was transformed in to risk playing an observer/advisory role that provides a comprehensive analysis of risks associated in a proposal with suitable recommendations to mitigate such risks. This tests the perseverance ability of risk managers and decision-making capacity of approvers. This procedure has converted the role played by the risk department in to a more dynamic risk advisory role. This practice has improved the risk-based credit culture in the Bank.

Strengthening of Loan Review

Mechanism (LRM) - In this process, a loan review manager assesses the underlying assumptions of credit approvals and continuously evaluates the quality of credit approvers. This process has since been brought under the purview of Chief Risk Officer to ensure independence and results of the assessments are shared with the Board of Directors. Further, this function would in depth analyse the credits that have gone bad and bring any learning from those bad credits to support policy revisions where necessary.

Establishment of a Centralised Credit Monitoring Unit, Strengthening

Portfolio Risk Management - This central unit continuously monitors the quality of the credit booked in order to get a measurement of risks undertaken. The unit started with monitoring Temporary Over Drafts (TODs). It independently monitors TODs granted in the Bank, on a periodic basis and follows up with branches/ regions of their resolutions. The unit also tracks settlement of expired TODs/casual excesses, frequent TODs, kite flying, monitor promises to pay given by branch managers and provides a proactive forward-looking monthly estimate to work hard to resolve any pending excesses or TODs. The unit will eventually rate all TOD approvers in a scorecard, based on the success of managing this lucrative product within the Bank set parameters. Further, it will also analyse concentrations, new bookings, flow-rates and various other parameters to gauge the quality of the portfolio. In addition, this unit will actively identify Early Warning

Signals (EWS) of weaker credit and ensure accuracy and completeness of the watch-listing process. Thus, the unit contributes to proactive management of weaker credits.

Introduction of Risk and Control Self-Assessment (RCSA) Process

The operational risk management unit has rolled out a method to build a "Risk Registry" in the Bank, which supports a strong and robust internal control structure within. This has become a necessity given the implications seen in the operations front across the Bank. This process will examine the existing controls for their design and performance and will continuously keep testing those to ensure that such controls are not only limited to the process/procedure document but practiced in reality. This will also bring in more effective new controls to reduce operational lapses whilst it may discontinue certain controls, which are found to be less effective during the assessment process. This is one of the most dynamic and proactive operational risk management tools to gain a better control over managing operational losses.

Streamlining of Centre of Excellence (COE)

- This is one of the most futuristic units in the Bank i.e. the centralised credit-processing unit. Many changes have taken place in the COE to improve process efficiencies. The process has been divided in to separate compartments and action is being taken to improve overall delivery times whilst ensuring risk controls are not diluted. Data capturing has been outsourced and data verification has been strengthened. The Bank is also looking at system upgrades to cater to increased volumes whilst in the long run anticipating to manage volumes through non-judgemental scorecards. Such scorecards are a globally accepted credit approval mechanism where, customer demographic and other information are used to predict probability of default.

Centralisation of Disbursements and Recovery

- This is one of the key internal controls that have been revisited. Decentralisation of credit disbursement and recovery which has been followed by the Bank has created a heap of challenges in terms of controlling income leakage and

improving credit culture. Granting of loans and subsequent recoveries has since been scheduled to be centralized and this project has already commenced with corporate banking division, which covers nearly 40% of the advances book. The process will gradually be extended to all regions and thereafter loan disbursements and recoveries will come under one central unit. This initiative will also ensure approval conditions and covenants are captured and tracked in a more structured way.

Strengthened the ICAAP Methodology

- As a domestic systemically important bank, consequent to a more in depth study on the Basel guidelines under the Pillar 2 risks. Several new steps have been introduced to efficiently comply with applicable regulatory requirements. Further, revision effected to ICAAP methodology procedure provides a value to the management by giving insights of required capital levels based on the risk profile of the Bank. The new process includes following assessments.

Type of Assessment	Methodology
Assessment of robustness of risk governance framework in line with CBSL Direction No 07 of 2011	Assessment being carried out through a questionnaire based on a scorecard approach.
Assessment of level of comprehensiveness of corporate governance in line with CBSL Direction No 11 of 2007	Assessment involves a questionnaire where each question carries varied levels of importance and responses also carry various levels of significance depending on the level of compliance.
Assessment of strategic risk	Assessment being carried out based on a "scorecard approach".
Assessment of reputation risk	Assessment being carried out based on a "scorecard approach".
Assessment of credit concentration risk	"Quantitative assessment approach" and following credit concentration risks will be assessed. <ul style="list-style-type: none"> Name concentration risk Sector concentration risk Maturity concentration risk Product concentration risk Geographic concentration risk
Assessment of Interest Rate Risk in Banking Book (IRRBB)	"Quantitative assessment approach" to calculate vulnerability of NII and Economic Value of Equity (EVE) to variation in the Interest rates. Modified duration methodology used to calculate capital requirement.
Assessment of residual credit risk	"Quantitative Assessment Approach" as specified in the CBSL Direction and Basel document is used. This will calculate the additional capital requirement expected by the Bank based on its portfolio behavior
Strengthening of stress testing framework	Integrated level linking of individual stress levels. Required capital position will be projected based on most applicable scenario simulations. This can be used as an input/proxy for 5-year capital augmentation plan.

Risk Management

Future Trends in Banking Risk Management and Way Forward

Risk management in banking has been transformed over the last few years largely in response to regulations that emerged from the global financial crisis. But we believe it will undergo even more sweeping changes in the next decade. The trends shaping the risk function will come from all directions. While it's difficult to draw a blueprint of what a bank's risk function will look like in 2020 and beyond, with the disruptions that might lie ahead, we have attempted to picture some of the important changes that are relatively certain. We see financial and non-financial regulations continuing to broaden and deepen as public sentiment become less tolerant of preventable errors and inappropriate practices or of bank failures. Simultaneously, customers' expectations will also rise in line with changing technology.

Continuous Improvements in Banking Regulations and Practices

More stringent and tightened regulatory requirements are on the way and the immediate challenge of the banking sector in 2017 will be to meet the increased capital structure as required by the regulators. With the implementation of Basel III guidelines, the minimum regulatory CAR requirement would be increased by 40%-50% from the existing level of 10% in next two years. Further, disclosure requirements have been increased with the introduction of market discipline governance under Pillar 3 guideline of Basel II.

Increasing the breadth and depth of the regulations would force the banks to optimise the capital, liquidity, leverage ratios and recovery process within the financial system. This position will compel banks to re-examine their business strategies closely to comply with emerging standards.

Increase in Customer Expectations and Digital Disruption

Fin-tech companies have already encroached in to the banking business by providing innovative products in the market. Whilst such innovations have taken away a part of the banking business, on the other

hand it compels banks to rapidly adopt technological changes to provide similar facilities to customers to suit their increased needs and expectations. Smart phone applications have changed the banking services utility by the customer. Fin-techs offer a wider range of highly competitive, seamless offerings. In order to keep abreast with the innovation, banks have to heavily invest in redesigning the whole organisation from a customer-experience perspective. Such changing strategies open up enormous challenges to risk management function. When the bank leads its new product strategies in digital front, risk management function needs to be more proactively support the bank to assess risks in cyber space by introducing innovative real time solutions.

New Analytical Tools and Techniques

With the availability of advanced analytical tools, banks are enabled to make prudent risk decisions. Faster, cheaper and reliable data will be accessible to banks in greater depths to understand the customer payment and spending behavior, early warning signals, detection of financial crimes and prediction of operational losses which would lead to better management of portfolios. Machine learning will enhance the accuracy of predictive models. However, data privacy and protections will become extremely challenging. Nevertheless, it is expected to be an important prerequisite.

It is eminent that high-performing risk functions will depend on a high-performing data infrastructure. What perhaps deserves more attention is the importance of starting to build the right mix of talent and embedding a risk culture. Data scientists with advanced mathematical and statistical knowledge will increasingly need also to be able to work as "Business Translators," collaborating across the bank to convert data insights into business actions.

Emerging Non-Financial Risks

With the implementations of Basel II guidelines, significant emphasis has been placed on operational, reputation, strategic and compliance risk under Pillar 2 risk assessment. In addition, to those risks

identified, contagion risk, model risk, cyber security risk, conduct risk etc... are at the top of the list as emerging risks. While the banks have to be prepared to face new risks at any point in time, they are required to manage the new risks as their strategic priorities due to the fact that those risks can have alarming consequences. Risk function of the HNB has witnessed continuous and consistently improving trend in its capabilities and processes in managing ever-evolving risks

Way Forward

Whilst implementing a framework of robust risk management practices and rolling out dynamic tools, the Bank recognised the importance of sustaining such improvements over the medium to long term. To address these developments, the practice that would be followed will encompass continuous monitoring and improvements to these initiatives. Keeping abreast of fast-paced changes and staying robust at times of challenge would be the key focus. Few initiatives that have been planned to be accomplished during challenging times and to further improve the risk management capabilities and architecture of the Bank are elaborated below.

Initiative	Key Result Area
<ul style="list-style-type: none"> Strengthen credit underwriting standards 	<ul style="list-style-type: none"> Improved assessment and appraisal of credit proposals focusing on quality credit. Early identification of acceptable and successfully bankable propositions would help growing “relationships beyond transactions”.
<ul style="list-style-type: none"> Strengthen forward looking credit risk assessment by validating and recalibrating Internal Risk Rating (IRR) system 	<ul style="list-style-type: none"> Comparability for better risk underwriting and pricing for risk. Thus, would be able to benchmark credit risk Strong IRR mechanism linked with credit delegated authority structure will provide improved turn-around times as obligors rated less riskier can get approved at lower level committees. Emphasis on spending more time on assessment of more riskier credit proposals.
<ul style="list-style-type: none"> Improve quality of credit appraisals by introducing more concise, focused, sharper and comprehensive credit appraisal formats by improving/implementing a robust Loan Originating System (LOS) 	<ul style="list-style-type: none"> Sharper credit assessments Shorter turn-around times Standardisation Embrace machine learning for decision making
<ul style="list-style-type: none"> Centralise security documents management-security repository project 	<ul style="list-style-type: none"> Ensure security documents that the Bank obtains from customers who availed for credit facilities are watertight, so that the Bank has the comfort of execution in case of need. The project will look at all the existing files for deficient or incomplete documents and also implement a process to ensure all new files created are checked for completeness and accuracy before the funds are disbursed. Storing and retrieval will be more streamlined with state-of-the art bar coding system.
<ul style="list-style-type: none"> Introduce non- judgemental scorecards to underwrite Personal Financial Solutions (PFS) 	<ul style="list-style-type: none"> Improved standardisation in credit decision making Incorporation of machine learning to decision making process Better management of portfolio risk-return matrix
<ul style="list-style-type: none"> Strengthen collection and recoveries by establishing a centralised collection function 	<ul style="list-style-type: none"> Improved collections and reduced overdue through a sophisticated IT system. Improved time allocation for quality business acquisitions
<ul style="list-style-type: none"> Strengthen and align management of information and cyber security to the mainstream risk management function 	<ul style="list-style-type: none"> Management of information security risk is within the purview of Chief Risk Officer Implementation of cyber security risk management policy and Information security risk management policy. Strengthen the awareness culture and ability to proactively manage threats.
<ul style="list-style-type: none"> Strengthen the processes related to verification of immovable collateral and its valuation 	<ul style="list-style-type: none"> Strengthen the existing valuation verification process where a refined process is introduced to ensure a Bank officer is visiting and appraising the property objectively prior to disbursing facilities.
<ul style="list-style-type: none"> Incorporate impairment and Basel III specifications to Internal Capital Adequacy Process (ICAAP) of the Bank. 	<ul style="list-style-type: none"> Ability to proactively ascertain a comprehensive view of additional capital requirement.

Credit Risk

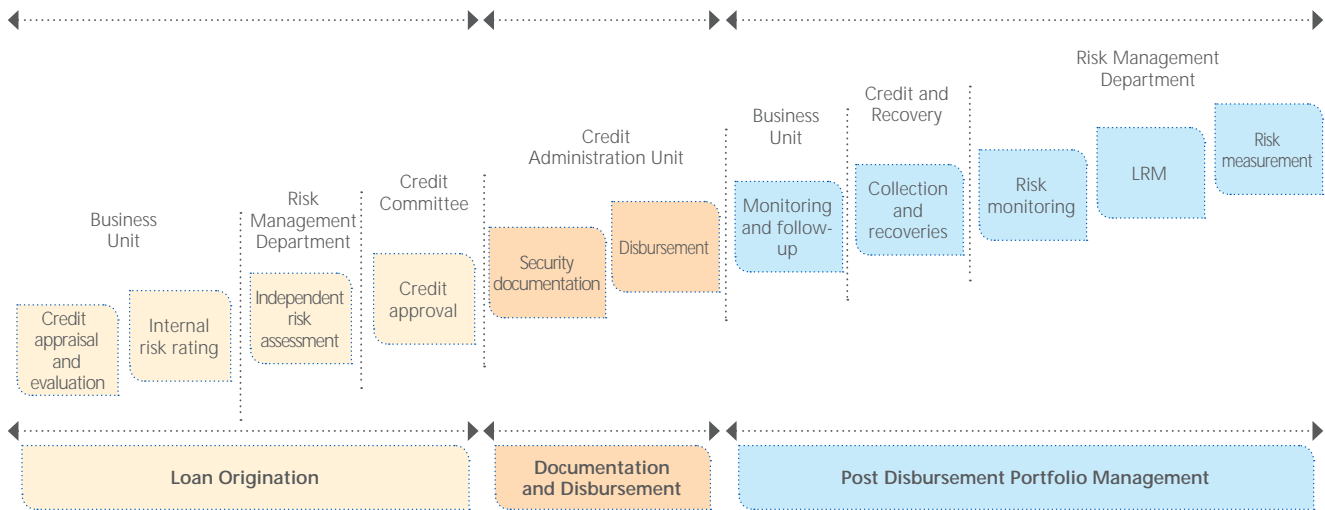
This is the risk of financial loss arising from the inability or failure of a borrower or counterparty to fulfil its contractual obligations. Credit risk consists of more than 80% of the risks undertaken by the Bank. Hence, it is more important than market risk, as our focus is much on traditional lending and credit and less on capital market activity. Basic concept of measuring credit risk is based on Probability of Default (PD), expected losses, Loss Given Default (LGD)

and recovery rates. The Bank makes an enormous effort in practical implementation of these concepts, estimation and measurement to ensure proactive credit risk management.

The Bank has continuously strengthened the monitoring mechanism of the credit risk to ensure regular, more frequent review of loans and advance portfolio. This would help the Bank to understand any emerging risk trends, aligning credit risk appetite to its business strategy, whilst promoting

risk based business decision making. With the new system implementation to tackle overdue collections, the Bank is expected to improve the efficiency of the collection process especially from the customers in financial difficulty. Further, the Bank will continue to focus on improvements to data sources, and models/analytics to improve the group's portfolio risk management activity, risk measurement and thereby risk-adjusted returns. Further, the Bank is also keen on improving internal risk measurement models as well as the current processes as part of

Risk Management



the internal capital adequacy assessment process (ICAAP) by way of introducing new initiatives to monitor credit concentration and residual credit risks of the loans and advance book of the Bank.

Loan Origination

Collective involvement of business units, risk management division and credit approving committees complete the loan origination process of the Bank. Respective business units carry out initial credit appraisal and evaluation of the borrower covering a detailed assessment of the borrower's financial performance and capacity to repay the contractual obligations, as per the lending guidelines of the Bank. Further, business units clearly indicate the purpose of the facility. It is the duty of business units to pursue new business opportunities while not compromising the credit quality. Obligor credit quality is estimated prior to submitting credit proposals for approval via an evolving IRR system. IRR system takes in to account obligor's financial indicators, management quality, market/business position and operating environment and the state of the industry sector in which the borrower operates. Credit proposals are then subject to an independent risk assessment by the risk management unit of the Bank, for facilities above a specified threshold, prior to those have been approved by the final approving authorities. All retail loans i.e. personal loans, credit cards, housing loans and leases are processed centrally by a

separate unit, Centre of Excellence, where staff have specialised in assessment and appraisal of personal financial products.

The Bank has reformulated its credit approval process where risk department is now in advisory capacity instead of approving credit facilities. This allows the risk officer to provide an independent opinion of the credit proposal. In HNB, credit approving committees sanction the credit, and comments and recommendations made by the risk division supports to make an informed decision. However, in an event the risk department does not support a credit proposal, it will reach the next level of approval authority for a decision.

Security Documentation and Disbursement

Execution of security documents is an important part in the credit activity chain. Prior to disbursement of a package of credit facilities, security documents are generally completed. The Bank is moving towards centralisation of security documentation process in order to ensure completeness and accuracy. This function was historically been decentralised, given the wide spread customer service locations and the practice of completion of security documentation had significant differences from place to place. Nevertheless, with the process initiated for centralisation of security documentation, it will allow the Bank to standardise the existing practice over time. Centralised checking, validation and

confirmation of authenticity of security documents will ensure accuracy and completeness. The new initiative, whilst rectifying deficiencies in existing security documents, will also ensure new facilities are not disbursed without submission and execution of necessary documents. Further, the new initiative will optimise storing, protection, retrieval and management of security documents as well through a user friendly state-of-the art document management system and an outsourcing strategy.

Similarly disbursement of facilities post completion of security documentation is also being centralised. This function ensures that a correct limit is marked in the system at an accurate interest rate for draw down by the customer.

Centralised security documentation and loan disbursement units work closely to ensure service delivery is seamless and not adversely affected. The envisaged transformation of these functions emphasising division of responsibility and process changes will bring in host of benefits to the Bank whilst significantly elevating the robustness of processes. Some of the key benefits are;

- "Segregation of duties" of security documents preparation/execution and checking accuracy/completeness -
- Robust and "structured tracking/follow-up of incomplete documents" .

- “Optimise management and retrieval through digitalization” - Outsourced storing and barcoding each document (Phase II – Scanning and make available a digital copy of each security document.)
- Centralised disbursement unit will ensure “approval conditions are adhered to” prior to disbursement of funds.
- Branch staff released from operations work for business activities supporting Bank’s overall business strategy.
- “Minimise /eliminate income leakage” via assured recovery of fees/charges and implementation of structured mechanism to revise interest rates as per approved terms.
- “Strengthen valuation verification process “ to ensure that in addition to a formal report from a member of the panel of valuers, Bank staff will visit the property to get a reasonable assessment of the resale ability of the property.
- “Build a repository of property valuation reports “ with a view to facilitating comparability of property values to avoid deception on inflated valuations during the loan appraisal phase.

Duties of loan origination and disbursement are segregated by ensuring credit administration unit functions independent to business lines. The new initiative commenced mid-year successfully and transformed the activities of corporate banking division, which accounts for 40-45% of the advances book, to centralised operation. This project is in the process of being rolled out to all the regions systematically so that centre will take over all security documentation, loan disbursements and credit operations eventually. This will ensure proper interest rates are fed into the system, contain income leakage due to non recovery of fees and charges and unhealthy credit practices. This initiative will also ensure approval conditions and covenants are captured and tracked in a structured manner.

Post Disbursement Portfolio Management

It is of paramount importance that the business units closely monitor credit granted to ensure that funds are utilised for the purpose of what they are approved for. Further, business units keep a track of utilisation of facilities granted and monitors that the debt is serviced on regular basis. Identifying problematic loans is also a part of business unit’s responsibility. However, in order to enhance the level of independent monitoring, the Bank has been more focused in strengthening portfolio risk management within the risk management division. Such independent function would help the Bank building a quality loan book by identifying and treating weaker credits early.

Management of Large Exposures

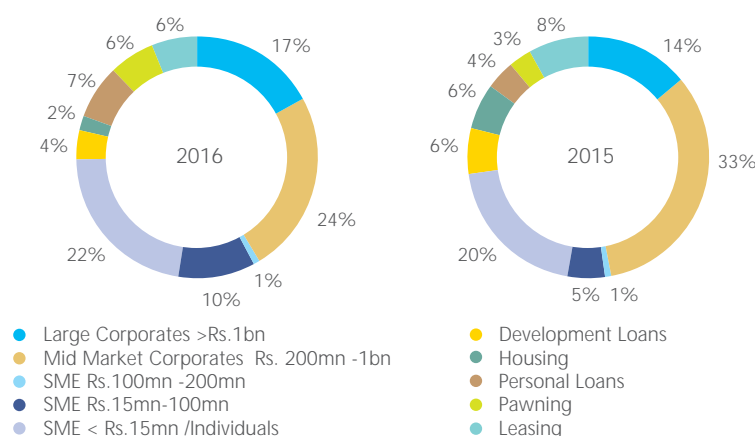
In normal circumstances, capital bases are not designed to protect the Bank from losses arising due to significant/sizable exposures to single borrowers, as the underlying assumption of risk based capital is that, the Bank maintains an infinitely granular portfolio. However, in contrary, concentration risk cannot be eliminated from the portfolio, though it is negated through an additional capital buffer allocated under Pillar 2 calculation. Thus, the Bank takes an extra effort in closely monitoring large borrower exposures and aggregate exposure limits to manage risks. It also ensures compliance to regulatory thresholds as well. The Bank has established internal risk limits for 20 largest exposures,

limits on lending to government and limits on single industry concentration etc... These large exposures are closely monitored and corrective action is being taken to manage any adverse conditions proactively. Performance of these large exposures is submitted to the Board of Directors and subcommittees via credit risk dashboard on a monthly basis.

Management of Off-shore Exposures - Country Risk

HNB has extended its lending beyond borders. Currently the Bank has exposures in Maldives, Cambodia, Bangladesh and Uganda. Given the complexities, the Bank is keen on identifying and analysing the underlying risks of international lending. As such, credit approval process for such lending involves comprehensive analysis of macroeconomic environment (PESTEL analysis) of the respective counterparties. Further, sovereign risk, currency risk, and transfer risk are also looked at in detail. Country risk of counterparties is closely monitored and a detailed independent analysis of country risks is presented to BIRMC by risk management unit bi-annually. Further, those countries have been visited by a team of bank officials at least once a year in order to gauge operating conditions on the ground. The Bank has established country limits and risk management unit reviews those limits annually. Country limits are linked to core capital of the Bank, taking in to account series of risk indicators including economic, political, technical, and sovereign ratings given by International rating agencies.

Exposure by Counterparties



During the year 2016 counterparties by exposures were further refined

Risk Management

Risk Monitoring - Sensing “Early Warning Signals” and Robust “Watch-Listing”

One of the key activities of post disbursement monitoring unit is identifying the deteriorating credits early enough so that either it can be rehabilitated or the Bank can make a minimal-loss exit. Risk management division closely monitors Bank’s credit risk by using different portfolio risk management tools and techniques. Credit monitoring unit of the division, identifies problem loans through the early warning signals stemming from respective portfolios. EWS report captures customers with repeated warning indicators defined by the Bank. Findings are being discussed with business units to arrest the situation during early stages of the problem to safeguard the Bank’s interests. If the adverse situation persists, it is important that management be informed on potential deterioration of the credit worthiness of the loan book. In order to facilitate closer monitoring of weaker credit, a “watch List” report is prepared with customers indicating severe warning signals and submitted to BCC and BIRMC for their review.

Loan Review Mechanism (LRM)

The Bank has strengthened the review of the loan book by constantly evaluating the quality of loans granted by establishing LRM to highlight qualitative improvements in credit evaluation and administration processes. Further, LRM process provides insights on credit administration, including credit sanction process, risk evaluation and post-sanction follow-up. Credit review consists of reviewing credit files and any other associated documentation available on a transaction-by-transaction basis to form a view on credit, based on the individual reviewing officer’s judgement and ability.

Credit review is undertaken to:

- Provide additional assurance to the risk management committee and the Board of Directors that regulatory and internal obligations are being met in terms of credit management.

- Provide insights to management to improve, operational efficiency and effectiveness of the credit process.
- Confirm and maintain the continuing effectiveness of HNB’s credit policies, procedures and processes;
- Assess the adequacy of management control systems in appraising and monitoring credit.
- Determine the soundness of existing and potential customer/group credit exposures.

Risk Measurements

Credit risk is measured in line with the Basel II Pillar I standardised approach and the Bank allocates considerable amount of capital under credit risk. Coupled with Pillar 2 requirements the Bank has a comprehensive risk measurement criteria for credit risk. Whilst regulatory prescription provides for risk weighted assets estimations and capital allocation, the Bank uses different credit risk measurement tools to capture uncovered and underestimated risks. Main risk measures used by the Bank in Pillar 2 are credit concentration risk and residual risk assessment. Concentration of exposures in credit portfolios is an important aspect of credit risk and it could result due to either name, geography, product, sector or maturity concentration. It implies less than perfect granularity of the portfolio and possibility of too many defaults happening at the same time if a trigger event occurs. The Bank follows the normalised Herfindahl-

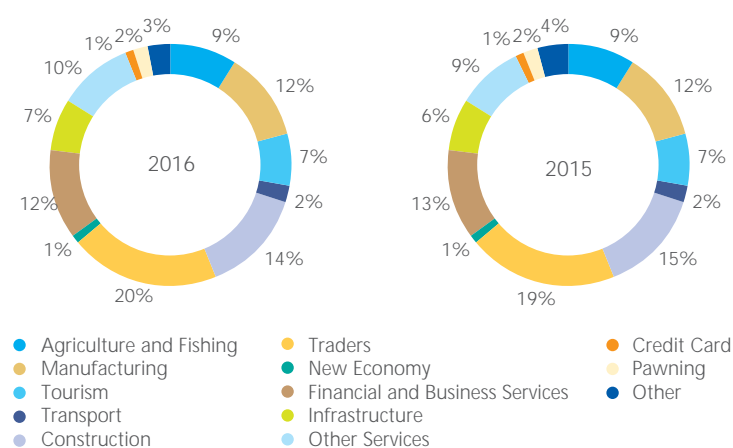
Hirschman Index (HHI) method to capture the concentration in the portfolio. This approach quantifies the additional capital requirement, which is stemming from concentration in loan portfolio.

The Bank’s concentration is mainly in to trading, construction, manufacturing, financial and business services. The Bank maintains healthy proportion among main sectors. However, the Bank continuously conduct stress testing exercises and scenario analysis to understand any emerging trends in market and contain lending to worrying industries accordingly.

Term loans account for nearly 60% of the total loan book and overdrafts contribute to 15%. The product concentration of the loan book remain almost similar compared to the last year. HNB has continuously been focused on lending to large and mid-corporate constituents and PFS has now increasingly become a new trend. With the rebranding strategy of the Bank, more emphasis will be given to retail and SME business segments promoting PFS and retail facilities.

Extended geographical reach of HNB network had always been an added advantage in reaching its prospective customers. Nevertheless, western province occupies the highest volume of lending and the balance is proportionately distributed among all other regions. Lending portfolio of the Bank is not restricted to domestic environment. Exposures based on geography are closely monitored by risk department to

Industry-wise Exposure



ensure reasonably proportionate distribution of credit based on GDP of respective regions.

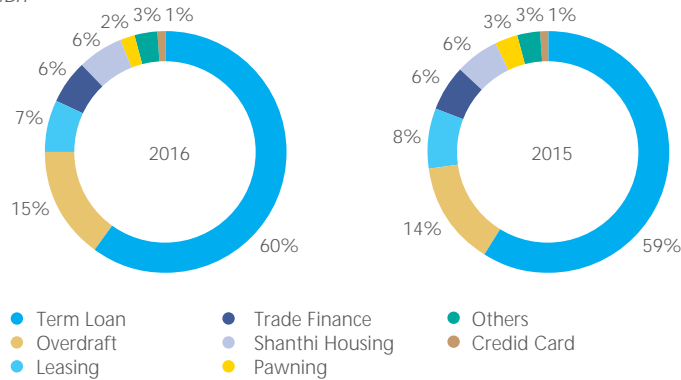
Pillar I credit risk capital charge is computed based on overall default rate in each asset class. However, actual default rates in different business segments are varied from overall default rate in each asset class due to limitations in classifying asset class with different external rating. Hence, the Bank adopts an IRR based approach to calculate the residual credit risk arising from actual default rate. The Bank uses business unit's Individual Probability of Default (PD) rates and business segment Loss Given Default (LGD) as a proxy.

In addition to the qualitative risk measurements, the Bank regularly monitors the loans and advance book in different dimensions. However, the Bank is also mindful of the environment within which it operates with a significant proportion of SME constituents. Therefore, it always optimises the risk return formula attracting a diverse mix of customers carrying varying degree of ratings. Approximately 60% of the corporate portfolio is rated A and above compared to 55% of the corporate portfolio in similar rating category a year ago.

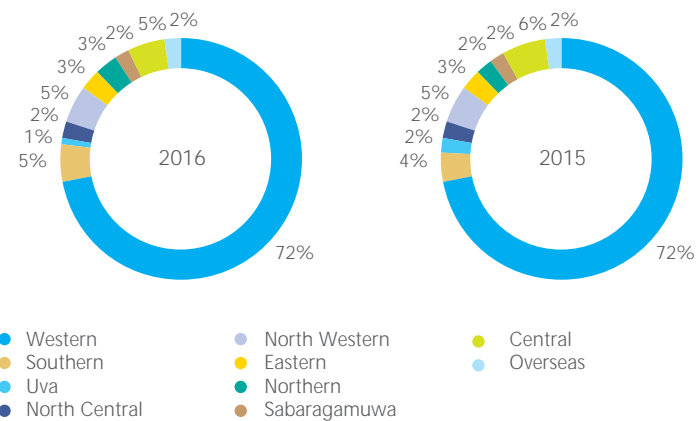
The default risk is being arrested by requesting for collateral as a fall back option when granting loans where risk is assessed to be higher. Different collateral types would provide a range of foreseeable values at the asset realisation time in an event of a default. These security types vary from cash, gold, properties and other securities.

Portfolio by Productwise

Rs. Bn

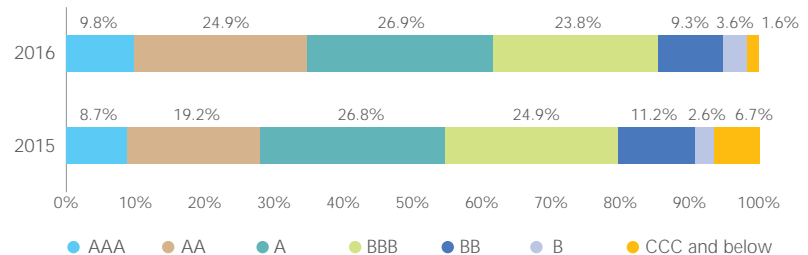


Geographical Distribution



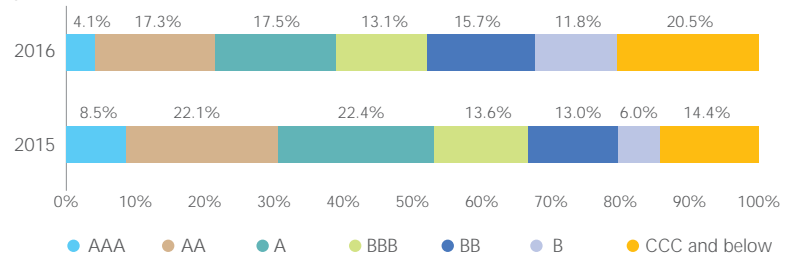
Corporate Portfolio based on Internal Risk Rating

Rs. Mn



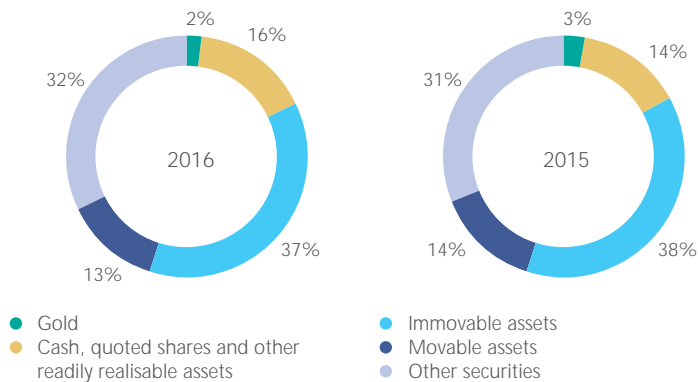
SME Portfolio based on Internal Risk Rating

Rs. Mn

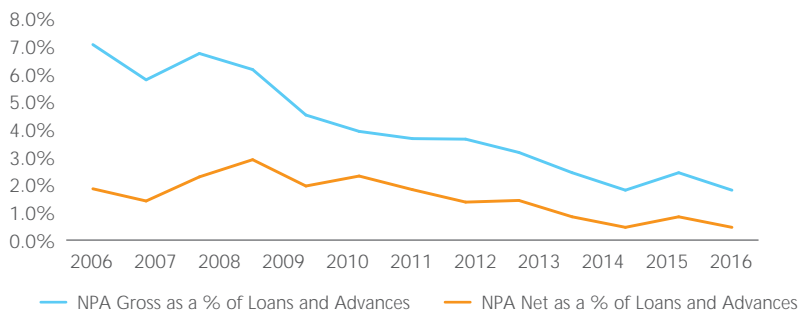


Risk Management

Main Types of Collateral



Non Performing Advances 2006-2016



Managing Non Performing Advances

While the Bank maintains Rs 594.4 Bn of a loan book yet, its gross NPA ratio remain as low as 1.8%. Quantitative credit risk parameters of the Bank have shown a notable improvement during the year. Provision cover has improved to 74.4%, by 14% compared to last year, and maintain well above the industry average. Improved credit quality, strengthened credit appraisal mechanism, rigorous monitoring and strong recovery effort have been the key contributors in managing lower NPAs. Bank's NPA has been on a declining trend over the last decade, which is a testimony of effectiveness of processes adopted to manage credit risks.

Operational Risk

As the size and the structural complexity increases, risks that the Bank faces have been ever challenging. Tightening of regulatory scrutiny has increased weight on Operational Risk Management (ORM) in banking institutions. Operational losses directly impact the income statement of the bank and significant operational lapses are punished by the equity market by dragging its share price down. Well-defined ORM framework could lead to substantial financial benefits by reducing capital requirement and reduction in operational losses, thereby increasing the profitability and improving the customer experience. Operational risk arises when there is potential for direct and/or indirect loss resulting from human factors, inadequate or failed internal processes, systems or external events. The Bank adopts a consistent and comprehensive approach customised to HNB's environment in managing operational risks. Inadequate ORM may resulting forgone opportunities as

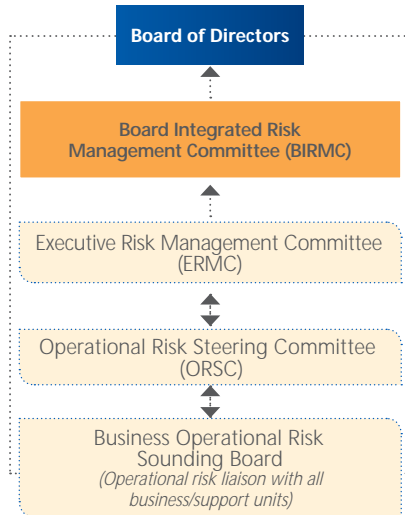
some of the new products launched could come at a higher cost due to lack of process revision or the operational lapses in the existing processes.

Recognising its due importance, operational risk management has been identified as one of the main pillars under bank's new 5-year strategic plan. As a new strategic initiative, the Bank has already taken steps to improve and expand operational risk boundaries to bridge the gaps in existing processes. During the year 2016, the Bank strengthened the ORM framework by Introducing Risk and Control Self-Assessment (RCSA) process to foster a culture of ORM and with the intention of identifying and prioritising the control gaps to ensure a consistently optimal control environment.

A significant leap forward in recognising operational risk by itself is of paramount importance. The Bank has established the Operational Risk Steering Committee (ORSC) chaired by Chief Risk Officer promoting a strong independent governance structure. Among many other outlined responsibilities of the senior management, primary objective of this establishment is to nurture good risk governance within the Bank. ORSC is under the overarching purview of ERMC and risk-based approach is embraced in managing internal controls set within the bank to minimise the operational losses. Key objectives of ORSC of the Bank are to,

- Critically evaluate all residual risks with high and ultra high priority ranking and make suitable recommendations to close control weaknesses/gaps swiftly
- Critically assess top five operational losses of each month and discuss findings of root cause analyses so that improved controls can be rolled across the Bank proactively.
- Highlight potential operational risks and mitigants which should then be included in respective RCSAs
- Discussion on internal control matrices and suitability of existing controls to mitigate identified risks
- Discuss fraud events or attempted fraud events - internal and external and make suitable recommendations to ensure mitigants are in place

Operational Risk Governance Framework



HNB has established a sound ORM framework. Main purposes of setting an ORM framework of the Bank is to achieve following objectives,

- Minimise the losses from operational activities and protect the Bank's assets and maintain stability
- Assist the Board of Directors to articulate and to cascade the Bank's overall risk appetite/tolerance and strategies for managing operational risk.
- Create a culture of risk awareness and ownership through communication and education of risk at every level of the Bank.
- Establish and maintain consistent approach in identifying and assessing of operational risk incidents and loss events
- Support business lines to assess their operational risks which they are exposed via a systematic process of "Risk and Control Self-Assessment" (RCSA).
- Establish a consistent and proactive approach to operational risk reporting via appropriate "Key Risk Indicators" (KRIs)
- Regularly monitor the Bank's operational risk profile and report to management and the Board of Directors.
- Develop escalation procedures applicable across the Bank, allowing management, committees and the Board of Directors to review and challenge key risk issues and assess business unit performance

- Support the effective, comprehensive, independent and on-going review to be provided by the Bank internal audit department in relation to the appropriateness and adequacy of the ORM framework.

Way forward in ORM would be,

- Improve the capturing and modeling of loss data of the Bank based on Basel requirement, to make the better use of data captured
- Risk transfer mechanism to be improved by extending the insurance cover of the Bank including cyber risks
- Refresh KRIs and its governance framework.
- Improve the data integrity by introducing automated systems to reduce the human intervention and thereby focusing on eliminating the risk at source and then implementing control points.
- Enhance risk management controls, tools and reporting. e.g. move into reporting risk heat maps
- Continue to strengthen operational risk infrastructure. Focus would be given to the areas of information technology, financial crime and cyber crime
- Create awareness and encourage all staff to be conversant with "Whistle Blowing" policy, to report any internal frauds, malpractices, misuse of Bank's property etc...

How do we, Identify and Measure Operational Risk

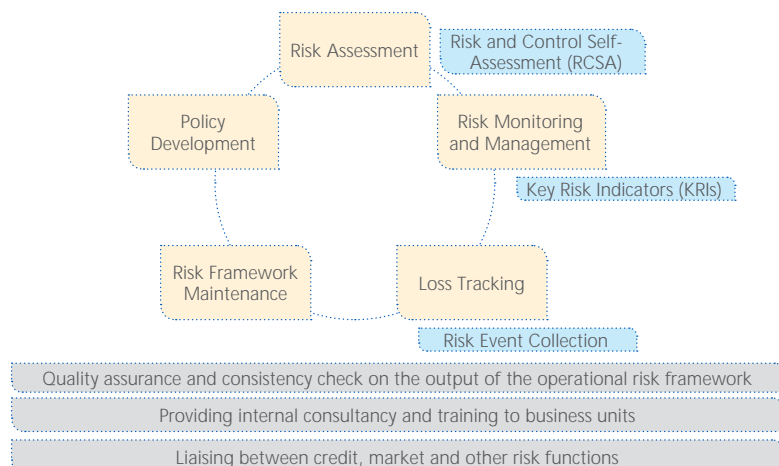
RCSA Process

In addition to all above, RCSA tool would enable the Bank to estimate risk levels uniformly across all units in a single scale. This helps in raising awareness of risks that need immediate attention and prioritises addressing operational weaknesses in a structured manner. Underlying assumption of RCSA is that, people doing business are in the best position to understand their own risks.

RCSA would ensure first line of defense taking more ownership of the risks arising from their own acts. With the implementation of RCSA, the Bank moved in to developing risk matrices at unit level, segment level and at overall Bank level. The key objectives of adopting an RCSA process are to:

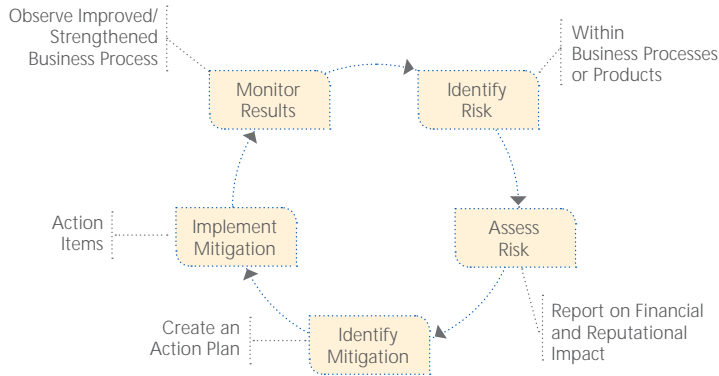
- Identify any possible operational risks which may have a negative impact on HNB, and assess its significance
- Develop a comprehensive operational risk profile for the Bank
- Identify and assess the controls applied to manage operational risks
- Identify potential remediation actions for improvements concerning Key Operational Risks Controls (KORCs)
- Ensure the behaviours and trends of key risks are fully understood and monitored

How do we, identify and measure operational risk



Risk Management

RCSA Process



KRI Process

KRIs are the early warning signs of risk. The KRI setting process focusses on root cause of plausible operational losses that have taken place. KRIs help detection of operational risks before actual failure occurs.

Risk indicators are subject to continuous monitoring and updated according to internal and external, regulatory changes that are taking place. Further, the operational risk management unit is in the process of developing new KRIs and strengthening existing KRIs by identifying suitable trigger thresholds for every business unit some of the indicative KRIs are shown below.

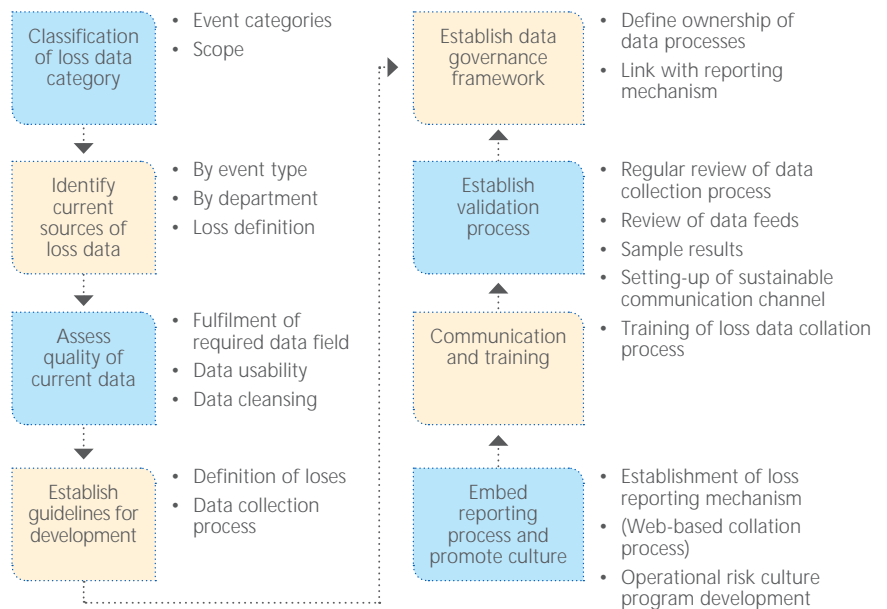
Business / Support Unit	Key Risk Indicators
Audit	Control violations
Card Centre	Skimmed transactions
Credit	Fraudulent title
Documentation	documents
Human Resources	Staff turnover Disciplinary actions
Operations and Systems	Counterfeit notes ATM availability excluding planned downtime. ATM errors Disturbances to systems
Pawning	Fake articles Stolen articles
Treasury	Deleted Deals
Foreign Inward Remittances	Straight through Processed (STP)-Vostro Straight through Processed(STP)-Nostro

Internal Loss Data Capturing and Reporting

Loss data of the Bank indicates the internal losses and "near misses" and document material exposures from all appropriate sub-systems and geographic locations. These losses are categorised based on Basel guidelines on loss classification

The Bank maintains a procedure for assessing the on-going relevance of loss data and make judgemental adjustments, such as mapping business lines to loss category. Further, trend in recovery of operational losses has improved during the year.

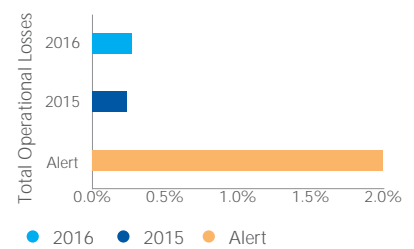
Internal Loss Data Collection



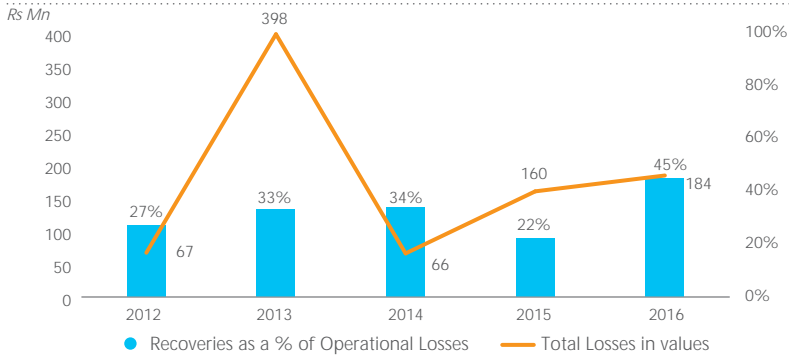
As per the Bank's loss data captured during the year, the highest number of events were reported due to external frauds. Thus, the Bank is of the view that it is important to tighten the process controls subsequent stringent RCSA and reviewing guidelines accordingly. Nevertheless, it is encouraging to note, events that are within the control purview internally has been managed satisfactorily.

The Bank has set an operational loss tolerance limit of 2% of the Bank's gross revenue and reported operational loss events have been maintained well within the tolerance limit.

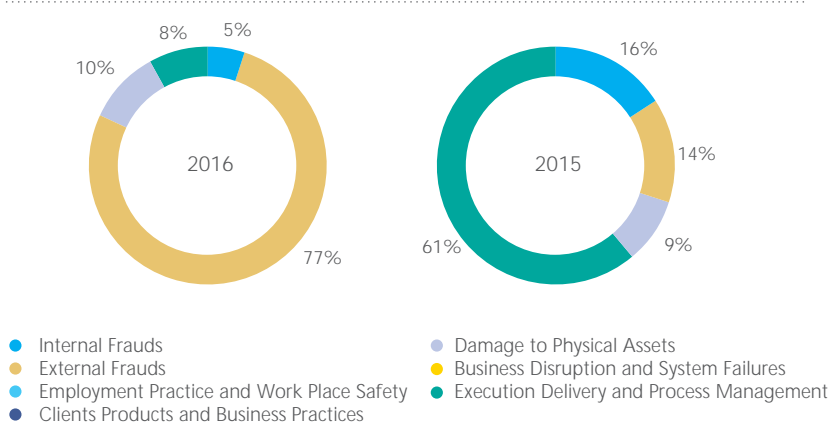
Operational Risk vs. Tolerance 2015-2016



Trend in Operational Losses



Operational Losses According to Incident Type

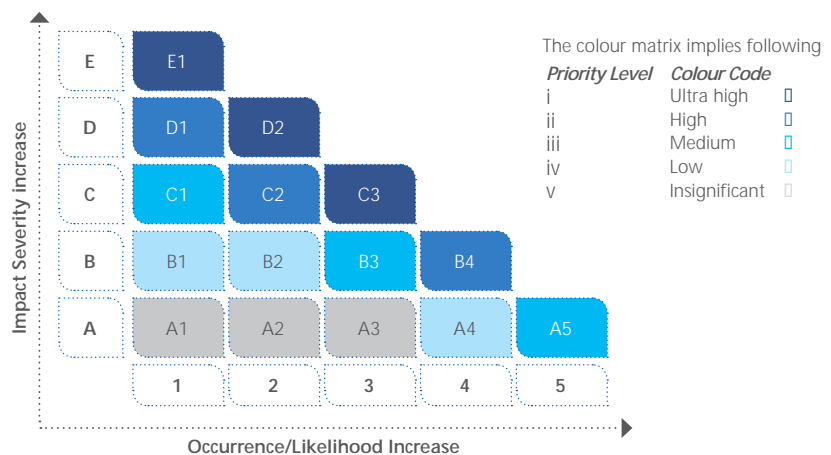


Risk Matrices

The Bank introduced an overall bank risk matrix covering risks stemming from internal and external environment factors that would affect banking operations at strategic level. These risks are assessed based on impact- severity and likelihood of occurrence matrix. Risk matrices provide guidance on understanding of inherent risks and its underlying causes. Residual risk is derived by weighing the adequacy of current controls in place. Outcome of the risk matrix would be to decide whether residual risk is acceptable or require further improvements to applicable controls. Action owners and time lines are assigned based on improvements proposed. The Bank intends to introduce risk matrices to all business units in time to come.

Excellence in ORM

The Bank has a clearly defined risk strategy and a culture that establishes the Bank wide operational risk strategy and tolerance limits. Risk Governance structure within the operational risk vertical of the Bank supports to identify measure, monitor and mitigate

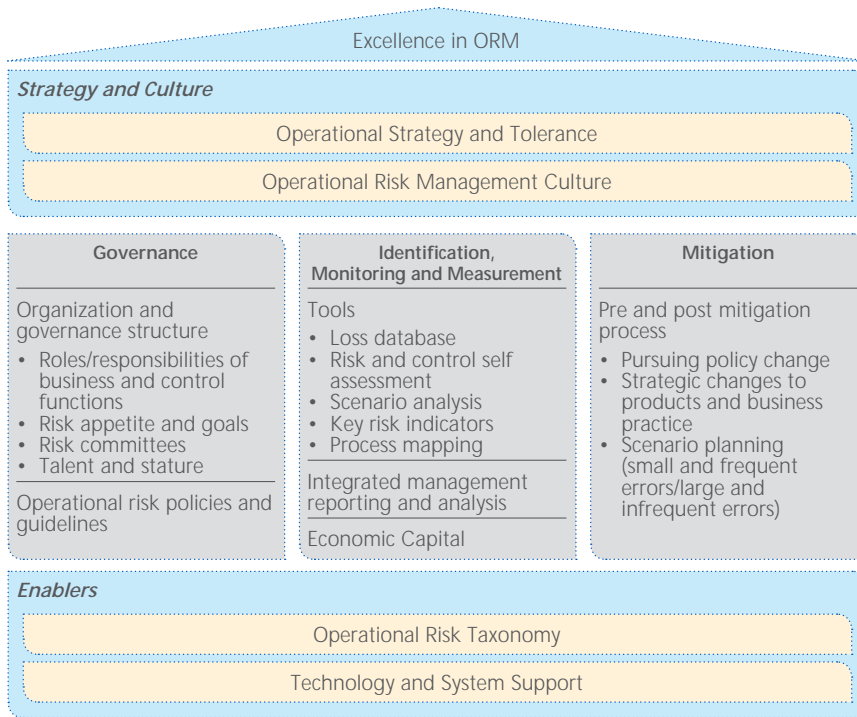


operational risk across the Bank. Duties and responsibilities are clearly defined and individuals/committees are held accountable for the duties assumed. Duties are entrusted with technically sound risk professionals. The framework to achieve operational excellence promotes strong sense of ownership and awareness.

Extensive scenario analysis, loss database, RCSA and KRIs for all business processes are being continuously improved as risk measurement methodologies. Mitigation process includes both prior and post operational risk event analysis. Preventive risk tools of the Bank are, establishing policy and guidelines, making strategic changes in products and business practices. The Bank is expected to focus on conducting risk-culture transformation programs, strengthening internal controls and up skilling the existing talent. Post mitigation would be the ability to quickly respond to operational risk events. Scenario planning would help in assuming the impact of the event and developing appropriate responses to significant loss events.

The Bank promotes a common language for operational risk and controls to ensure an effective ORM framework. Risk policies and guidelines would design appropriate system and technology support. These enablers help the Bank to maintain the consistent approaches for operational risk assessment, aggregation and mitigation.

Risk Management



of low frequency- high severity and high frequency- low severity.

Significant policies in force covering losses arising from under mentioned assets / processes or functions

- Cash and cash equivalents
- Pawned articles
- Premises and other fixed assets
- Public liability
- Computer frauds
- Employee infidelity
- Negligence
- Personal accidents and workmen's compensation

Adequacy and effectiveness of insurance covers are reviewed annually with the assistance of market expertise retained by way of an insurance intermediary. Further, the Bank is having comprehensive discussions in obtaining an insurance policy covering cyber risk.

Business Continuity Plan (BCP)

BCP is a structured way to identify and initiate actions to improve the ability to recover from and better prepare for adverse operating conditions faced by the organisation. The Bank has a well defined BCM policy. Identified Mission Critical Units (MCUs) conduct periodic BCP testing along with a comprehensive IT disaster recovery drill.



BCP and Disaster Recovery (DR) Drill

BCP of the Bank focuses on two main areas, i.e. systems and processes. The Bank ensures regular testing on call - tree activation, backup site readiness, shared devices, backup restoration and recovery of data for daily transactions, retrieval of vital records,

and Recovery Time Objectives (RTO) and overall system of the Bank.

The IT department of the Bank has classified all systems of the Bank to a multi-tiered list and conduct disaster recovery drills of systems identified as critical i.e. Tier 1, on quarterly basis to ensure main systems that support banking operations/network are smoothly transferred to disaster recovery server/location and the Bank could operate under DR server without any disturbance. Other critical processes such as treasury and centralised operations too undergo similar DR drills on regular intervals at least once a year. Such drills are subject to an independent validation by internal audit department with their observations. Learning and improvements to disaster recovery activities are ratified by the BIRMC.

Insurance

Insurance plays a key role as an operational risk mitigating approach in banking context due to the financial impact that any single event could trigger. The Bank has a comprehensive insurance coverage to safeguard the Bank's bottom line against possible operational loss events, which are

Outsourcing

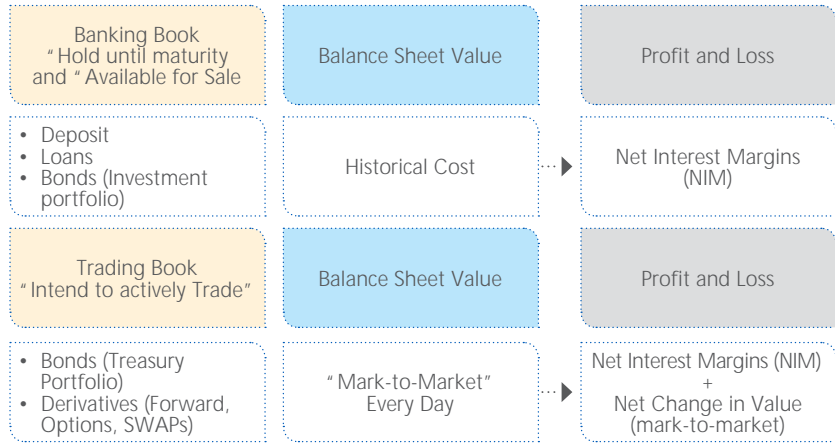
This is an agreement between the Bank and an external 'Service Provider' whereby the service provider performs an activity, functions or processes connected with the operations of the Bank. The Bank has a well-defined policy and guideline on outsourcing functions and it is within the purview of compliance division of the Bank. Archival of documents, ATM cash management and cash transport and selected recovery functions are some of the outsourcing activities of the Bank. A comprehensive report on all such outsourced activities is periodically submitted to CBSL for their review. The Bank conducts a detail KYC and due diligence tests prior to selecting a new service provider or renewing an existing contract, which fully assesses the AML/CFT risks associated with the relevant outsourcing arrangement.

Market Risk

Market risk is the risk of loss that arises due to the value of 'On' or 'Off' Balance Sheet positions adversely affecting the price movements in the market. The loss could occur due to changes in equity prices, interest rates, credit spreads, foreign-exchange rates, commodity prices, and other indicators of which values are set in a public market. Internationally active banks have significant exposure to foreign exchange risk trading and financial instruments in the foreign exchange markets, while many local banks are active in the foreign exchange market with limited transactions to provide services to their clients. We at HNB identify complexity of the financial market and its relevance to Sri Lankan market place. Accordingly, control mechanisms have been put in place to ensure any losses, arising due to actions of any of the market participants as outlined below, are managed within pre-set parameters.

Price uncertainty allows banks to make profits or could result losses. The aim of managing market risk is not to eradicate it but to understand and quantify it. If it is undertaken diligently, it would allow the bank to generate significant revenue and profits. However, an informed decision could only be made on how acceptable the risk is, after analysing and understanding both upside and downside risks. As there

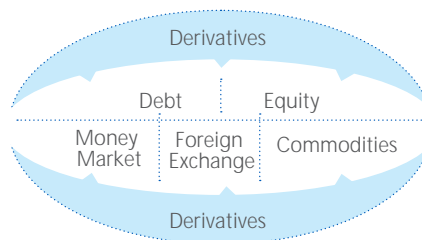
Managing Banking and Trading Book



are many opportunities to make attractive profits, the Bank has invested heavily in research, suitable systems and tools and skills and expertise to predict the future performance of its return on investments.

The Bank enters in to both spot and derivative trading activities. Whilst the Bank trades currencies to meet its customer

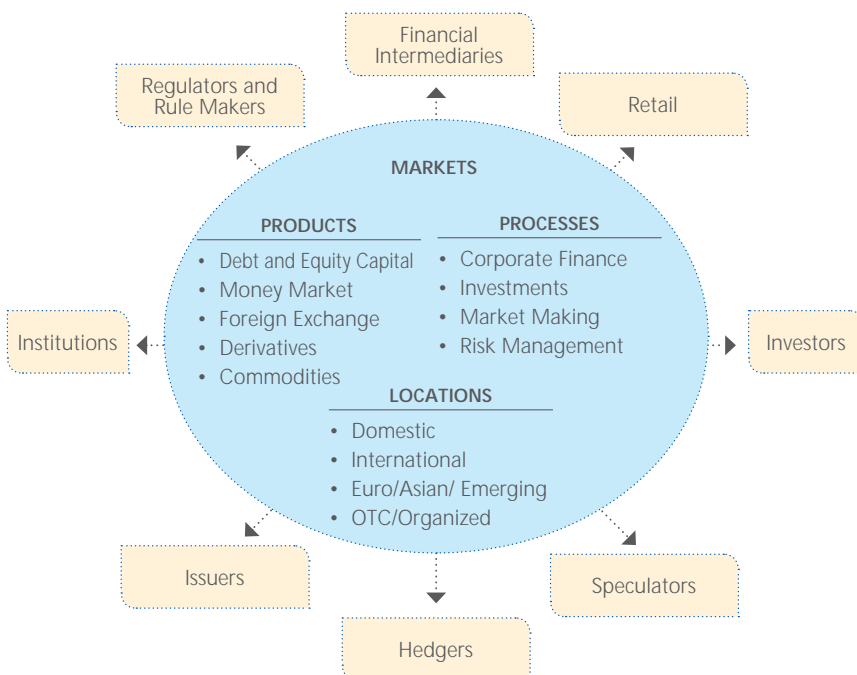
demand, the Bank also takes positions on expected future demand based on an understanding of its own transaction flow. As the Bank has sought to create innovative products for its customers and reduce their trading costs. Derivatives have grown to become a major constituent of trading over the last few years. The Bank uses derivatives in foreign exchange to facilitate customer transactions. Hence, derivatives are an increasing element of risks undertaken in the foreign exchange market, even though it is not yet significant.



At HNB, managing market risk assumes a priority given the size of its assets in the balance sheet. Our approach in managing market risks is structured around key risk types that we focus on closely as stated below;

- Interest rate risk
- Liquidity risk
- Foreign exchange (Fx) risk
- Commodity price risk
- Equity price risk

We observe that, the degree of sophistication and complexity of treasury functions are comparatively low in local context, unlike in developed markets, due to plain-vanilla treasury products available. However, still there are enough risks in this vertical to be managed carefully to avoid losses. Treasury assumes the market risk in the normal course of business Treasury operations play an important role in managing both banking/trading book and asset and liability position of the Bank. Balance sheet valuation and P and L



Risk Management

implications of trading and banking book are indicated above.

The treasury function is segregated in to three areas namely; treasury front office, treasury middle office and treasury back office. Treasury front office assumes risk positions within stipulated guidelines and in line with risk appetite of the Bank on a day-to-day basis. Treasury back office processes, transactions entered in to by the treasury front office according to accepted norms and best practices. Both these operations are monitored independently by Treasury Middle Office (TMO) unit, which is directly reporting to Chief Risk Officer to ensure independence. TMO ensures treasury front office is trading within limits approved by the Board of Directors and provide an objective assessment of front and back office activities. Any exceptions or breaches are immediately highlighted to the management. Regular reconciliation is carried out to ensure completeness and accuracy.

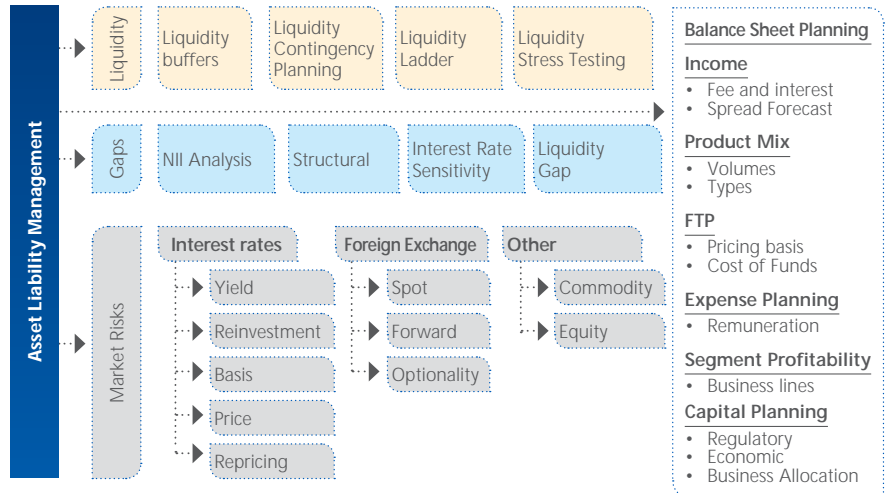
Market risk management is a critical aspect in implementing Asset and Liability Management (ALM) framework of the Bank.

Measurement of Market Risk

Although CBSL directed banks to adopt the standardised measurement approach to derive regulatory capital requirement for market risk it has set out a road map to enable banks to move on to advanced approaches i.e. Internal Model Approach (IMA) as well. In addition to the standardised measurement approach, IMA includes several incremental assessments of risk factors. HNB started computing the capital charge under IMA in parallel since 2013 and noted resulting impact is minimal, specially in view of small trading portfolio which is less than 1% of banking book. However, we will continue to weigh the consequences of value addition and the implementation cost of moving in to IMA.

Banks are in the transforming stage in adopting new tools to measure possible losses associated in market risk, with a focus on redesigning the economic-capital model, the Value-at-Risk (VaR) model, and stress-testing frameworks.

Elements of ALM



HNB TMO uses the VaR statistical model approach to estimate the potential loss from adverse price movements under normal market conditions for currency risks at 99% confidence level. VaR is calculated based on historical simulations and for a "one-day" time horizon. Basel expectation on VaR on capital calculation is depicted below. Even though VaR is a valuable guide to risk, the Bank is aware of its limitations such as the use of historical data as the proxy for estimating future events.

Value at Risk Analysis

The Bank uses VaR, to measure market risk exposure of the Bank's overnight foreign

exchange positions and equity portfolio. VaR of overnight foreign exchange position is calculated by using 10 day VaR, at 99% confidence level and the equity positions of the Bank is reflected through 10 day, 99% confidence VaR measure.

A comprehensive market risk management limit structure is in place and TMO monitors limits online as well as on pre-set time intervals to ensure the Bank operates within set risk appetite and regulatory framework. Any trigger point is escalated to CRO, MD/ CEO or Board of Directors as deemed appropriate.

Market Risk Capital: VaR, Regulatory Capital, and Economic Capital

Description	VaR	Basel II Regulatory Capital	Economic Capital
Percentile	95% (or 99%)	99.9%	Depends on bank's appetite for risk – 99.9% or to 99.98%
Time Horizon	Short term 1 or 10 Days	10 Days	Varies, e.g. 1 year
Conversion of VaR to Capital		VaR (99.9% , 10 days) x multiplication factor (Min of 3 days) including; stress testing incremental capital	Model Annualised VaR Scale daily VaR

HNB's Value at Risk (VaR) Position

	Dec-16 Rs Mn	VaR (99%,1d)	Dec-15 Rs Mn	VaR (99%,1d)
Foreign Currency Risk* (USD net open position)	16.64	0.63%	12.64	0.54%
		VaR (99%,10d)		VaR (99%,10d)
Equity Risk	32.28	4.98%	26.47	4.29%

*Over 98% of the Bank's foreign currency is to the USD

Management of Market Risk

HNB predominantly applies following techniques to manage its market risk.

- Market risk limits – e.g. CBSL imposes NOP limits and internal prudential limits established i.e. room limits, dealer limits,
- Independent monitoring through TMO – e.g. stop loss limits, exceptions reporting etc...

- Mark to Market on daily basis and profit/loss recognition on daily basis by TMO
- Hedging -all possible foreign currency positions are hedged suitably via currency swaps
- Diversification
 - Interest rate risk and liquidity risk are managed by well diversified banking book consisting of

- » Deposits and borrowings
- » Deposit mix of ST/LT (FD, CASA)
- » Diversified deposit base
- » Fixed rates/ floating rates loans

Market Risk Limits

Treasury Activity Limits		
Limit Description	Target Risk Area	Effectiveness
FCY Borrowings	Governs the maximum percentage of foreign currency borrowings limiting undue exposures that could arise from liquidity mismatches and exchange rate risk.	Currently governed by statutory limit of 15% of capital base for DBU
SWAP Ratio	Governs the maximum percentage of foreign currency deposits convertible to LKR.	Monitored daily, any breach escalated for appropriate covering approval and informed to treasury department for corrective action
Cap on inter-bank " Call " borrowing	Limits the Bank's exposure to adverse fluctuations in inter-bank call money rates	
Transaction/Dealer Limits		
Limit Description	Target Risk Area	Effectiveness
Stop-Loss Limit (Single deal/ daily/ monthly)	Restricts the extent of loss per single trading transaction/ loss on a particular day/ loss on a monthly basis	Monitored on daily basis

Interest Rate Risk (IRR)

Interest rate risk is the exposure of the bank's current or future earnings and capital to adverse interest rate changes. Interest rate fluctuations affect earnings by changing net interest income and other interest-sensitive income and expense levels. Interest rate risk has many components, including re-pricing risk, basis risk, yield curve risk, option risk and price risk.

Managing IRR in a prudent manner is essential for the safety and soundness of the bank. Primary reason for IRR is, the differences in timing of re-pricing of bank assets, liabilities and Off-Balance Sheet (OBS) instruments. Another reason is due to basis risk, i.e. adjustment of the rates earned and paid on imperfectly correlated yet otherwise similar re-pricing characteristics. The moment interest rates fluctuate, it results a change in cash flows and earnings spread between assets, liabilities and OBS instruments of similar maturities or re-pricing frequencies. The Bank has established appropriate risk-measurement framework

supported by rigorous monitoring of major holdings and instruments, which are sensitive to rate changes. Exposures vs. Limits on IRR appetite, are reported periodically in order ascertain the status and take corrective action if needed. Further, any exceptions to set guidelines/limits are escalated to various levels based on the severity of the breach. These escalations are independently identified and highlighted by TMO.

Interest Rate Risk in Banking Book (IRRBB)

IRRBB is referred to the risks related to non-traded assets and liabilities such as loan and deposits. It is different to credit risk and relates to the impact interest rate change may have on the value of the loans and deposits and by extension, the overall earnings of the bank. IRRBB arises due to the differences in re-pricing of Rate Sensitive Assets (RSA) and Rate Sensitive Liabilities (RSL), which will have an impact on the future income and expenses produced

by relevant gap positions and an impact on bank's NII compared to the level of NII expected from current interest rate levels. Re-pricing gap analysis would determine the appropriate strategies to manage the asset-liability rate mismatch.

Interest rates could have adverse effects on both the Bank's earnings and its economic value. Hence, gap between the Bank's interest rate sensitive assets and interest rate sensitive liabilities for the different maturity buckets are prepared, to decide on suitable strategies to be adopted based on future interest rate forecasts. The Bank uses modified duration gap approach for analysing the changes in economic value of equity, which requires the mapping of assets and liabilities into different time buckets based on their residual maturity

Such analysis done as at 31-December-2016 is appended below.

Risk Management

Interest Rate Sensitivity Analysis as at 31st December 2016 (in Rs. Mn)

	Up to 1 Month	1-3 Months	3-6 Months	6-12 Months	1-3 Years	3-5 Years	Over 5 Years	Non- Sensitive	Total Rs Mn
Assets and Off Balance Sheet Exposures									
Balances due from Head Office, Affiliates and Own Branches	-	-	-	-	-	-	-	3,772	3,772
Bills of Exchange	1,701	939	174	-	-	-	-	-	2,814
Cash on hand	-	-	-	-	-	-	-	16,643	16,643
Deposits with Central Bank	-	-	-	-	-	-	-	33,778	33,778
Investments (Net of provisions)	13,872	21,799	75,702	2,336	34,627	30,126	7,666	-	186,128
Loans and Advances	272,987	39,514	18,772	32,835	70,357	28,020	13,108	-	475,593
Non-Performing Loans	-	-	-	-	2,091	2,474	9,055	-	13,620
Net Inter-Branch Transactions	-	-	-	-	-	-	-	-	-
Other Assets	-	-	-	-	-	-	-	19,134	19,134
Overdrafts	45,998	6,735	4,622	28,847	-	-	-	-	86,202
Accrued Interest	-	-	-	-	-	-	-	4,320	4,320
Balances due from Other Banks	17	-	-	-	-	-	431	-	448
Fixed Assets	-	-	-	-	-	-	-	12,771	12,771
Reverse Repo	4,208	-	-	-	-	-	-	-	4,208
Total	338,783	68,987	99,270	64,018	107,075	60,620	30,260	90,418	859,431
Liabilities and Off Balance Sheet Exposures									
Balances due to Other Banks	3,298	60,270	20,007	10,920	-	-	-	-	94,495
Bills Payable	1,684	-	-	-	-	-	-	-	1,684
Demand Deposits	-	-	-	-	-	-	-	36,129	36,129
Interest Payable	-	-	-	-	-	-	-	15,100	15,100
Other Liabilities	-	-	-	-	-	-	-	23,661	23,661
Savings Deposits	188,642	-	-	-	-	-	-	-	188,642
Time Deposits	58,731	149,966	72,536	87,845	10,414	4,593	6	-	384,091
Bonds Issued	-	-	-	659	6,757	15,330	2,896	-	25,642
Borrowings	77	196	318	609	1,800	735	498	-	4,233
Capital	-	-	-	-	-	-	-	15,071	15,071
Certificates of Deposits	1	1	4	20	251	-	-	-	277
Repo	8,403	281	4,459	-	-	-	-	-	13,143
Reserves	-	-	-	-	-	-	-	57,263	57,263
Total	260,836	210,714	97,324	100,053	19,222	20,658	3,400	147,224	859,431
Period Gap	77,949	(141,729)	1,946	(36,034)	87,852	39,962	26,860	-	-
Cumulative Gap	77,949	(63,780)	(61,833)	(97,867)	(10,015)	29,947	56,807	-	-
RSA/RSL	1.30	0.33	1.02	0.64	5.57	2.93	8.90	-	-

Notes:

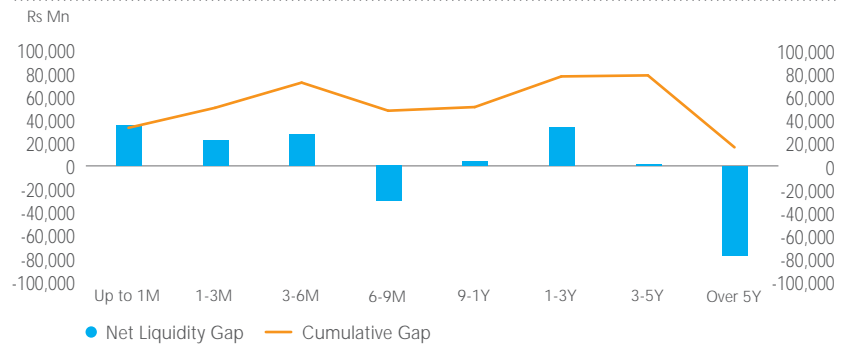
- 1) The above figures have been prepared as per SLAS and may differ from SLFRS figures given in the Statement of Financial Position.
- 2) Prepared as per requirement given in the Banking Act Direction No 7 of 2011 on "Integrated Risk Management Framework".

Liquidity Risk

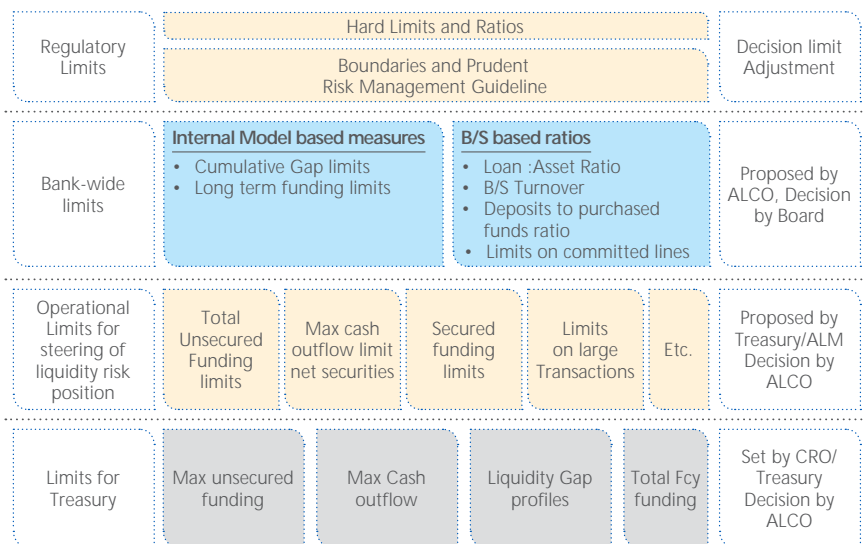
Liquidity risk arises when obligations cannot be met when they fall due or can only be met at an uneconomic price or a given security or asset cannot be traded quickly enough in the market to prevent a loss or make the required profit. The main source of the Bank's funding are capital, core deposits from retail and SME customers, corporate deposits and borrowed funds from interbank money market. In addition to that, the Bank also maintains readily marketable securities to strengthen its liquidity position. Liquidity risk predominantly arises from potential short term cash demands that are placed upon the Bank, by depositors, borrowers, the Bank's own borrowing activity, trading activities and counterparty interactions. The Bank has main liquidity objectives in day-to-day operations i.e. ability to fund deposit withdrawals as depositors redeem their deposits and the ability to fund loan drawdowns when the borrowers need to have access to the lent funds. HNB has addressed its management of liquidity risk through a strong liquidity risk management framework which includes contingency plan with both contracted and un-contracted liquidity positions. Under normal circumstances liquidity could be managed by shifting assets and liabilities, obtaining interbank loans and drawing down credit lines. The Bank prepares liquidity ladders, probabilistic analysis and stress tests to understand the changing liquidity requirement of the Bank. It uses both stock and flow approaches to gauge the real liquidity position.

Some products, with short maturities or on floating rates in highly competitive markets such as the interbank market would get re-priced rapidly. Others, such as fixed/floating rate loans, would re-price at maturity or at a pre-set frequency. Deposits can be fairly rigid or inelastic. The Bank aggregates the

Liquidity Gap analysis of the Bank's Total Assets and Liabilities as at 31st December 2016



Liquidity Risk Management Framework



information from each product line into an assessment of the impact of interest rate changes on the Bank's projected earnings, for a specific period, such as a year and segments within that period, such as a month. For each month, the Bank identifies the gap produced by the re-pricing of the assets and liabilities. The Bank also looks at how the gaps accumulate and ensures cumulative gaps in different maturity buckets are not too large and within pre-set risk appetite limits. ALCO plays a critical and active role in managing liquidity risks of the

Bank. Liquidity gap analysis of the Bank's assets and liability 31-December 2016 is shown above.

The Bank also monitors liquidity gaps based on the behavioral analysis of the Bank's assets and liabilities, such as the behavior of fixed deposit rollovers based on historical rollover patterns, drawdown of unutilised overdrafts and disbursement of approved but undisbursed loans.

A simplified extraction of the liquidity risk limit setting framework is depicted above.

How Do We Measure, Manage and Monitor Funding Liquidity Risk

Funding Plan	Monitoring Liquidity risk	Managing intra-day liquidity risk	Identify Contingent Funding requirement	Managing Regulator
Identify concentration risk in banking book	Establish liquidity policy and appetite	Maintain liquidity buffers	Early warning indicators	Maintaining LCR
Pricing liquidity risk via transfer pricing mechanism within the bank	Monitor intra-day limits and carry out stress testing	Daily clearing and settlement	Conduct liquidity simulations	Reporting on liquidity assets and reserves

Risk Management

HNB manages liquidity risk with regulatory guidelines and international best practices. A Board approved liquidity policy in place to manage liquidity on day-to-day basis whilst a contingency funding plan is available to deal with a crisis situation. Monthly liquidity forecast generated from the ALM system are reviewed at ALCO meetings whilst, extreme events are assessed via stress testing. In a very summarised way, the above table indicates how we measure, monitor and manage funding liquidity risk in the Bank.

Foreign Exchange Risk

The Bank faces foreign exchange risk due to impact on foreign currency inflow and outflow on daily basis. However, currency risk that can be carried through overnight is contained by the regulator through Net Open Position (NOP) limit. With the developments in emerging markets and increasing demand for US Dollar from importers would further depreciate the rupee vale. The Bank generally manages this risk using currency swaps.

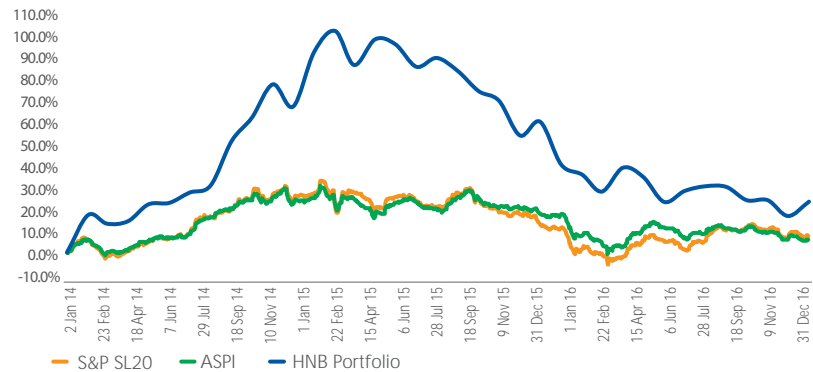
Commodity Price Risk

Commodity risk arises as result of fluctuations in the prices of commodities, which is driven by economic factors affecting demand and supply. The Bank does not deal in commodities and therefore has no direct exposure to commodity risk. However, the risks faced by the Bank would be the credit risk as a result of commercial counterparties not meeting its financial obligations due to adverse impact on commodity price movements. Indirect exposures impacting due to commodity price movements are managed through concentration limits and stringent credit criteria with suitable fall back options to support in an eventuality. Key commodity risk HNB faces are on gold price movements in view of its pawning portfolio. However, risk of losses is contained using suitable and conservative LTVs so that exposure against gold is not excessive.

Equity Price Risk

It is defined as decrease in fair value of equities as a result of changes in the levels of equity indices and the value of individual

Performance of Equity Portfolio and Stock Markets Jan 2014 Jan to Dec 2016



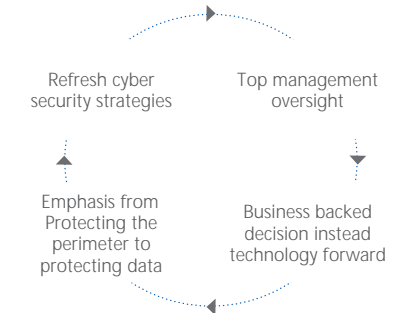
stocks. The extent of the Bank's trading in equities is impacted by the regulator. Equity would become a factor for instability in the Banks' financial health if not managed well. Individual equity risk drivers are, aggregate earning expectations, macro-economic, systemic or political risks affecting earnings, market pricing of industry risk, risk free interest rates, market equity risk premium, aggregate asset volatility, market liquidity and margin cash demands. Equity is a relatively small part of the Bank's trading activities. Such equity investments carried out reflects as more strategic investments than trading investments. Nevertheless, such equity investments are monitored closely and marked-to-market regularly to estimate potential impact of such equities in the Bank's bottom line.

Despite the volatility in the stock market, equity portfolio of HNB continue to generate higher returns over benchmarked returns.

Cyber Risk

This is a destructive and influential risk emerging in the banking industry. In banking business, the next level of innovation and growth will likely involve "one touch" processes without manual intervention. However, success comes with how far banks maintain the trust and confidence of its customers. There is an upward trend in the number and the impact of incidents related to breach of cyber security affecting all types of companies and institutions including banks. Hence, protection against cyber threats has become bank's top strategic priority. Banks heavily depend on software, information technology

Managing Cyber Risk



and systems comprising confidential customer data, loosing of which would lead to loss of customer confidence. However, it is vital that cyber security is integrated in to the business operations and overall risk management framework rather than just as an IT function.

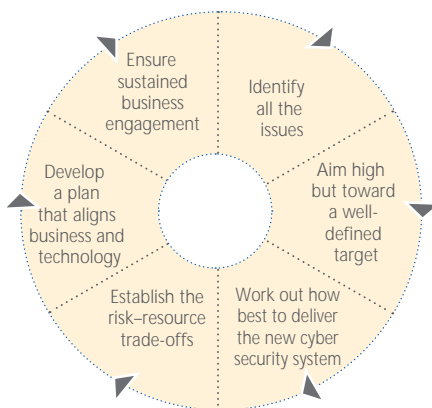
The Bank has taken every step to ensure complete assurance that the Bank would protect every customer's funds and data confidentiality by investing in digital resilience i.e. the ability to design customer applications, business processes, technology architectures, and cyber security defenses with the protection of critical information assets in mind. The Bank is currently in the process of establishing a cyber-security risk unit within Information security vertical under the purview of Chief Risk Officer. The Bank's strategic focus is to manage cyber risk dynamically, by using the four-step process as depicted above which, would help the Bank to sustain its digital resilience.

The Bank has clearly identified key information threats that could threaten the Bank's corporate image. The Bank believes that even a single successful cyber-attack

would have shattering impact on the Bank's financials and reputation, resulting loss of customer confidence. This is where up-to-date information security matters, so the management takes informed decisions in managing security vulnerabilities and threats.

"Hacktivists" attack companies with the motive of carrying out a fraudulent activity or selling valuable information to a competitor or for political or ideological reasons. Thus, HNB has embedded cyber-security in to the existing risk management framework. HNB has become the pioneer banking institution to introduce a comprehensive "Cyber Risk Policy". It covers internal/external threats, recovery process, surveillance, cyber intelligence required and creating awareness among employees as a critical tool for cyber risk mitigation. The Bank has a very clear action plan to uphold its digital resilience as depicted below.

Action Plan for Digital Resilience



The Bank's risk appetite statement has clearly defined the acceptable risk levels stemming from cyber-crimes. Continuous management discussions take place to ensure awareness among top management and take corrective action. HNB believes that mere compliance of cyber-security would not protect its shareholders' wealth as it will not sufficiently identify new and dynamic threats. Thus, the Bank is keen on adopting industry best practices and standards to address unknown vulnerabilities. The Bank conducts comprehensive due diligence

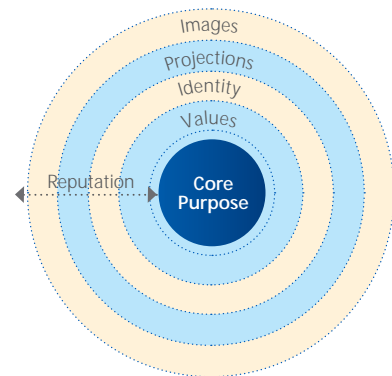
tests and enter in to data confidentiality maintenance agreements with IT vendors and outsourcing suppliers. Further, business continuity is ensured via comprehensive and tested IT disaster recovery plan. Level of readiness to manage cyber risks and progress of on-going initiatives are being presented monthly through a "cyber risk dashboard" to BIRMC.

Strategic Risk

The Bank makes deliberate decisions as to which choices to make to arrive at the highest risk-return trade off whilst understanding the critical bank-wide risks affecting the Bank's ability to reach its strategic objectives. This is only possible through a concerted effort from top management of the Bank. Best decisions would derive considering risk-adjusted return in combination of other factors such as strategic fit and risk diversification. The Bank adopts a scorecard approach to quantify the strategic risk under the Basel II Pillar 2 calculation. HNB as a D-SIB is subject to stringent regulatory supervision and capital requirement under proposed Basel III new Direction No 01 of 2016. Complying Basel III guideline would be extremely challenging. Hence, it is vital that the Bank takes proactive action to mitigate any strategic risks, which could otherwise hinder business performance. The Bank looks at different parameters in assessing its strategic risk, which could have an impact on the Bank's strategic direction. Thus, scorecard focuses on extended of compliance in setting business strategy, planning and implementation, Product and customer segmentation, business impact from macroeconomic environment etc. Every aspect is offered a score, based on the severity impact on the Bank's strategic decision. These scorings are mapped with applicable percentage of Pillar 1 capital charge on the basis that lower the scoring higher the capital requirement would be. HNB believes that prudent and proactive approach in managing strategic risk would deliver results and outperform its peers in many aspects including profitability, market share, customer loyalty, etc...

Reputation Risk

Reputational risk is increasingly becoming more prominent in view of its wide spread nature and inability to quantify. Underlying drivers of reputation risk are violation of ethics and integrity such as fraud, bribery, corruption, non-compliance to regulatory requirements and both physical and cyber security breaches. Thus, the Bank takes every step to safeguard its core values/ purpose. HNB has been truly a "Partner in Progress" to its all stakeholders, without compromising its reputation and corporate image.



The Bank conducts a comprehensive analysis on its reputation risks through a scorecard approach to ascertain the additional capital requirement under Basel II, Pillar 2 calculation. Reputation risk will likely to be increasingly critical in the years to come, it is already treated as a strategic issue, and trend will accelerate. Major factors considered for the assessment of reputation risk include, management integrity, severity of loss events, business process and practices, corporate culture of the HNB and transparency and accountability. Same as in strategic risk scorecard assessment, scoring is given based on severity impact and additional capital will be set aside based on the score achieved during the assessment.

Whilst scorecards attempts to quantify reputational risk in more structured way HNB promotes managing its reputation risk by creating culture of accountability and transparency and improving awareness of possible consequences. There are key focus areas that HNB would emphasise to manage impact of reputational risk.

Risk Management

Our Focus on Reputation Risk Management

- 01 **Drive** - Senior Management, together with the Board, needs to instil and drive the risk culture within the organization and demonstrate the right behavior by example
- 02 **Incentivize** - Encourage employees to guard Bank's reputation
- 03 **Develop an "Outside-In" perspective** - Apply a "reputational lens" to key traditional risk categories
- 04 **Value Reputational Capital** - Review the impact of various reputational issues and communicating this widely across the Bank
- 05 **Monitor Reputation** - Actively listen to main groups of stakeholders on the issues that affect bank's reputation, and learn how to use new tools such as social media to monitor external perceptions more systematically.
- 06 **Create Transparency and Accountability** - Encourage a sense of ownership for the brand among employees, and ensure that information is not "sanitised"
- 07 **Communicate bank's Values** - clear, common understanding about the Bank's values throughout all levels of the organization and measure personal performance against them
- 08 **Plan for the next Crisis** - identifying the right team and processes to address these issues will help Bank to handle a crisis faster and more effectively
- 09 **Multi-Disciplinary Approach** - CRO has expertise in risk management, but must work with business front line and professional experts combining several disciplines
- 10 **Learn from others' Mistakes**

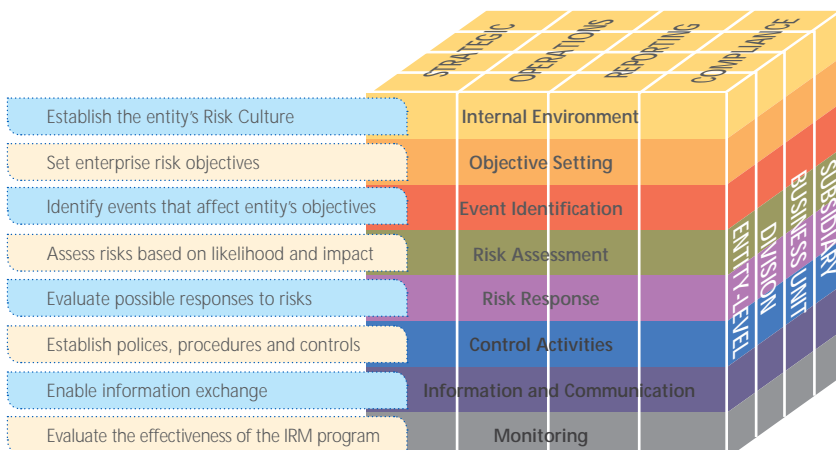
Integrated Risk Management

This is the overarching pillar through amalgamation of all identified risks in banking operations. IRM function of the risk unit facilitates a structured and disciplined approach to aggregated risk management. Further, IRM approach aligns to business strategy, processes, people, technology and knowledge within all risk pillars and integrate in all levels of decision-making. Main scope under IRM pillar is to carry out inter-linked stress tests across risk verticals. It also prepares the comprehensive ICAAP document of the Bank. It will further support development of risk appetite and high-level

risk goals to maintain risks within the Bank's risk appetite.

The establishment of IRM framework adopts its core structure and values from the CoSo framework which is depicted below, ensuring appropriate internal controls are in place to optimize strategic vision of the Bank and risk return formula.

Integrated risk management enables the Bank to pragmatically deal with uncertainty and associated risks and opportunities thus enhancing the brand value and profitability. Integrated risk management helps in identifying, selecting among alternative



risk responses, risk avoidance, reduction, transfer and acceptance. It also helps to ensure effective reporting and compliance with laws and regulations and avoid damage to the entity's reputation and associated consequences.

In summary, IRM framework helps HNB to achieve its business objectives and avoid pitfalls and surprises along the way. The Bank has understood the challenges, various risk domains and risk areas relevant to its business and various risk activities, which need to be carried out to successfully implement an IRM framework.

Internal Capital Adequacy Assessment Process (ICAAP)

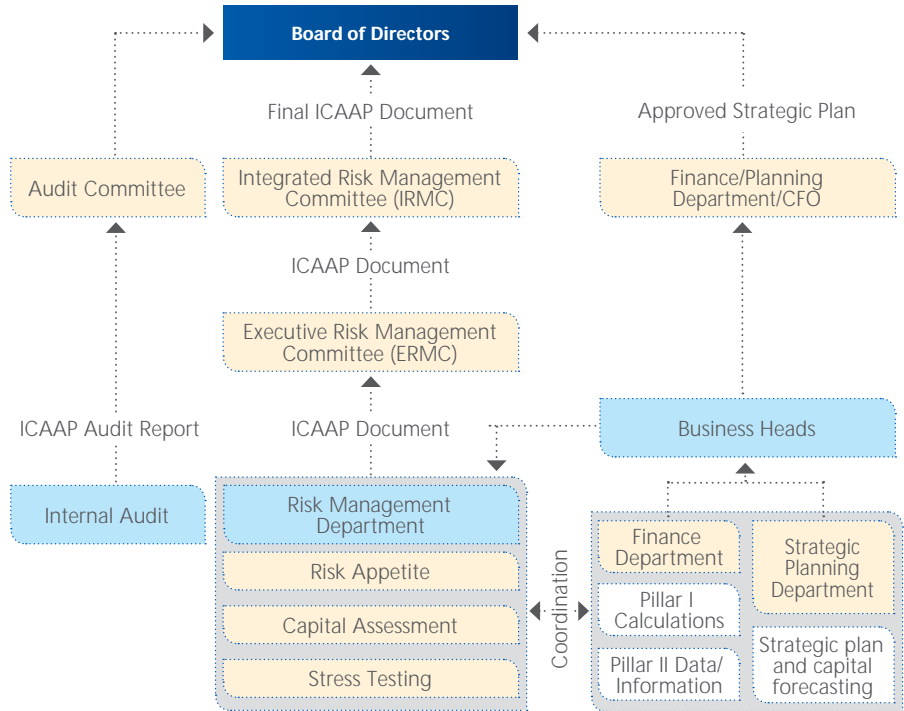
ICAAP demonstrates that the Bank has implemented methods and procedures to capture all material risks and adequate capital is available to cover such risks. CBSL conducts a supervisory review and evaluation process to assess the soundness of bank's ICAAP and advice with appropriate actions that may be required. This document integrates Pillar 1 and Pillar 2 processes of the Bank wherein Pillar 1 deals with regulatory capital whilst Pillar 2 deals with economic capital. Approaches that are available to derive at minimum capital requirement for credit, market and operational risk under Pillar 1 are regulatory. HNB currently reports based on standardised approaches in credit and market risk computation and operational risk related capital is computed based on basic indicator approach. However, the Bank has geared itself along the road maps set to compute capital based on advanced approaches..

As per the direction issued by CBSL, under supervisory review of Basel II CBSL encourages banks to enhance their risk management framework and manage emerging risks in a more proactive manner. This is to ensure that, the Bank maintains adequate capital buffer in case of a crisis. Regulatory capital is well adhered by the bank by maintaining CAR well above the required level of 10%.

CBSL is now focusing more intently on Pillar 2 and ICAAP. Pillar 2 of the Basel II guideline, which directs maintaining an economic capital buffer addressing risks, which did not, capture under Pillar 1. HNB uses a mix of quantitative and qualitative assessment methods to measure Pillar 2 risks. A quantitative assessment approach is used for concentration risk, residual credit risk and Interest rate risk in banking book (IRRBB) whilst qualitative scorecard approach is used to gauge the reputation risk and strategic risk. Risk governance and corporate governance of the Bank is also assessed based on a scorecard approach, though there is no capital allocation is required yet scorecards, provide an indicative level of robustness.

Senior management team is closely involved in formulating risk strategy and governance thereby achieves the Bank's capital planning and corporate objectives. Capital forecasting under Pillar I and Pillar 2 for next three years covering envisaged business projections is covered in the budgeting process. This forward-looking capital planning helps bank to be ready with additional capital requirement in future. Further, the Bank conducts a detailed stress testing to gauge the impact of adverse scenarios on the Bank's CAR as a result of credit and market risk trigger events. Finally, the Bank derives at the overall impact on CAR aggregating stress test results combining most likely scenarios.

HNB ICAAP at a Glance



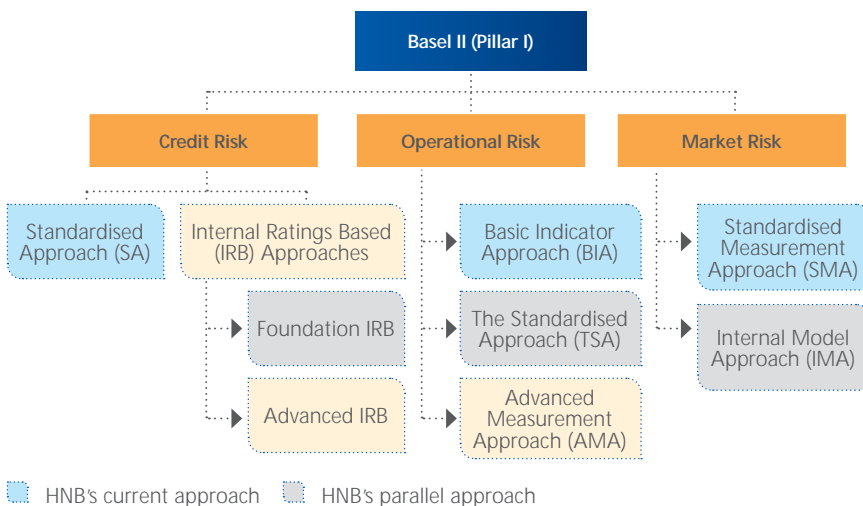
Group Risk

Group risk of HNB is arising from the Bank's subsidiaries and associates in different financial operations. HNB subsidiaries are providing insurance, micro financing, real estate development and an investment banking operations. HNB holds varied stakes in these institutions and the Bank closely monitors the business operations. Aggregating risk of the group companies remains a challenge due to their diverse business models.

Risk management division of each subsidiary submit risk management review reports including key risks identified, mitigant measures, and financial highlights during the preceding month to the BIRMC of the Bank. The Bank is continuously improving the group risk assessment methodology. However, the Bank is confident that group risk mitigated to a larger extent by the following,

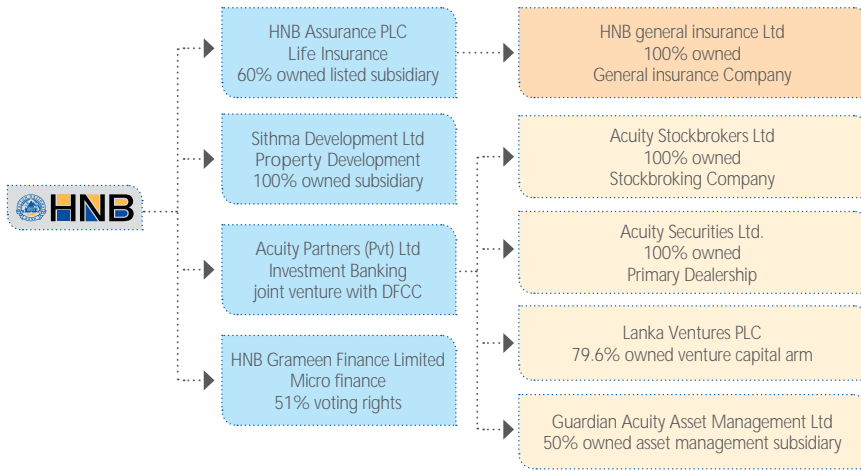
- HNB's capital at risk is limited to amount invested in these companies in the form of equities at the time of companies were incorporated or acquired.

Pillar I: Current Approach Adopted by the Bank



■ HNB's current approach ■ HNB's parallel approach

Risk Management



The governance of the group companies in terms of HNB participation is summarized in the below table.

Name of the Company	Board Representation	Board Composition	Chairman	Board Risk Committee Representation
HNB Assurance PLC	✓	✓	✓	✓
Sithma Development Ltd	✓	✓	✓	✓
Acuity Partners (Pvt) Ltd	✓	✓	✓	✓
HNB Grameen Finance Ltd	✓	✓	✓	✓

- The largest subsidiary HNB Assurance PLC is regulated by SEC and IBSL as well.
- HNB's directors/key management personnel are represented on the Board of Directors, board audit committee, board risk committees of its subsidiaries ensuring full and sufficient knowledge of subsidiaries operations and risk profiles.

HNB risk division provides oversight and independent governance of the effectiveness of risk management in the group companies. It also reviews, challenges and reports on the group's risk profile to ensure that group's risk mitigation activities are appropriate. The process for identifying, measuring and controlling is integrated into HNB's overall framework for risk governance. Group's risks impacting HNB are aggregated to assess capital requirements under ICAAP.

HNB risk division carries out a group risk assessment bi-annually in order to gauge material risks that prevails or foreseen within the group companies.

Stress Testing

Stress testing and scenario analyses have proven to be valuable additions to the traditional risk measures. Stress testing evaluates the Bank's vulnerability to explicitly defined shocks. The Bank has taken steps to be more resistant against future crisis situations. The Bank covers range of stress stressing on different risk aspects such as, increase in the Non-Performing Advances (NPAs) and the respective provisioning, Large borrowers defaulting, negative shift in the NPA categories and hence the increase in respective provisioning, Impact of increase in concentration, foreign exchange risk, liquidity risk, Interest rate risk in banking book etc... Different stress levels are applied for diverse risk areas and at appropriate frequency. The Bank conducts stress testing consist of sensitivity analyses and scenario analyses on individual exposures, portfolios or business units, as well as bank-wide, against mentioned risk types.

Stress Testing Scenarios and Results

Type of Risk	Scenarios	Results
Credit Risk	<ul style="list-style-type: none"> • The increase in the Non-Performing Advances (NPAs) and the respective provisioning • Negative shift in the NPA categories and hence the increase in respective provisioning • Large borrowers Default • Increase in NPA due to fall in FSV of mortgaged collateral 	<ul style="list-style-type: none"> • Stressed CAR derived from different scenarios is well above regulatory capital of 10% in all scenarios except in "worse-case" scenario under top 20 borrower default.
Market Risk	<ul style="list-style-type: none"> • Volatility in the foreign exchange covering USD, LKR and other currencies • Shocks in the local stock/equity market and impact on the Bank's equity portfolio • Impact of Interest rate changes on the Bank's fixed income portfolios • Impact of interest rate changes on the banking book 	<ul style="list-style-type: none"> • Stressed CAR is maintained well above the regulatory CAR of 10% at all times.
Operational Risk	<ul style="list-style-type: none"> • Increase in operational losses at different thresholds based on loss database of the Bank 	<ul style="list-style-type: none"> • Stressed operational losses are well within the board approved alert level of 2% of turnover of the Bank.
Liquidity Risk	<ul style="list-style-type: none"> • Loss of short term liquidity in the local market • Global banking crisis which could affect interbank liquidity • Possible run on deposits 	<ul style="list-style-type: none"> • LAR is maintained above 20% at "Low" and "Moderate" level of shock scenarios and drops below 20% at the "worse-case" shock level, which would be rectified by internally defined funding strategies of the Bank.

Regulatory Environment

HNB strongly believes, the stability of the banking sector is often improved with the existence of an independent regulator with credible and demonstrated enforcement powers and an adherence to standards of effective regulation and supervision. The prime objective of banking regulator is to protect bank depositors and promote a healthy banking system. A strong regulatory environment can promote sound banking practices while taking acceptable risks and thereby foster economic growth and development.

Basel III Readiness

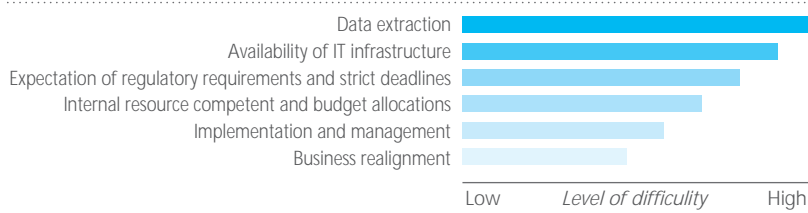
In light of changes that took place in global economic conditions and risk landscape, CBSL has shifted the risk management in banking industry to the next level. Basel III will continue to follow 3-Pillar approach with considerable changes in minimum capital and capital buffer requirement, further improvements in supervisory review process and with additional disclosure requirements under market discipline. Basel III will have significant impact in capital levels of banks, specially HNB being a D-SIB. Key objective of Basel III is to improve quality of core capital. Following are key challenges to achieve technical compliance with the new rules and ratios,

- Maintaining capital conservation buffer
- Possible restrictions on profit distributions in the event of not meeting capital levels defined
- Complications in raising Tier II capital by way of debentures in view of mandatory embedded conversion option triggering debentures converting to common equity – Subject to a pre specified trigger event.
- Business-specific impact - rules on risk-weighted assets (RWAs), liquidity and long-term-funding.

Key Elements of Sound Regulatory Framework

Independence	The bank regulator is free from political or industry influences Laws are clear enough to enable the regulator to impose and enforce standards and rules
Regulatory Standards	Regulatory standards are published and in line with the Basel practices for banking supervision Regulatory standards address licensing, capital, asset quality and liquidity issues
Supervision	The supervisor is active, with frequent, thorough, and on-site inspections The supervisor has sufficient resources and a well-qualified staff
Enforcement	Regulatory standards are strongly and successfully enforced and regulators have sufficient knowledge to enforce wisely
Maturity of Regulatory Framework	The regulatory framework has been adopted more than five years ago and has been successfully implemented by all banks

Challenges in Implementing Basel III Reforms



- Significant impact on Liquidity Coverage Ratio (LCR) – aims to ensure that bank maintains an adequate level of unencumbered, high quality asset that could be converted in to cash to meet its liquidity needs for one month period under an acute liquidity stress scenario specified by the CBSL.
- Net Stable Funding Requirement (NSFR) to ensure stable funding on an ongoing, viable entity basis, over one year time horizon based on liquidity risk factors assigned to assets, off-balance sheet liquidity exposure and other contingent funding obligations to cover an extended firm specific stress scenario

$$LCR = \frac{\text{Stock of high quality liquid assets}}{\text{Net cash outflow over next 30 day period}} \geq 100$$

LCR is progressively implemented as per the below road map

$$NSFR = \frac{\text{Available amount of stable funding} = \text{Liabilities weighted for their liabilities in times of stress}}{\text{Required amount of stable funding} = \text{Asset weighted by their "lack" of liquidity}} > 100$$

Implementation of this ratio is currently under consideration

Bank's Performance Ratio	December 2015		December 2016		2017 Target	2018 Target	2019 Target
	Target	Actual	Target	Actual			
LCR - All CCY	60%	88.43%	70%	118.45%	80%	90%	100%
LCR - LKR	60%	127.53%	70%	176.48%	80%	90%	100%

Risk Management

Despite the transition period for compliance with Basel III reforms, there is a need to adhere to new reporting guidelines by early 2017. The Bank reviewed its strategic planning, capital and risk strategy, and implementation plan, which would facilitate a smooth execution of Basel III implementation plan accordingly. In response to the new regulation, the Bank is already building its capital. With the implementation of Basel III Direction No 01 of 2016, the impact on the Bank's CAR is depicted as follows.

Basel IV

Banks and financial institutions are yet to adopt Basel III reforms but Basel IV is also in progress in western continents. Industry experts are of the view that, upcoming Basel reforms would require banks to follow standard approach in calculating its capital resulting, significant further increase in required regulatory capital. Even though implementing such guidelines are still in primitive discussion stages, political changes in USA are sending sentiments of deregulation contrary to this attempt.

Roadmap to strengthen the CAR under Basel III

Ratios	Bank's Position based on Current Requirement		CBSL Road Map on Proposed Changes from 2017		
	31-Dec-15	31-Dec-16	1-Jul-17	1-Jan-18	1-Jan-19
CET 1	10.53	11.22	4.50	4.500	4.50
Capital Conservation Buffer (CCB)	-	-	1.25	1.875	2.50
Capital Surcharge for D-SIBs	-	-	0.50	1.000	1.50
Minimum CET 1 + CCB and Capital Surcharge for D-SIBs	10.53	11.22	6.25	7.375	8.50
Minimum Tier 1 + CCB and capital surcharge for D-SIBs	-	-	7.75	8.875	10.00
Total CAR (CET1+AT1 +Tier 2 + CCB+ CSD-SIB)	12.70	15.27	11.75	12.875	14.00

Above excludes the requirements under Pillar 2 ICAAP.

Capital for Pillar 2 risks will be held in addition to the above indicated CAR

Areas subject to review are as follows,

- The leverage ratio,
- Trading book
- Counterparty risk
- Interest rate risk in the banking book
- Risk-sensitive standardized approaches for trading books and credit (banking book)

- Modeling for credit risk, operational risk and;
- Total loss-absorbing capacity for D-SIBs

Though, there is no impact on capital to RWAs ratio, there will likely be a significant impact on size of the RWAs.

Summary of Major Risks Identified by the Bank

Type of Risk	Perceived level of Risk	Identification Mechanism	Measurement	Monitoring / Mitigants
Credit Risk	Moderate Due to unseasoned credit portfolio	<ul style="list-style-type: none"> • Structured credit appraisal process– In depth analysis of potential risks • Revised delegated authority structure - advisory role from risk department and addition layers for low rated credit • Stringent attention to early Warning Signals– Deeper analysis of potential warnings • Closer monitoring through "Management Review List" and "Watch List" • Internal limits/goals/ hurdle rates on credit concentration, asset quality, portfolio composition and loan loss provisioning • Focused "Loan Review Mechanism" 	<ul style="list-style-type: none"> • Internal risk rating - PD, LGD • Impairment (Collective / Individual) • Stress testing on concentration risk, NPA, portfolio etc... • Net flow rates • NPA ratio 	<ul style="list-style-type: none"> • Continuous monitoring through centralized credit monitoring Team i.e. excesses overdue, NPAs, watch listed customers etc. • Submissions of credit risk dashboard to credit policy committee, board credit committee and BIRMC on monthly basis • Timely restructuring of weaker credit • Implementation of exit strategies • Additional collateral cover for weaker credits

Type of Risk	Perceived level of Risk	Identification Mechanism	Measurement	Monitoring / Mitigants
Market Risk	Moderate	<ul style="list-style-type: none"> Risk management framework with independent TMO Dealer limits Treasury activity limits Regulatory limits i.e. NOP Interest rate gaps 	<ul style="list-style-type: none"> Mark to market the trading book VaR statistical model Economic-capital Stress testing 	<ul style="list-style-type: none"> Market risk dashboard Exceptions reporting done by TMO Trading limit monitoring done by TMO Submissions to ALCO BIRMC and Board of Directors on monthly basis State-of –the art treasury system being implemented
Liquidity Risk	High	<ul style="list-style-type: none"> Liquidity gap Stock and flow approaches Liquidity contingency plan Monthly liquidity forecast 	<ul style="list-style-type: none"> Probabilistic analysis and stress tests Modified duration gap approach for analysing the changes in economic value of equity 	<ul style="list-style-type: none"> Monitor max cash outflow limits Limits on large transactions L/T funding limits Dashboard submissions to ALCO, BIRMC and Board of Directors
Operational Risk	High	<ul style="list-style-type: none"> Risk and control self-assessment process Loss database Root cause analysis on control violations Control design and performance evaluation Thematic audits 	<ul style="list-style-type: none"> KRIs Bank's overall risk matrix Max operational loss limits Unit wise risk matrices based on Impact severity and likelihood of occurrence Risk ranking and prioritization Economic capital 	<ul style="list-style-type: none"> Establishment of ORSC Broaden insurance coverage Sound Business Continuity Plan (BCP) in place covering all Mission critical business activities of the bank. Operational risk dashboard is submitted to ERM, BIRMC and Board of Directors on a monthly basis
Cyber Risk	Moderate	<ul style="list-style-type: none"> Listing key information risks Possible system procedure violation/ attempts Security vulnerabilities Market incidents 	<ul style="list-style-type: none"> Setting cyber risks loss limits Measuring perimeter / firewall protection 	<ul style="list-style-type: none"> Establishing cyber risk policy Adopts industry best practices Frequent penetration tests Cyber risk dashboard is submitted to BIRMC on a monthly basis
Reputation Risk	Moderate	<ul style="list-style-type: none"> Customer feedback/complaints Positive/negative publicity 	<ul style="list-style-type: none"> Qualitative scorecard approach 	<ul style="list-style-type: none"> Actively listen and provide feedback Enhanced customer support service Maintain service level standards Increased transparency
Strategic Risk	Low	<ul style="list-style-type: none"> Bank's financial performance Product performance Peer performance and strategic initiatives 	<ul style="list-style-type: none"> Qualitative scorecard approach 	<ul style="list-style-type: none"> Monitoring strategic objectives Vs. performance on an ongoing basis Peer performance analysis on periodic basis

Compliance Risk

HNB conducts its business in accordance with the laws and regulations imposed by the regulatory authorities in line with the Bank's internal policies and codes of conduct, with a broad vision of establishing a high

standard of corporate governance and risk mitigating culture within the Bank.

Compliance risk is the risk of regulatory sanctions, financial loss or loss of reputation

the Bank may suffer as a result of its failure to comply with laws and regulations, standards of ethical conduct and good market practices applicable to the banking industry.

Risk Management

In order to manage compliance risk, number of policies have been adopted by the Bank, to include the following:

- Compliance policy
- Anti-Money Laundering / Combating Financing Terrorism (AML / CFT) and KYC Policy
- Management of related party transactions
- Managing business relationships with Politically Exposed Persons (PEP)
- Whistle blowing policy
- Outsourcing policy.

The Bank's policies are updated regularly, driven by changes in the economic and regulatory landscape, internal business process re-engineering, technological innovation and competition. All policies are reviewed and approved by HNB's Board of Directors.

The Bank's independent compliance division, headed by the Compliance Officer reports directly to the Board Integrated Risk Management Committee (BIRMC) on compliance matters with an indirect line of reporting on administrative matters to the Bank's Chief Operating Officer.

The compliance division contributes towards knowledge enhancement and awareness building on regulatory requirements, principles and the importance of compliance among staff at all levels, by participating

in the regional and head office training sessions.

During the second half of 2016, with a view to creating a better compliance culture within the Bank, the compliance division embarked on specialized training sessions to meet the individual requirements of branches in order to match the product needs of their customers. Specific requests were for example to cover information and handling of foreign currency account opening, debit and credit card regulations for specific customer types (resident / non-resident), dealing with loans to foreign nationals and dual citizens as well as the importance of regulatory reporting requirements.

The compliance division also drives the data governance project of the Bank which commenced in 2014 with a view of improving the quality and integrity of data which is extremely vital not only from a view point of ensuring accuracy and integrity of statutory returns submitted to regulatory authorities but also in generating quality Management Information (MI) required for decision making and policy reviews.

Key Initiatives in 2016

Implementation of the gazette on financial institutions (Customer Due Diligence) Rules, No. 1 of 2016 made by the CBSL financial intelligence unit. The Bank has taken measures to identify, assess and manage

money laundering and terrorist financing risks in line with the "risk based approach."

New areas identified under the data governance project to improve data quality and facilitate cross-selling. Project initiated at the compliance division and progress closely monitored.

Branch specific training to address customer needs in a particular geographical area or community and updating branch staff on weak areas which require attention and further knowledge building.

Raising staff awareness on compliance and AML/CFT related issues, to further intensify effective compliance culture within the bank. AML/CFT training material updated on the bank's e-Learning module "Talent Space" in line with new regulations.

In compliance with the requirements of the US Foreign Account Tax Compliance Act (FATCA). Review carried out by the Bank's internal audit on the FATCA policy and related processes.

Intensified board reporting on AML/CFT matters, regulatory audit reports and other compliance areas.

Monitoring of outsourced service providers for business activities relating to core banking functions centralized and limit guidelines set for service providers and types of service outsourced.

Conformity to New Regulations Introduced During the Year – 2016

Date issued / by CBSL Department	Mandatory Regulations / Directions / Determinations	Bank's Present Status
20.01.2016 Exchange Control Department	Directions issued to authorised dealers on Non Resident Foreign Currency Account (NRFC) -No.1 of 2016	Compliant
20.01.2016 Exchange Control Department	Directions issued to authorised dealers on Resident Foreign Currency Account (RFC) - No.2 of 2016	Compliant
20.01.2016 Exchange Control Department	Directions issued to authorised dealers on Resident Non-Nationals' Foreign Currency (RNNFC) Accounts - No.3 of 2016	Compliant
20.01.2016 Exchange Control Department	Directions issued to authorised dealers on Foreign Exchange Earners' Accounts (FEEA) - No.4 of 2016	Compliant
25.01.2016 Bank Supervision Department	Reporting on cyber security events	Noted cyber risk dashboard developed

Date issued / by CBSL Department	Mandatory Regulations / Directions / Determinations	Bank's Present Status
27.01.2016 Financial Intelligence Unit	Gazette notice from CBSL on Financial Institutions (Customer Due Diligence) Rules No. 1 of 2016	In process to achieve full compliance. Implementation of requirements in the AML/CFT system underway in order to bridge remaining gaps.
01.02.2016 Bank Supervision Department	Display of interest rates, exchange rates, service charges, fees and commissions	In process to achieve full compliance. Website been updated to meet requirements.
02.02.2016 Payment & Settlement Department	Business Continuity Management (BCM) and Disaster Recovery (DR) Site Operations- 2016	Compliant
23.03.2016 Exchange Control Department	Directions issued to authorised dealers on Non Resident Foreign Currency Account (NRFC) -No.5 of 2016	Compliant
23.03.2016 Exchange Control Department	Directions issued to authorised dealers on Resident Foreign Currency Account (RFC) - No.6 of 2016	Compliant
23.03.2016 Exchange Control Department	Directions issued to authorised dealers on Resident Non-national Foreign Currency Account (RNNFC) - No.7 of 2016	Compliant
23.03.2016 Exchange Control Department	Directions issued to authorised dealers on Foreign Exchange Earners Account (FEEA) - No.8 of 2016	Compliant
23.03.2016 Exchange Control Department	Directions issued to authorised dealers and primary dealers appointed as designated agents for Sri Lanka development bonds - No.9 of 2016	Compliant
19.04.2016 Exchange Control Department	Directions issued to authorised on foreign currency and rupee accounts for foreign diplomatic missions, diplomatic personnel and their family members in Sri Lanka - No.10 of 2016	Compliant
16.05.2016 Exchange Control Department	Directions issued to authorised dealers on non resident blocked accounts - No.11 of 2016	Compliant
16.05.2016 Exchange Control Department	Directions issued to authorised dealers on sale of foreign exchange to emigrants - No.12 of 2016	Compliant
16.05.2016 Exchange Control Department	Directions issued to authorised dealers on sale of foreign exchange to emigrants - No.13 of 2016	Compliant
07.06.2016 Exchange Control Department	Directions issued to authorised dealers on External Commercial Borrowing Account (ECBA) - No.14 of 2016	Compliant
25.07.2016 Monetary Board	Banking Act determination on annual licensed fee of licensed commercial banks and licensed specialized banks	Noted
05.08.2016 Exchange Control Department	Directions issued to authorised dealers appointed as designated agents for Sri Lanka Development Bonds - No.15 of 2016	Compliant
11.08.2016 Exchange Control Department	Directions issued to authorised dealers on reservation of import cargo for the Ceylon Shipping Corp. Ltd - No.16 of 2016	Compliant
01.09.2016 Bank Supervision Department	Secondary market trading of government securities and reporting by Licensed Commercial Banks and Licensed Specialized Banks	Compliant
24.10.2016 Bank Supervision Department	Second consultation paper on Implementation of Basel III - minimum capital requirements for Licensed Commercial Banks	Noted Parallel computations under Basel II and III carried out by the bank in order to assess future capital adequacy needs.
10.11.2016 Financial Intelligence Unit	Clarifications on several terms included in the Financial Institutions Rules, No.1 of 2016 published under Gazette Extraordinary No.1951/13 dated 27.01.2016.	Noted.
29.12.2016 Bank Supervision Department	Banking Act Directions No. 01 of 2016 - capital requirements under Basel III for Licensed Commercial Banks and Licensed Specialised Banks	Noted for compliance by 01.07.2017. Computations underway in order to assess Basel III requirements.

Computation of Capital Adequacy Ratio

Capital Base

As at 31st December	2016 Rs Mn	2015 Rs Mn
TIER 1		
Voting ordinary shares	12,339	10,931
Non-voting ordinary shares	3,001	2,682
Statutory reserve fund	4,560	3,760
Published retained earnings (Note 1)	10,628	6,640
General & other reserves	37,247	31,100
Less: Deductions from Tier 1 capital (Note 2)	(2,693)	(2,654)
Eligible Tier 1 capital	65,082	52,459
TIER II		
50% of approved asset revaluation reserves (Note 3)	2,091	2,104
General provision for loan losses	2,756	2,295
Approved subordinated term debt	21,333	9,045
Tier II capital	26,180	13,444
Less: Deductions from Tier II capital (Note 2)	(2,693)	(2,654)
Eligible Tier II capital	23,487	10,790
Capital Base	88,569	63,249
Risk Adjusted capital ratios		
Tier 1 (Eligible Tier 1 capital / Total risk adjusted balance) *	11.22	10.53
Total (Capital base / Total risk adjusted balance) **	15.27	12.70

* Statutory minimum 5%

** Statutory minimum 10%

Risk adjusted On-Balance sheet exposure

As at 31st December	Balance		Risk Weights %	Risk Adjusted Balance	
	2016 Rs Mn	2015 Rs Mn		2016 Rs Mn	2015 Rs Mn
Exposures					
- To Central Government and CBSL	253,721	198,565	0	-	-
- To banks/foreign sovereigns	3,857	4,544	20 - 150	3,257	2,953
- To financial institutions	33,690	31,265	20 - 150	18,664	16,830
- To corporates	209,744	177,023	20 - 150	167,845	164,116
- To retail sector (excluding claims secured by residential properties)	216,037	182,221	75 - 100	169,566	142,595
- Secured on residential property mortgages	37,276	33,809	50 - 100	23,781	20,790
- Non performing advances	5,501	6,597	50 - 150	5,902	7,340
- Cash and cash items in the process of collection	20,873	15,927	0 - 20	1,003	891
- Other assets	20,559	17,853	100	20,559	17,853
Asset base for risk weight	801,258	667,804		410,577	373,368

Risk adjusted Off-Balance sheet exposure

As at 31st December	Amount of Off-Balance Sheet Items	Credit Conversion Factor	Credit Equivalent Amount	Risk Weights	Risk Adjusted Balance	
	2016 Rs Mn	%	2016 Rs Mn	%	2016 Rs Mn	2015 Rs Mn
Financial guarantees, bank acceptances and other guarantees	57,082	100	57,082	0 -100	55,806	27,371
Performance related guarantees and Warranties and stand by LCs related to particular transactions	46,338	50	23,169	0 -100	21,965	19,860
Shipping guarantees, documentary letter of credit and trade related acceptances	45,939	20	9,188	0 -100	8,842	7,270
Other commitments with an original maturity of < 1year	69,309	0 - 20	-	0 -100	-	-
> 1year	44,936	50	22,469	0 -100	22,469	17,420
Foreign exchange contracts	121,423	2	2,428	0 -100	2,428	3,082
Total off- balance sheet exposures	385,027		114,336		111,510	75,003

Capital charge for Market Risk

As at 31st December	Capital Charge		Risk Adjusted Balance	
	2016 Rs Mn	2015 Rs Mn	2016 Rs Mn	2015 Rs Mn
Interest rate	-	-	-	-
Equity	64.6	70.9	646	709
Foreign exchange & gold	266.8	239.3	2668	2,393
Total risk adjusted balance for market risk	331.4	310.2	3,314	3,102

Capital charge for Operational Risk

As at 31st December	Capital Charge	
	2016 Rs Mn	2015 Rs Mn
Average gross income	36,319.8	31,141.4
15% of average gross income	5,448.0	4,671.2
Total capital charge for operational risk	5,448.0	4,671.2

As at 31st December	2016 Rs Mn	2015 Rs Mn
	Total risk adjusted balance for operational risk	54,480
Total risk adjusted balance (credit risk, market risk, operational risk)	579,881	498,185

NOTES:

- In computing the CAR profits for the year was computed based on SLFRS/LKAS
- Deductions

As at 31st December	Tier I		Tier II	
	2016 Rs Mn	2015 Rs Mn	2016 Rs Mn	2015 Rs Mn
Additional investment in Sithma Development (Pvt) Ltd.	450	450	450	450
HNB Grameen Finance Ltd	330	330	330	330
Equity and Debenture investments	1,913	1,874	1,913	1,874
Total deductions	2,693	2,654	2,693	2,654

- Revaluation reserves approved by CBSL is Rs 4,181 Mn.

A man with dark hair, wearing a white long-sleeved shirt, is sitting at a dark wooden desk outdoors. He is looking down at a laptop, which is partially visible on the desk. He is wearing a silver watch on his left wrist. The background is a blurred outdoor setting with green foliage and a white pillar. The text is overlaid on the bottom left of the image.

**An excellent financial
performance
that will
surely please
our investors...**



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FINANCIAL CALENDAR - 2016

47th Annual General Meeting held on	30th March 2016
Rs 7/00 per share Final Dividend for 2015 paid on.....	08th April 2016
(Cash Dividend Rs 3.50 per share and Scrip Dividend Rs 3.50 per share)	
Rs 1/50 per share Interim Dividend for 2016 paid on.....	16th December 2016
Audited Financial Statements signed on	23rd February 2017
48th Annual General Meeting to be held on.....	30th March 2017
Rs 7/00 per share Final Dividend for 2016 payable in.....	* April 2017
Interim Financial Statements published in terms of Rule 8.3 of the Colombo Stock Exchange and as per the requirements of the Central Bank of Sri Lanka:	
1st Quarter Interim Results released on	9th May 2016
2nd Quarter Interim Results released on.....	10th August 2016
3rd Quarter Interim Results released on.....	15th November 2016

PROPOSED FINANCIAL CALENDAR - 2017

Interim Dividend for 2017 to be payable in **	December 2017
49th Annual General Meeting to be held in	March 2018
Final Dividend for 2017 to be payable in ***	April 2018
Interim Financial Statements to be published in terms of Rule 8.3 of the Colombo Stock Exchange and as per the requirements of the Central Bank of Sri Lanka:	
1st Quarter Interim Results to be released in	May 2017
2nd Quarter Interim Results to be released in.....	August 2017
3rd Quarter Interim Results to be released in.....	November 2017

* Subject to confirmation by Shareholders

** Subject to confirmation by Directors

*** Subject to confirmation by Directors and Shareholders

Chief Executive Officer's and Chief Financial Officer's Responsibility Statement

The financial statements of Hatton National Bank PLC ("the Bank") and the consolidated financial statements of the Bank and its subsidiaries as at 31st December 2016 are prepared and presented in compliance with the requirements of the following:

- Sri Lanka Accounting Standards issued by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka),
- Companies Act No 7 of 2007,
- Sri Lanka Accounting and Auditing Standards Act No 15 of 1995,
- Banking Act No 30 of 1988 (as amended),
- Listing Rules of the Colombo Stock Exchange,
- Banking Act Direction No 11 of 2007 on Corporate Governance for Licensed Commercial Banks in Sri Lanka (as amended from time to time) and
- Code of Best Practice on Corporate Governance issued jointly by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) and the Securities and Exchange Commission of Sri Lanka

The formats used in the preparation of the financial statements and disclosures made comply with the formats prescribed by the Central Bank of Sri Lanka.

The Accounting Policies used in the preparation of the financial statements are appropriate and are consistently applied by the Group. There are no departures from the prescribed Accounting Standards in their adoption. Comparative information has been reclassified wherever necessary to comply with the current presentation.

The significant accounting policies and estimates that involved a high degree of judgment and complexity were discussed with the Audit Committee and external auditors.

The Board of Directors and the management of the Bank accept responsibility for the integrity and objectivity of these financial statements. The estimates and judgments relating to the financial statements were made on a prudent and reasonable basis; in order that the financial statements reflect a true and fair view, the form and substance of transactions and the Bank's state of affairs are reasonably presented. To ensure this, the Bank has taken proper and sufficient care in installing a system of internal control and accounting records, for safeguarding assets and for preventing and detecting frauds as well as other irregularities, which are reviewed, evaluated and updated on an on going basis. It is confirmed that the Bank has adequate resources to continue its operations in the foreseeable future. Therefore, the Bank will continue to adopt the 'going concern' basis in preparing these financial statements.

Our internal auditor has conducted periodic audits to provide reasonable assurance that the established policies and procedures of the Bank were consistently followed. However, there are inherent limitations that should be recognised in weighing the assurances provided by any system of internal controls and accounting. Further, your Board assessed the effectiveness of the Bank's internal controls over financial reporting during the year ended 31st December 2016, as required by the Banking Act Direction No 11 of 2007, result of which is given on pages 150 to 151 in the Annual Report, the "Directors' Statement on Internal Control". External auditor's Assurance Report on the "Directors' Statement on Internal Control" is given on page 152 of the Annual Report.

The financial statements of the Group for the year 2016 were audited by Messrs Ernst & Young, Chartered Accountants, the independent external auditors. Their report is given on page 197 of the Annual Report.

The Audit Committee of the Bank meets periodically with the internal audit team

and the independent external auditor to review their audit plans, assess the manner in which these auditors are performing their responsibilities and to discuss their reports on internal controls and financial reporting issues. To ensure complete independence, the external auditor and the internal auditor have access to the members of the Audit Committee to discuss any matter of substance. Details of which are given in the 'Audit Committee Report' on pages 137 to 138.

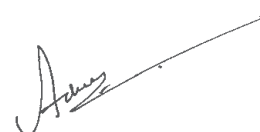
The Audit Committee approves the audit and non audit services provided by external auditor, Messrs Ernst & Young, in order to ensure that the provision of such services does not impair Ernst & Young's independence.

We confirm that,

- the Bank and its subsidiaries have complied with all applicable laws, regulations and prudential requirements;
- there are no material non compliances; and
- there are no material litigations that are pending against the Group other than those disclosed in the Note 59 (d) to the financial statements in this Annual Report.



Jonathan Alles
*Managing Director /
Chief Executive Officer*



Anusha Gallage
AGM - Finance

Colombo, Sri Lanka
23rd February 2017

Directors' Responsibility for Financial Reporting

The responsibility of the Directors in relation to the financial statements of the Bank and its subsidiaries prepared in accordance with the provisions of the Companies Act No 7 of 2007 is set out in the following statement.

The responsibilities of the external auditor in relation to the financial statements are set out in the report of the auditors given on page 197 of the Annual Report.

As per the provisions of sections 150 (1), 151, 152 and 153 (1) & (2) of the Companies Act No 7 of 2007, the Directors are required to prepare financial statements for each financial year and place them before a General Meeting. The financial statements comprise the Statement of Financial Position as at 31st December 2016, and the Statement of Comprehensive Income, Statement of Changes in Equity and Statement of Cash Flows for the year then ended and notes thereto.

The financial statements of the Bank and its subsidiaries give a true and fair view of:

1. the state of affairs of the Bank and its subsidiaries as at 31st December 2016; and
2. the profit or loss of the Bank and its subsidiaries for the financial year then ended.

In preparing these financial statements, the Directors are required to ensure that:

1. appropriate accounting policies have been selected and applied in a consistent manner and material departures, if any, have been disclosed and explained;
2. judgments and estimates have been made which are reasonable and prudent; and
3. all applicable accounting standards, as relevant, have been complied with;

The Directors are also required to ensure that the Bank and its subsidiaries have adequate resources to continue in operation to justify applying the going concern basis in preparing these financial statements.

Further, the Directors have a responsibility to ensure that the Companies within the Group maintain sufficient accounting records to disclose, with reasonable accuracy the financial position of the Bank and its subsidiaries.

Financial statements prepared and presented in this report have been prepared based on new Sri Lanka Accounting Standards (SLFRS) which came to effect from January 01, 2012 and are

consistent with the underlying books of accounts and are in conformity with the requirements of Sri Lanka Accounting Standards, Companies Act No 7 of 2007, Sri Lanka Accounting and Auditing Standard Act No 15 of 1995, Banking Act No 30 of 1988 and amendments thereto, Banking Act Direction No 11 of 2007 on Corporate Governance for Licensed Commercial Banks in Sri Lanka (as amended from time to time), the Listing Rules of the Colombo Stock Exchange and the Code of Best Practice on Corporate Governance issued jointly by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) and the Securities and Exchange Commission of Sri Lanka (SEC).

In addition, these financial statements comply with the prescribed format issued by the Central Bank of Sri Lanka for the preparation of annual financial statements of Licensed Commercial Banks.

The Directors have also instituted effective and comprehensive systems of internal control for identifying, recording, evaluating and managing the significant risks faced by the Bank throughout the year and it is being under regular review of the Board of Directors. This comprises internal reviews, internal audit and the whole system of financial and other controls required to carry on the business of banking in an orderly manner, safeguard its assets, prevent and detect frauds and other irregularities and secure as far as practicable the accuracy and reliability of the records. The results of such reviews carried out during the year ended 31st December 2016 are given on pages 150 to 151 of the Annual Report, "Directors' Statement on Internal Control". External Auditor's Assurance Report on the "Directors' Statement on Internal Control" is given on page 152 of the Annual Report.

The Directors have taken appropriate steps to ensure that the Bank and Group maintain proper books of accounts and review the financial reporting system directly by them at their regular meetings and also through the Board Audit Committee, the report of the said Committee is given on pages 137 to 138. The Board of Directors also approves the interim financial statements prior to their release following a review and recommendation by the Board Audit Committee.

The Board of Directors accepts responsibility for the integrity and objectivity of the financial statements presented in this Annual Report.

Directors are required to prepare the financial statements and provide the Bank's external auditor, Messrs Ernst & Young, with every opportunity to carry out whatever reviews and checks on the system of internal control they may consider appropriate and necessary for expressing their independent audit opinion on the financial statements.


The financial statements of the Bank and the Group have been certified by the AGM - Finance of the Bank, the officer responsible for their preparation, as required by Sections 150 (1) (b) and 152 (1) (b) of the Companies Act. Also the financial statements of the Bank and the Group have been signed by two Directors and the Company Secretary of the Bank on February 23rd, 2017 as required by Sections 150 (1) (c) and 152 (1) (c) of the Companies Act.

Further, as required by Section 56 (2) of the Companies Act No 7 of 2007, the Directors have confirmed that the Bank, based on the information available, satisfies the solvency test immediately after the distribution of dividends, in accordance with Section 57 of the Companies Act No 7 of 2007, and has obtained a certificate from the auditors, prior to declaring a final dividend of Rs 7/- per share for this year to be paid in April 2017.

The Directors to the best of their knowledge and belief, are satisfied that all statutory payments in relation to all relevant regulatory and statutory authorities which were due and payable by the Bank and its subsidiaries as at the Statement of Financial Position date have been paid or where relevant provided for.

The Directors are of the view that they have discharged their responsibilities as set out in this statement.

By order of the Board



K A L Thushari Ranaweera (Mrs)
Deputy General Manager (Legal) / Company Secretary

Colombo, Sri Lanka
23rd February 2017

Independent Auditors' Report



Ernst & Young
Chartered Accountants
201 De Saram Place
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TO THE SHAREHOLDERS OF HATTON NATIONAL BANK PLC

Report on the Financial Statements

We have audited the accompanying financial statements of Hatton National Bank PLC, (the "Bank"), and the consolidated financial statements of the Bank and its subsidiaries (the "Group"), which comprise the statement of financial position as at 31 December 2016, and the statement of profit or loss, statement of comprehensive income, statement of changes in equity and, statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Board's Responsibility for the Financial Statements

The Board of Directors (the "Board") is responsible for the preparation of these financial statements that give a true and fair view in accordance with Sri Lanka Accounting Standards, and for such internal control as Board determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Sri Lanka Auditing Standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the Bank's preparation of the financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by Board, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the financial position of the Group as at 31 December 2016, and of its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

Report on Other Legal and Regulatory Requirements

As required by Section 163(2) of the Companies Act No. 7 of 2007, we state the following:

- a) The basis of opinion, scope and limitations of the audit are as stated above.
- b) In our opinion :
 - we have obtained all the information and explanations that were required for the audit and, as far as appears from our examination, proper accounting records have been kept by the Bank,
 - the financial statements of the Bank give a true and fair view of the financial position as at 31 December 2016, and of its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards, and
 - the financial statements of the Bank and the Group, comply with the requirements of sections 151 and 153 of the Companies Act No. 07 of 2007.

23rd February 2017
Colombo

Partners: W R H Fernando FCA FCMA M P D Cooray FCA FCMA R N de Saram ACA FCMA Ms. N A De Silva FCA Ms. Y A De Silva FCA W K B S P Fernando FCA FCMA
Ms. K R M Fernando FCA ACMA Ms. L K H L Fonseka FCA A P A Gunasekera FCA FCMA A Herath FCA D K Hulangamuwa FCA FCMA LLB (Lond) H M A Jayasinghe FCA FCMA
Ms. A A Ludowyke FCA FCMA Ms. G G S Manatunga FCA N M Sulaiman ACA ACMA B E Wijesuriya FCA FCMA

Principal T P M Ruberu FCMA FCCA

A member firm of Ernst & Young Global Limited

Statement of Profit or Loss

For the year ended 31st December	Note	Bank		Group	
		2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Gross income	7	84,350,823	61,153,466	95,990,771	70,026,698
Interest income		75,608,193	52,615,463	81,533,502	56,893,956
Less: Interest expenses		41,236,605	26,279,934	42,444,643	27,200,236
Net interest income	8	34,371,588	26,335,529	39,088,859	29,693,720
Fee and commission income		7,139,253	5,874,928	7,905,879	6,426,080
Less: Fee and commission expenses		90,594	98,622	180,531	182,093
Net fee and commission income	9	7,048,659	5,776,306	7,725,348	6,243,987
Net interest, fee and commission income		41,420,247	32,111,835	46,814,207	35,937,707
Net gain/(loss) from trading	10	(1,795,691)	196,993	(1,824,452)	212,364
Net gain from financial investments	11	111,713	253,858	103,165	297,978
Net insurance premium income	12	-	-	5,490,712	4,679,897
Other operating income	13	3,287,355	2,212,224	2,781,965	1,516,423
Total operating income		43,023,624	34,774,910	53,365,597	42,644,369
Less: Impairment charge for loans and other losses	14	237,160	931,925	508,159	1,022,111
Net operating income		42,786,464	33,842,985	52,857,438	41,622,258
Less : Operating expenses					
Personnel expenses	15	8,703,575	7,927,695	10,416,099	9,155,160
Benefits, claims and underwriting expenditure	16	-	-	4,571,389	4,211,996
Other expenses	17	9,584,304	8,050,939	10,785,144	9,093,136
Total operating expenses		18,287,879	15,978,634	25,772,632	22,460,292
Operating profit before Value Added Tax (VAT) and Nation Building Tax (NBT) on financial services		24,498,585	17,864,351	27,084,806	19,161,966
Less: Value Added Tax (VAT) and Nation Building Tax (NBT) on financial services	18	4,352,756	2,814,334	4,734,949	3,061,783
Operating profit after Value Added Tax (VAT) and Nation Building Tax (NBT) on financial services		20,145,829	15,050,017	22,349,857	16,100,183
Share of profit of joint venture (net of income tax)	19	-	-	148,790	60,085
PROFIT BEFORE INCOME TAX		20,145,829	15,050,017	22,498,647	16,160,268
Less: Income tax expense	20	6,002,423	4,601,231	6,833,685	5,064,424
PROFIT FOR THE YEAR		14,143,406	10,448,786	15,664,962	11,095,844
Profit attributable to:					
Equity holders of the Bank		14,143,406	10,448,786	14,755,634	10,553,568
Non-controlling interests		-	-	909,328	542,276
PROFIT FOR THE YEAR		14,143,406	10,448,786	15,664,962	11,095,844
Earnings per share	21				
Basic earnings per ordinary share (Rs)		34.25	25.41	35.73	25.67
Diluted earnings per ordinary share (Rs)		34.17	25.31	35.65	25.56
Dividend per share					
Dividend per share: Gross (Rs)		*8.50	8.50	*8.50	8.50

The notes to the financial statements from pages 206 to 327 form an integral part of these financial statements.

*Calculated on interim dividend paid and final dividend proposed, which is to be approved at the Annual General Meeting.

Statement of Comprehensive Income

For the year ended 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
PROFIT FOR THE YEAR	14,143,406	10,448,786	15,664,962	11,095,844
OTHER COMPREHENSIVE INCOME FOR THE YEAR, NET OF TAX				
Other comprehensive income to be reclassified to profit or loss in subsequent periods				
Available-for-sale financial assets:				
Net change in fair value during the year	(3,158,637)	(2,450,679)	(3,312,113)	(2,538,159)
Transfer to life policy holder reserve fund	-	-	134,781	97,098
Net amount transferred to profit or loss (available-for-sale financial assets)	-	-	14,466	(19,242)
Deferred tax effect on above	404,328	150,890	406,153	152,176
Share of other comprehensive income of equity accounted joint venture	-	-	(21,154)	17,041
Net other comprehensive income to be reclassified to profit or loss in subsequent periods	(2,754,309)	(2,299,789)	(2,777,867)	(2,291,086)
Other comprehensive income not to be reclassified to profit or loss in subsequent periods				
Re-measurement gains/(losses) on defined benefit plans	361,720	(897,969)	377,525	(909,543)
Revaluation of freehold land and buildings	2,273,397	2,095,076	5,748,917	5,597,137
Deferred tax effect on above	(54,489)	(104,040)	(157,789)	(104,040)
Deferred tax effect on realisation of revaluation surplus	1,214	-	1,214	-
Net other comprehensive income not to be reclassified to profit or loss in subsequent periods	2,581,842	1,093,067	5,969,867	4,583,554
OTHER COMPREHENSIVE INCOME FOR THE YEAR, NET OF TAX	(172,467)	(1,206,722)	3,192,000	2,292,468
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	13,970,939	9,242,064	18,856,962	13,388,312
Total comprehensive income attributable to:				
Equity holders of the Bank	13,970,939	9,242,064	17,865,820	12,855,605
Non-controlling interests	-	-	991,142	532,707
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	13,970,939	9,242,064	18,856,962	13,388,312

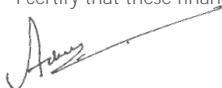
The notes to the financial statements from pages 206 to 327 form an integral part of these financial statements.

Statement of Financial Position

As at 31st December	Note	Bank		Group	
		2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
ASSETS					
Cash and cash equivalents	24	17,511,446	14,909,598	18,668,703	15,419,654
Balances with Central Bank of Sri Lanka	25	33,777,614	20,096,090	33,777,614	20,096,090
Placements with banks	26	753,050	26,827	2,198,446	1,174,326
Reverse repurchase agreements	27	4,303,460	4,869,219	5,756,794	7,782,374
Derivative financial instruments	28	289,989	1,302,872	289,989	1,302,872
Financial investments - fair value through profit or loss	29	544,915	593,390	716,009	1,948,772
Non-current assets held for sale	30	-	20,151	-	20,151
Loans and receivables to customers	31	584,412,727	498,341,628	597,467,460	507,244,329
Financial investments - loans and receivables	32	99,260,698	84,206,702	102,063,229	87,087,205
Financial investments - available-for-sale	33	89,915,153	78,046,505	95,797,142	79,718,231
Financial investments - held to maturity	34	-	-	465,081	1,257,433
Investment in joint venture	35	755,000	655,000	1,450,806	1,253,370
Investment in subsidiaries	36	3,017,285	3,017,285	-	-
Investment properties	37	403,959	386,643	1,054,300	1,041,797
Property, plant and equipment	38	13,945,002	11,473,569	29,844,234	23,908,688
Intangible assets and goodwill	39	789,648	659,309	1,180,269	1,001,230
Other assets	40	9,193,879	6,602,922	10,720,506	7,328,053
Total assets		858,873,825	725,207,710	901,450,582	757,584,575
LIABILITIES					
Due to banks	41	69,928,789	58,232,034	69,964,380	58,283,838
Derivative financial instruments	28	665,890	304,485	665,890	304,485
Securities sold under repurchase agreements	42	13,458,127	16,630,201	13,458,127	16,630,201
Due to customers	43	623,494,969	527,126,181	635,371,097	536,132,789
Dividends payable	44	1,007,075	764,771	1,015,463	764,771
Other borrowings	45	27,130,358	26,833,109	27,130,358	26,833,109
Debt securities issued	46	4,653,057	4,490,742	5,115,801	4,913,751
Current tax liabilities	48	6,223,943	4,542,977	6,425,379	4,762,707
Deferred tax liabilities	49	231,364	378,820	824,778	579,102
Insurance provision - life	50	-	-	8,747,856	7,007,081
Insurance provision - general	51	-	-	1,921,567	1,546,266
Other provisions		3,158,444	2,538,111	3,407,050	2,746,294
Other liabilities	52	5,751,107	6,250,856	7,190,028	7,250,893
Subordinated term debts	47	26,153,476	12,064,370	25,901,110	12,085,598
Total liabilities		781,856,599	660,156,657	807,138,884	679,840,885
EQUITY					
Stated capital	54	15,340,158	13,826,873	15,340,158	13,826,873
Statutory reserve	55	4,560,000	3,760,000	4,560,000	3,760,000
Other reserves	57	47,592,832	42,193,332	58,569,401	50,027,681
Retained earnings	56	9,524,236	5,270,848	12,821,116	7,949,848
Total equity attributable to equity holders of the Bank		77,017,226	65,051,053	91,290,675	75,564,402
Non-controlling interests		-	-	3,021,023	2,179,288
Total equity		77,017,226	65,051,053	94,311,698	77,743,690
Total liabilities and equity		858,873,825	725,207,710	901,450,582	757,584,575
Contingent liabilities and commitments	59	502,372,909	343,386,012	502,372,909	343,386,012
Net assets value per share (Rs)	63	186.11	160.29	220.60	186.20

The notes to the financial statements from pages 206 to 327 form an integral part of these financial statements.

I certify that these financial statements are in compliance with the requirements of Companies Act No 7 of 2007.



Anusha Gallage

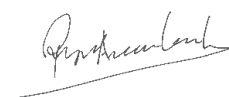
Assistant General Manager - Finance

For and on behalf of the Board



Jonathan Alles

Managing Director /
Chief Executive Officer



Rienzie Arseculeratne

Chairman



K A L Thushari Ranaweera (Mrs)

Deputy General Manager (Legal) /
Company Secretary

Statement of Changes in Equity

	Stated Capital			Other Reserves				Total Rs 000	
	Voting Shares Rs 000	Non-Voting Shares Rs 000	Statutory Reserve Rs 000	Capital Reserve Rs 000	Available-for- Sale Reserve Rs 000	General Reserve Rs 000	ESOP Reserve Rs 000		Retained Earnings Rs 000
Balance as at 1st January 2015	10,640,391	2,649,601	3,160,000	4,466,918	6,755,355	25,100,000	318,339	7,808,059	60,898,663
Super gains tax paid [Note 56 (a)]	-	-	-	-	-	-	-	(2,074,248)	(2,074,248)
Balance as at 1st January 2015 - Adjusted	10,640,391	2,649,601	3,160,000	4,466,918	6,755,355	25,100,000	318,339	5,733,811	58,824,415
Total comprehensive income for the year	-	-	-	-	-	-	-	10,448,786	10,448,786
Net profit for the year 2015	-	-	-	-	-	-	-	(897,969)	(1,206,722)
Other comprehensive income, net of tax	-	-	-	1,991,036	(2,299,789)	-	-	9,550,817	9,242,064
Total comprehensive income for the year	-	-	-	1,991,036	(2,299,789)	-	-	-	-
Transactions with equity holders, recognised directly in equity	-	-	-	-	-	-	-	-	-
Contributions by and distributions to equity holders	368,785	52,113	-	-	-	-	-	-	-
Final dividend 2014 - Cash	-	-	-	-	-	-	-	(2,827,776)	(2,827,776)
Interim dividend 2015 - Cash	-	-	-	-	-	-	-	(608,548)	(608,548)
Issue of shares under ESOP	-	-	-	-	-	-	-	-	420,898
Total contributions by and distributions to equity holders	368,785	52,113	-	-	-	-	-	(3,436,324)	(3,015,426)
Transfers during the year 2015	101,513	14,470	600,000	(22,544)	-	6,000,000	(115,983)	(6,577,456)	-
Balance as at 31st December 2015	11,110,689	2,716,184	3,760,000	6,435,410	4,455,566	31,100,000	202,356	5,270,848	65,051,053
Balance as at 1st January 2016	11,110,689	2,716,184	3,760,000	6,435,410	4,455,566	31,100,000	202,356	5,270,848	65,051,053
Total comprehensive income for the year	-	-	-	-	-	-	-	14,143,406	14,143,406
Net profit for the year 2016	-	-	-	-	-	-	-	362,934	(172,467)
Other comprehensive income, net of tax	-	-	-	2,218,908	(2,754,309)	-	-	14,506,340	13,970,939
Total comprehensive income for the year	-	-	-	2,218,908	(2,754,309)	-	-	-	-
Transactions with equity holders, recognised directly in equity	-	-	-	-	-	-	-	-	-
Contributions by and distributions to equity holders	1,022,473	256,607	-	-	-	-	-	(1,421,200)	(1,421,200)
Final dividend 2015 - Cash	-	-	-	-	-	-	-	(142,120)	(142,120)
Interim dividend 2016 - Cash	-	-	-	-	-	-	-	(620,387)	(620,387)
Issue of shares under ESOP	-	-	-	-	-	-	-	-	178,941
Total contributions by and distributions to equity holders	1,022,473	256,607	-	-	-	-	-	(1,421,200)	(1,421,200)
Transfers during the year 2016	48,444	6,820	800,000	(9,835)	-	6,000,000	(55,264)	(6,790,165)	-
Balance as at 31st December 2016	12,338,734	3,001,424	4,560,000	8,644,483	1,701,257	37,100,000	147,092	9,524,236	77,017,226

Statement of Changes in Equity

Group	Attributable to Equity Holders of the Bank														
	Stated Capital			Other Reserves							Retained Earnings	Non Controlling Interests	Total		
	Voting Shares	Non-Voting Shares	Statutory Reserve	Capital Reserve	Available-for-Sale Reserve	General Reserve	Life Policy Holder Reserve Fund	ESOP Reserve	Rs 000	Rs 000				Rs 000	
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Balance as at 1st January 2015	10,640,391	2,649,601	3,160,000	8,792,778	6,806,191	25,100,000	40,748	318,339	10,396,517	1,734,132	69,638,697				
Super gains tax paid [Note 56 (a)]	-	-	-	-	-	-	-	-	(2,093,074)	(12,551)	(2,105,625)				
Balance as at 1st January 2015 - Adjusted	10,640,391	2,649,601	3,160,000	8,792,778	6,806,191	25,100,000	40,748	318,339	8,303,443	1,721,581	67,533,072				
Total comprehensive income for the year															
Net profit for the year 2015	-	-	-	-	-	-	-	-	10,553,568	542,276	11,095,844				
Other comprehensive income, net of tax	-	-	-	5,493,000	(2,287,750)	-	-	-	(903,213)	(9,569)	2,292,468				
Total comprehensive income for the year	-	-	-	5,493,000	(2,287,750)	-	-	-	9,650,355	532,707	13,388,312				
Transactions with equity holders, recognised directly in equity															
Contributions by and distributions to equity holders															
Final dividend 2014 - Cash	-	-	-	-	-	-	-	-	(2,827,776)	(75,000)	(2,902,776)				
Interim dividend 2015 - Cash	-	-	-	-	-	-	-	-	(608,548)	-	(608,548)				
Issue of shares under ESOP	368,785	52,113	-	-	-	-	-	-	-	-	420,898				
Total contributions by and distributions to equity holders	368,785	52,113	-	-	-	-	-	-	(3,436,324)	(75,000)	(3,090,426)				
Transfer to life policy holder reserve fund	-	-	-	-	-	-	(97,098)	-	-	-	(97,098)				
Deemed disposal gain through joint venture	-	-	-	-	-	-	-	-	9,830	-	9,830				
Transfers during the year 2015	101,513	14,470	600,000	(22,544)	-	6,000,000	-	(115,985)	(6,577,456)	-	-				
Balance as at 31st December 2015	11,110,689	2,716,184	3,760,000	14,263,234	4,518,441	31,100,000	(56,350)	202,356	7,949,848	2,179,288	77,743,690				

Group

	Attributable to Equity Holders of the Bank											
	Stated Capital			Other Reserves								Total
	Voting Shares	Non-Voting Shares	Statutory Reserve	Capital Reserve	Available-for-Sale Reserve	General Reserve	Life Policy Holder Reserve Fund	ESOP Reserve	Retained Earnings	Non Controlling Interests		
Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	
Balance as at 1st January 2016	11,110,689	2,716,184	3,760,000	14,263,234	4,518,441	31,100,000	(56,350)	202,356	7,949,848	2,179,288	77,743,690	
Total comprehensive income for the year	-	-	-	-	-	-	-	-	14,755,634	909,328	15,664,962	
Net profit for the year 2016	-	-	-	-	-	-	-	-	-	-	-	
Other comprehensive income, net of tax	-	-	-	5,518,506	(2,776,906)	-	-	-	368,586	81,814	3,192,000	
Total comprehensive income for the year	-	-	-	5,518,506	(2,776,906)	-	-	-	15,124,220	991,142	18,856,962	
Transactions with equity holders, recognised directly in equity	-	-	-	-	-	-	-	-	(1,421,200)	(149,407)	(1,570,607)	
Contributions by and distributions to equity holders	1,022,473	256,607	-	-	-	-	-	-	(1,421,200)	-	(142,120)	
Final dividend 2015 - Cash	-	-	-	-	-	-	-	-	(620,387)	-	(620,387)	
Interim dividend 2016 - Cash	-	-	-	-	-	-	-	-	-	-	-	
Issue of shares under ESOP	157,128	21,813	-	-	-	-	-	-	-	-	178,941	
Total contributions by and distributions to equity holders	1,179,601	278,420	-	-	-	-	-	-	(3,462,787)	(149,407)	(2,154,173)	
Transfer to life policy holder reserve fund	-	-	-	-	-	-	(134,781)	-	-	-	(134,781)	
Transfers during the year 2016	48,444	6,820	800,000	(9,835)	-	6,000,000	-	(55,264)	(6,790,165)	-	-	
Balance as at 31st December 2016	12,338,734	3,001,424	4,560,000	19,771,905	1,741,535	37,100,000	(191,131)	147,092	12,821,116	3,021,023	94,311,698	

The notes to the financial statements from page 206 to 327 form an integral part of these financial statements.

Statement of Cash Flows

Accounting Policy

The statement of cash flows has been prepared using the direct method of preparing cash flows in accordance with Sri Lanka Accounting Standard - LKAS 7 on "Statement of Cash Flows" whereby gross cash receipts and gross cash payments of operating activities, financing activities and investing activities have been recognised. Cash and cash equivalents comprise short term, highly liquid investments that are readily convertible to known amounts of cash and are subject to an insignificant risk of change in value.

The cash and cash equivalents include cash in hand, balances with banks, placements with banks, money at call and short notice.

For the year ended 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Cash flows from operating activities				
Interest and commission receipts	77,766,617	57,870,224	84,142,896	62,541,611
Interest payments	(36,874,859)	(26,162,039)	(37,989,919)	(26,960,267)
Cash payments to employees	(8,610,079)	(7,787,955)	(10,255,904)	(9,016,129)
Cash payments to other operating activities	(12,385,159)	(9,658,598)	(16,156,447)	(13,221,249)
Receipts from other operating activities	3,152,693	2,486,728	9,035,322	7,422,487
Recovery of loans written off in prior years	34,014	19,989	52,881	33,267
Operating profit before changes in operating assets and liabilities [Note (a)]	23,083,227	16,768,349	28,828,829	20,799,720
(Increase) / decrease in operating assets				
Deposits held for regulatory or monetary control purpose	(13,681,524)	(3,188,552)	(13,681,524)	(3,188,552)
Loans and receivables to customers	(85,148,644)	(102,633,950)	(89,595,887)	(106,052,373)
Reverse repurchase agreements	567,579	11,922,595	2,043,130	11,731,355
Other short term assets	(343,355)	(1,385,665)	(1,090,556)	(1,356,430)
	(98,605,944)	(95,285,572)	(102,324,837)	(98,866,000)
Increase / (decrease) in operating liabilities				
Deposits from customers	91,722,310	106,591,985	94,514,994	109,212,989
Securities sold under repurchase agreements	(3,446,549)	(342,332)	(3,446,549)	(342,332)
Other liabilities	(621,447)	686,371	(434,220)	696,755
	87,654,314	106,936,024	90,634,225	109,567,412
Net cash generated from operating activities before income tax	12,131,597	28,418,801	17,138,217	31,501,132
Income taxes paid	(3,447,705)	(2,142,303)	(3,949,092)	(2,340,344)
Super gains tax paid	-	(2,074,248)	-	(2,105,625)
Net cash generated from operating activities	8,683,892	24,202,250	13,189,125	27,055,163
Cash flows from investing activities				
Dividend income	886,229	1,236,084	145,082	298,749
Dividend income received from joint venture	-	-	30,200	30,130
Net proceeds from sale, maturity and purchase of financial investments	(28,227,265)	(61,270,205)	(30,271,537)	(62,764,719)
Proceeds from deemed disposal of subsidiary company by joint venture	-	-	-	9,830
Investment in joint venture company	(100,000)	-	(100,000)	-
Proceeds from sale of non-current assets held for sale	23,734	31,000	23,734	31,000
Proceeds from sale of property, plant and equipment	12,151	23,522	11,577	23,593
Purchase of intangible assets	(350,477)	(77,194)	(441,837)	(156,306)
Purchase of property, plant and equipment	(975,198)	(882,803)	(1,285,867)	(1,091,320)
Proceeds from sale of investment properties	-	-	3,650	-
Improvements to investment properties	(22,787)	-	(21,516)	(4,221)
Net cash used in investing activities	(28,753,613)	(60,939,596)	(31,906,514)	(63,623,264)
Cash flows from financing activities				
Dividends paid	(1,799,283)	(3,258,631)	(1,948,690)	(3,333,631)
Debenture issue expenses	(35,233)	-	(35,233)	-
Increase in subordinated term debts	13,000,000	-	12,750,000	-
Increase in long term borrowings	12,053,368	37,580,671	12,045,541	37,556,509
Proceeds from issue of shares under ESOP	178,940	420,898	178,940	420,898
Net cash generated from financing activities	23,397,792	34,742,938	22,990,558	34,643,776
Net increase/ (decrease) in cash and cash equivalents	3,328,071	(1,994,408)	4,273,169	(1,924,325)
Cash and cash equivalents at the beginning of the year	14,936,425	16,930,833	16,593,980	18,518,305
Cash and cash equivalents at the end of the year [Note (b)]	18,264,496	14,936,425	20,867,149	16,593,980

For the year ended 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Note (a) - Reconciliation of operating profit before changes in operating assets and liabilities				
Profit before income tax	20,145,829	15,050,017	22,498,647	16,160,268
Amortisation of intangible assets	220,138	220,613	260,357	244,835
Accrual for interest payable	7,035,640	1,633,362	7,017,836	1,721,691
Accrual for interest receivable	(4,047,724)	(56,035)	(4,326,631)	(123,440)
Accrual for other payable	234,917	113,144	587,249	110,290
Accrual for other receivable	(92,289)	53,776	(92,289)	61,900
Depreciation of investment property	5,471	5,445	4,813	4,810
Depreciation of property, plant and equipment	810,321	740,538	1,128,658	1,001,399
Debenture issue expenses	35,233	-	35,233	-
Dividend income	(888,352)	(1,236,834)	(145,007)	(299,499)
(Gain) / loss on FCBU revaluation	25,080	(147,688)	25,080	(147,688)
Gain on disposal from sale of non-current assets held for sale	(3,556)	(763)	(3,556)	(763)
Loss on disposal of investment property	-	-	550	-
Gain on disposal of property, plant and equipment	(4,379)	(14,805)	(1,807)	(14,722)
Impairment charge for loans and other losses	237,160	931,925	508,159	1,022,111
Increase in insurance contract liabilities - life	-	-	1,740,775	1,444,432
Movement in general insurance reserve fund	-	-	375,301	267,127
Net capital (gain) / loss from financial investments - available-for-sale	-	-	14,466	(44,066)
Net capital (gain) / loss from financial investments - fair value through profit or loss	(4,712)	(32,744)	12,719	(15,884)
Net loss from marked to market valuation of financial investments - fair value through profit or loss	44,604	8,825	63,732	4,064
Notional tax credit and WHT credit	(670,154)	(500,427)	(726,666)	(537,060)
Share of profits of associate and joint venture	-	-	(148,790)	(60,085)
	23,083,227	16,768,349	28,828,829	20,799,720

As at 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Note (b) - Cash and cash equivalents at the end of the year				
Cash and cash equivalents (Note 24)	17,511,446	14,909,598	18,668,703	15,419,654
Placements with banks (Note 26)	753,050	26,827	2,198,446	1,174,326
	18,264,496	14,936,425	20,867,149	16,593,980

The notes to the financial statements from pages 206 to 327 form an integral part of these financial statements.

Notes to the Financial Statements

1 REPORTING ENTITY

1.1 Corporate Information

Hatton National Bank PLC (the "Bank") is a public quoted company incorporated on 5th March 1970 with limited liability and domiciled in Sri Lanka. It is a licensed commercial bank registered under the Banking Act No. 30 of 1988 and amendments thereto. The Bank was re-registered under the Companies Act No. 07 of 2007. The registered office of the Bank is situated at No 479, T B Jayah Mawatha, Colombo 10. The shares of the Bank have a primary listing on the Colombo Stock Exchange. The staff strength of the Bank as at 31st December 2016 was 4,190 (2015 - 4,285).

1.2 Consolidated Financial Statements

The consolidated financial statements of the Group for the year ended 31st December 2016 include the Bank and its subsidiaries (together referred to as the "Group" and individually as "Group entities") and the Group's interest in its joint venture. The financial statements of all companies in the Group have a common financial year which ends on December 31st except for HNB Grameen Finance Ltd, a subsidiary of the Bank and Lanka Ventures PLC, a subsidiary of Acuity Partners (Pvt) Limited, the joint venture, whose financial year ends on March 31st.

Hatton National Bank PLC is the ultimate parent of the Group.

There were no significant changes in the nature of the principal activities of the Group during the financial year under review.

1.3 Principal Activities and Nature of Operations

Entity	Principal business activities
Bank	Banking and related activities such as accepting deposits, corporate and retail banking, personal financial services, off shore banking, foreign currency operations, trade services, investment banking, development banking, rural finance, project finance, dealing in government securities, leasing, islamic banking etc.
Subsidiaries	
HNB Assurance PLC	Life insurance
HNB General Insurance Ltd (Held through HNB Assurance PLC)	General insurance

Entity	Principal business activities
Sithma Development (Pvt) Ltd	Construction and letting of premises for commercial purposes and related services
HNB Grameen Finance Ltd	Micro finance facilities and accepting deposits
Joint venture	
Acuity Partners (Pvt) Ltd	Operating as an investment company and providing financial services

2 BASIS OF PREPARATION AND OTHER SIGNIFICANT ACCOUNTING POLICIES

2.1 Basis of Preparation

2.1.1 Statement of Compliance

The consolidated financial statements of the Group and the separate financial statements of the Bank which comprise of the statement of financial position, statement of profit or loss, statement of comprehensive income, statement of changes in equity, statement of cash flows and notes thereto, have been prepared in accordance with Sri Lanka Accounting Standards (commonly referred as "SLFRS" / "LKAS") laid down by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) and comply with the requirements of Companies Act No 7 of 2007, Banking Act No 30 of 1988, Insurance Industry Act No 43 of 2000 and Finance Business Act No 42 of 2011 and amendment thereto.

2.1.2 Responsibility for Financial Statements

The Board of Directors is responsible for the preparation and presentation of the financial statements of the Group and the Bank as per Sri Lanka Accounting Standards and the provisions of the Companies Act No 07 of 2007.

2.1.3 Approval of Financial Statements by Directors

The financial statements of the Group and the Bank were authorised for issue by the Board of Directors in accordance with the resolution of the directors on 23rd February 2017.

2.1.4 Basis of Measurement

The financial statements have been prepared on the historical cost basis and applied consistently except for the following items in the statement of financial position.

Item	Basis of measurement
Derivative financial instruments	Fair value
Financial instruments classified as fair value through profit or loss	Fair value
Available-for-sale financial assets	Fair value
Freehold land and buildings	Measured at cost at the time of acquisition and subsequently at revalued amounts (except investment properties), which are the fair values at the date of revaluation
Non-current assets held for sale	Measured at lower of its carrying amount and fair value less costs to sell
Defined benefit obligations	Liability for defined benefit obligations is recognised as the present value of the defined benefit obligation less the fair value of the plan assets.

2.1.5 Functional and Presentation Currency

The financial statements of the Group are presented in Sri Lankan Rupees (LKR), which is the currency of the primary economic environment in which the Group operates (Group's functional currency). Financial information presented in Sri Lankan Rupees has been rounded to the nearest thousand unless indicated otherwise.

Each entity in the Group determines its own functional currency and items included in the financial statements of each individual entity are measured using that functional currency. There was no change in the Group's presentation and functional currency during the year under review.

2.1.6 Presentation of Financial Statements

The assets and liabilities of the Group presented in the statement of financial position are grouped by nature and listed in an order that reflects their relative liquidity and maturity pattern. An analysis on recovery or settlement within 12 months after the reporting date (current) and more than 12 months after the reporting date (non-current) is presented in Note 61 to the financial statements.

Financial assets and financial liabilities are offset and the net amount is reported in the statement of financial position only when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the assets and settle the liabilities simultaneously. Income and expenses are not offset in the statement of profit or loss unless required or permitted by an accounting standard or interpretation, and as specifically disclosed in the accounting policies of the Group.

Each material class of similar items is presented separately in the financial statements. Items of dissimilar nature or function are presented separately unless they are immaterial as permitted by the Sri Lanka Accounting Standard - LKAS 1 on "Presentation of Financial Statements".

2.1.7 Changes in Accounting Policies

There were no changes in accounting policies and the accounting policies adopted are consistent with those of the previous financial year.

2.1.8 Comparative Information

The comparative information is re-classified wherever necessary to conform with the current year's classification in order to provide a better presentation. The details of such re-classifications have been provided in Note 65 to the financial statements.

2.2 Significant Accounting Judgements, Estimates and Assumptions

The preparation of financial statements in conformity with Sri Lanka Accounting Standards requires management to make judgements, estimates and assumptions that affects the reported amounts of revenues, expenses, assets, liabilities, and the accompanying disclosures, as well as the disclosure of contingent liabilities. Uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of assets or liabilities affected in future periods.

The most significant areas of estimation uncertainty and critical judgements in applying accounting policies that have most significant effect on the amounts recognised in the financial statements of the Group are as follows.

2.2.1 Going Concern

The directors have made an assessment of the Group's ability to continue as a going concern and are satisfied that it has the resources to continue in business for the foreseeable future. Furthermore, Board is not aware of any material uncertainties that may cast significant doubt upon the Group's ability to continue as a going concern and they do not intend either to liquidate or to cease operations of the Group. Therefore, the financial statements continue to be prepared on the going concern basis.

Notes to the Financial Statements

2.2.2 Fair Value of Financial Instruments

Where the fair values of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, those are determined using a variety of valuation techniques that include the use of mathematical models. The inputs to these models are derived from observable market data where possible, but if this is not available, judgement is required to establish fair values. The valuation of financial instruments is described in more detail in Note 5 to the financial statements.

2.2.3 Impairment Losses on Loans and Advances

Individual impairment assessment

The Group reviews their individually significant loans and advances at each reporting date to assess whether an impairment loss should be recorded in the statement of profit or loss. In particular, management judgement is required in the estimation of the amount and timing of future cash flows when determining the impairment loss. These estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the impairment allowance made.

Collective impairment assessment

Loans and advances that have been assessed individually and found not to be impaired and all individually insignificant loans and advances are then assessed collectively, by categorising those into groups of assets with similar credit risk characteristics, to determine whether a provision should be made due to incurred loss events for which there is an objective evidence, but the effects of which are not yet evident. The collective assessment takes account of data from the loan portfolio such as number of days in arrears and judgements on the effect of concentrations of risks and economic data (including levels of unemployment, inflation, interest rates, exchange rates, effect of regulatory changes), and trends in non-performing loans.

The impairment loss on loans and advances is disclosed in Note 31 (b) to the financial statements.

2.2.4 Impairment of Available for Sale Investments

Debt securities

The Group reviews their debt securities classified as available-for-sale investments at each reporting date to assess whether those are impaired. This requires application of similar judgements as applied to the individual assessment of loans and advances.

Equity investments

The Group also records impairment charges on available-for-sale equity investments when there has been a significant or prolonged decline in the fair value below the cost. The

determination of what is 'significant' or 'prolonged' requires judgement. In making this judgement, the Group evaluates, among other factors, historical share price movements, duration and extent to which the fair value of an investment is less than its cost.

The impairment loss on available-for-sale investments is disclosed in Note 33 to the financial statements.

2.2.5 Impairment of Investments in Subsidiaries and Other Financial Assets

The Group follows the guidance of Sri Lanka Accounting Standard - LKAS 36 on "Impairment of Assets" and Sri Lanka Accounting Standard - LKAS 39 on "Financial Instruments : Recognition and Measurement" in determining whether an investment or a financial asset is impaired. This determination requires significant judgement. The Group evaluates, among other factors, the duration and extent to which the fair value of an investment or a financial asset is less than its cost and the financial health of the near-term business outlook of the investment or the financial asset, including factors such as industry and sector performance, changes in technology and operational and financing cash flows.

2.2.6 Impairment of Goodwill

The Group estimates the value in use of the Cash Generating Units (CGU) to which goodwill has been allocated in order to determine whether goodwill is impaired. The value in use calculation requires the entity to estimate the future cash flows expected to arise from the CGU and a suitable discount rate in order to calculate present value. The carrying amount of goodwill as at 31st December 2016 is Rs 122.9 Mn (2015 : Rs 122.9 Mn).

The details on assessment of goodwill impairment is given in Note 39 (b).

2.2.7 Deferred Tax Assets

Deferred tax assets are recognised in respect of loan impairment allowances which will be recovered in the foreseeable future and tax losses to the extent that it is probable that future taxable profit will be available against which the losses can be utilised. Judgement is required to determine the amount of deferred tax assets that can be recognised, based on the likely timing and level of future taxable profits, together with future tax planning strategies.

Details on deferred tax assets are disclosed in Note 49 (b) to the financial statements.

2.2.8 Defined Benefit Obligation

The cost of the defined benefit pension plan is determined using an actuarial valuation. The actuarial valuation involves making assumptions about discount rates, expected rates of return on assets, future salary increases, mortality rates, increase in cost

of living allowances and future pension increases. Due to the long term nature of these plans, such estimates are subject to significant uncertainty. All assumptions are reviewed at each reporting date.

In determining the appropriate discount rate, management considers the interest rates of Government of Sri Lanka Treasury Bonds with maturities corresponding to the expected duration of the defined benefit obligation. Future salary increases and pension increases are based on expected future inflation rates and expected future salary increment rate of the Bank.

Details of the key assumptions used in the estimates are contained in Note 53 to the financial statements.

2.2.9 Fair Value of Freehold Land and Buildings

The freehold land and buildings of the Group are reflected at fair value. The Group engaged independent valuers to determine fair value of freehold land and buildings in terms of Sri Lanka Accounting Standard - SLFRS 13 on "Fair Value Measurement". When current market prices of similar assets are available, such evidence is considered in estimating fair values of these assets.

The methods used to determine the fair value of the freehold land and buildings, are further explained in Note 38 to the financial statements.

2.2.10 Useful Life time of Property, Plant and Equipment, Investment Properties and Intangible Assets

The Group reviews the residual values, useful lives and methods of depreciation of property, plant and equipment, investment properties and intangible assets at each reporting date. Judgement of the management is exercised in the estimation of these values, rates, methods and hence those are subject to uncertainty.

2.2.11 Classification of Investment Properties

Management uses its judgment to determine whether a property qualifies as an investment property. The Group has developed criteria so it can exercise its judgment consistently.

A property that is held to earn rentals or for capital appreciation or both, and which generates cash flows largely independent of the other assets held by the Group are accounted for as investment properties. On the other hand, a property that is used for operations or in the process of providing services or for administrative purposes and which do not directly generate cash flows as a standalone asset, are accounted for as property, plant and equipment. The Group assesses on an annual basis, the accounting classification of its properties, taking into consideration the current use of such properties.

2.2.12 Valuation of Life Insurance Contract Liabilities of Subsidiary HNB Assurance PLC (HNBA)

The liability for life insurance contracts with Discretionary Participation Features (DPF) is either based on current assumptions or on assumptions established at the inception of the contract, reflecting the best estimate at the time, increased with a margin for risk and adverse deviation. All contracts are subject to a liability adequacy test, which reflect management's best current estimate of future cash flows.

The main assumptions used relate to mortality, morbidity, longevity, investment returns, expenses, lapse and surrender rates and discount rates. For those contracts that insure risk related to longevity, prudent allowance is made for expected future mortality improvements, as well as wide ranging changes to life style, which could result in significant changes to the expected future mortality exposure.

Estimates are also made as to future investment income arising from the assets backing life insurance contracts. These estimates are based on current market returns, as well as expectations about future economic and financial developments.

Assumptions on future expense are based on current expense levels, adjusted for expected expense inflation, if appropriate.

Lapse and surrender rates are based on HNBA's historical experience of lapses and surrenders. Discount rates are based on current industry risk rates, adjusted for the HNBA's own risk exposure.

2.2.13 Valuation of General Insurance Contract Liabilities of Subsidiary HNB Assurance PLC (HNBA)

The estimates of general insurance contracts have to be made, both for the expected ultimate cost of claims reported at the reporting date and for the expected ultimate cost of claims Incurred But Not yet Reported (IBNR), at the reporting date. It can take a significant period of time before the ultimate claims cost can be established with certainty. The main assumption underlying estimating the amounts of outstanding claims is the past claims development experience.

Large claims are usually separately addressed, either by being reserved at the face value of loss adjusted estimates or separately projected in order to reflect their future development. In most cases, no explicit assumptions are made regarding future rates of claims, inflation or loss ratios.

2.2.14 Deferred Acquisition Expenses

Acquisition expenses, representing commissions, which vary with and are directly related to the production of business, are deferred and amortised over the period in which the related written premiums are earned. Reinsurance commission is also treated in the same manner with deferred acquisition costs.

Notes to the Financial Statements

2.2.15 Taxation

The Group is subject to income tax and judgement is required to determine the total provision for current, deferred and other taxes due to the uncertainties that exist with respect to the interpretation of the applicability of tax laws, at the time of preparation of these financial statements.

Uncertainties also exist with respect to the interpretation of complex tax regulations and the amount and timing of future taxable income. Given the wide range of business relationships and the long term nature and complexity of existing contractual agreements, differences arising between the actual results and the assumptions made, or future changes to such assumptions, could necessitate future adjustments to tax income and expense amounts that were initially recorded, and deferred tax amounts in the period in which the determination is made.

2.2.16 Share-Based Payments

The Group measures the cost of equity settled transactions with employees by reference to the fair value of the equity instruments on the date on which those are granted.

Estimating fair value for share based payment transactions require determination of the most appropriate valuation model, which is dependent on the terms and conditions of the grant.

This estimate also requires determination of the most appropriate inputs to the valuation model including the expected life of the share option, volatility and dividend yield and making assumptions about them.

2.2.17 Commitments and Contingencies

All discernible risks are accounted for in determining the amount of all known liabilities.

Contingent liabilities are possible obligations whose existence will be confirmed only by uncertain future events or present obligations where the transfer of economic benefit is not probable or cannot be reliably measured. Contingent liabilities are not recognised in the statement of financial position but are disclosed unless they are remote.

Details on commitments and contingencies are given in Note 59 to the financial statements.

2.2.18 Provisions for Liabilities and Contingencies

The Group receives legal claims against it in the normal course of business. Management has made judgements as to the likelihood of any claim succeeding in making provisions. The time of concluding legal claims is uncertain, as is the amount of possible outflow of economic benefits.

3 SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies set out below have been applied consistently to all periods presented in the financial statements of the Group, unless otherwise indicated. The accounting policies have been consistently applied by the Group entities where applicable and deviations if any have been disclosed accordingly.

3.1 Basis of Consolidation

The Bank's financial statements comprise the amalgamation of the financial statements of the Domestic Banking Unit (DBU) and the Foreign Currency Banking Unit (FCBU). The Group's financial statements comprise consolidation of the financial statements of the Bank, its subsidiaries in terms of the Sri Lanka Accounting Standard - SLFRS 10 on "Consolidated Financial Statements" and the proportionate share of the profit or loss and net assets of its joint venture (equity method) in terms of the Sri Lanka Accounting Standard - SLFRS 11 on "Joint Arrangements".

3.1.1 Business Combinations and Goodwill

Business combinations are accounted for using the acquisition method as per the requirements of Sri Lanka Accounting Standard - SLFRS 3 on "Business Combinations". When the Group acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date.

The Group measures goodwill as the fair value of the consideration transferred including the recognised amount of any non-controlling interest in the acquiree, less the net recognised amount (generally fair value) of the identifiable assets acquired and liabilities assumed, all measured as of the acquisition date. When the excess is negative, a bargain purchase gain is recognised immediately in the statement of profit or loss. Acquisition related costs are expensed as incurred and are included in other expenses. Goodwill is initially measured at cost and subsequently at cost less any accumulated impairment losses in accordance with the Sri Lanka Accounting Standard - SLFRS 3 on "Business Combinations".

Goodwill has to be reviewed for impairment annually or more frequently if events or circumstances indicate that the carrying value may be impaired.

The Group elects on a transaction by transaction basis whether to measure non-controlling interest at its fair value, or at its proportionate share of the recognised amount of the identifiable net assets, at the acquisition date.

The consideration transferred does not include amounts related to the settlement of pre-existing relationships. Such amounts are generally recognised in the statement of profit or loss.

3.1.2 Transactions Eliminated on Consolidation

Intra-group balances, transactions and income and expenses arising from intra-group transactions are eliminated in preparing the consolidated financial statements. Un-realised gains arising from transactions with equity accounted investees are eliminated to the extent of the Group's interest in the investee. Un-realised losses are eliminated in the same way as un-realised gains, except that those are only eliminated to the extent that there is no evidence of impairment.

3.1.3 Material Gains or Losses, Provisional Values or Error Corrections

There were no material gains or losses, provisional values or error corrections recognised during the year in respect of business combinations that took place in previous periods.

3.2 Foreign Currency

3.2.1 Foreign Currency Transactions and Balances

Transactions in foreign currencies are translated into the functional currency, which is Sri Lankan Rupees (LKR), using the middle rates of exchange prevailing at the dates on which the transactions were affected.

Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to Sri Lankan Rupees using the middle rates of exchange prevailing at that date. All differences arising on non-trading activities are taken to "other operating income" in the statement of profit or loss.

The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period and the amortised cost in foreign currency translated at the middle rates of exchange prevailing at the end of the reporting period. Foreign currency differences arising on retranslation are recognised in the statement of profit or loss, except for differences arising on the retranslation of available-for-sale equity instruments, a financial liability designated as a hedge of the net investment in a foreign operation, or qualifying cash flow hedges, which are recognised in other comprehensive income.

Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to Sri Lankan Rupees at the exchange rates on the date that the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates at the date of the transaction.

Foreign exchange differences arising on the settlement or reporting of monetary items at rates different from those which were initially recorded are dealt in the statement of profit or loss.

Forward exchange contracts are valued at the forward market rates prevailing on the reporting date. Resulting net unrealised gains or losses are dealt in the statement of profit or loss.

3.3 Financial Instruments – Initial Recognition, Classification and Subsequent Measurement

3.3.1 Date of Recognition

All financial assets and liabilities are initially recognised on the trade date, i.e., the date that the Group becomes a party to the contractual provisions of the instrument. This includes "regular way trades". Regular way trades means purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place.

3.3.2 Recognition and Initial Measurement of Financial Instruments

The classification of financial instruments at initial recognition depends on their purpose and characteristics and the management's intention in acquiring them.

All financial instruments are measured initially at their fair value plus transaction costs that are directly attributable to acquisition or issue of such financial instruments, except in the case of financial assets and financial liabilities at fair value through profit or loss according to Sri Lanka Accounting Standard - LKAS 39 on "Financial Instruments: Recognition and Measurement". Transaction costs in relation to financial assets and financial liabilities at fair value through profit or loss are dealt with through the statement of profit or loss.

In respect of financial assets and liabilities held at fair value through profit or loss, any changes in fair value from the trade date to settlement date are accounted in the statement of profit or loss, while for available-for-sale financial assets, any changes in fair value from the trade date to settlement date are accounted in the other comprehensive income.

3.3.2 (a) "Day 1" Profit or Loss

When the transaction price differs from the fair value of other observable current market transactions in the same instrument, or based on a valuation technique whose variables include only data from observable markets, the Group recognises the difference between the transaction price and fair value (a Day 1 profit or loss) over the tenor of the financial instrument using the Effective Interest Rate (EIR) method. In cases where fair value is determined using data which is not observable, the difference between the transaction price and model value is only recognised in the statement of profit or loss when the inputs become observable, or when the instrument is de-recognised.

Notes to the Financial Statements

3.3.3 Classification and Subsequent Measurement of Financial Instruments

- (i) At inception, a financial asset is classified in one of the following categories:
- Financial assets at fair value through profit or loss
 - Financial assets held for trading
 - Financial assets designated at fair value through profit or loss
 - Loans and receivables
 - Held to maturity financial assets
 - Available-for-sale financial assets
- (ii) At inception, a financial liability is classified in one of the following categories:
- Financial liabilities at fair value through profit or loss
 - Financial liabilities held for trading
 - Financial liabilities designated at fair value through profit or loss
 - Financial liabilities at amortised cost

The subsequent measurement of financial assets and liabilities depend on the classification.

Financial Liabilities at Fair Value through Profit or Loss

Financial liabilities at fair value through profit or loss include financial liabilities held for trading and financial liabilities designated upon initial recognition as at fair value through profit or loss. Subsequent to initial recognition, financial liabilities at fair value through profit or loss are measured at fair value and changes therein are recognised in the statement of profit or loss.

Financial Liabilities Held for Trading

Financial liabilities are classified as held for trading if they are acquired principally for the purpose of selling or repurchasing in the near term or holds as a part of a portfolio that is managed together for short term profit or position taking. This category includes derivative financial instruments entered into by the Group that are not designated as hedging instruments in hedge relationships.

Separated embedded derivatives are also classified as held for trading, unless they are designated as effective hedging instruments.

Gains or losses in liabilities held for trading are recognised in the statement of profit or loss.

Financial Liabilities Designated at Fair Value through Profit or Loss

The Group designates financial liabilities at fair value through profit or loss in the following circumstances:

- Such designation eliminates or significantly reduces measurement or recognition inconsistency that would otherwise arise from measuring the liabilities
- The liabilities are part of a group of financial liabilities, financial assets or both, which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy
- The liability contains one or more embedded derivatives that significantly modify the cash flows that would otherwise have been required under the contract.

The Group has not designated any financial liabilities upon initial recognition as at fair value through profit or loss as at the reporting date.

Financial Liabilities at Amortised Cost

Financial liabilities issued by the Group that are not designated as at fair value through profit or loss are classified as liabilities under 'due to banks', 'due to customers', 'other borrowings', 'debt securities issued' and 'subordinated term debts' as appropriate, where the substance of the contractual arrangement results in the Group having an obligation either to deliver cash or another financial asset to another entity, or to exchange financial assets or financial liabilities with another entity, under conditions that are potentially un-favourable to the entity or settling the obligation by delivering variable number of entity's own equity instruments.

The details of financial liabilities measured at amortised cost are given in Note 41, 42, 43, 45, 46 and 47 to the financial statements.

3.3.4 Reclassifications of Financial Instruments

The Group does not reclassify any financial instrument into the 'fair value through profit or loss' category after initial recognition. Further the Group does not reclassify any financial instrument out of the 'fair value through profit or loss' category if upon initial recognition it was designated as at fair value through profit or loss. The Group reclassifies non-derivative financial assets out of the 'held-for-trading' category and into the 'available-for-sale', 'loans and receivables', or 'held-to-maturity' categories as permitted by the Sri Lanka Accounting Standard - LKAS 39 on "Financial Instruments: Recognition and Measurement". Further, in certain circumstances, the Group is permitted to reclassify financial instruments out of the 'available-for-sale' category and into the 'loans and receivables' or 'held-to-maturity' category.

Reclassifications are recorded at fair value at the date of reclassification, which becomes the new amortised cost.

For a financial asset reclassified out of the available-for-sale category, any previous gain or loss on that asset that has been recognised in equity is amortised to profit or loss over the remaining life of the investment using the Effective Interest Rate (EIR). Any difference between the new amortised cost and the expected cash flows is also amortised over the remaining life of the asset using the EIR. If the asset is subsequently determined to be impaired, then the amount recorded in equity is recycled to the statement of profit or loss.

The Group may reclassify a non-derivative trading asset out of the 'held for trading' category and into the 'loans and receivables' category if it meets the definition of loans and receivables and the Group has the intention and ability to hold the financial asset for the foreseeable future or until maturity. If a financial asset is reclassified and if the Group subsequently increases its estimates of future cash receipts as a result of increased recoverability of those cash receipts, the effect of that increase is recognised as an adjustment to the EIR from the date of the change in estimate.

Reclassification is at the election of management and is determined on an instrument by instrument basis.

3.3.5 De-recognition of Financial Instruments

(i) Financial Assets

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is de-recognised when:

- the rights to receive cash flows from the asset have expired
- the Group has transferred its rights to receive cash flows from the asset or
- has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement; and either:
- the Group has transferred substantially all the risks and rewards of the asset
- or
- the Group has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset

On de-recognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset transferred), and consideration received (including any new asset obtained less, any new liability assumed) and any cumulative gain or loss that had been recognised in other comprehensive income is recognised in statement of profit or loss.

When the Group has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement and has neither transferred nor retained substantially all of the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Group's continuing involvement in the asset. In that case, the Group also recognises an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the Group has retained.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

(ii) Financial Liabilities

A financial liability is de-recognised when the obligation under the liability is discharged, cancelled or expired. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as de-recognition of the original liability and the recognition of a new liability. The difference between the carrying value of the original financial liability and the consideration paid is recognised in the statement of profit or loss.

3.3.6 Impairment of Financial Assets

At each reporting date, the Group assesses whether there is an objective evidence that financial assets not carried at fair value through profit or loss are impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is an objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (an incurred loss event), and that the loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

Objective evidence that financial assets (including equity securities) are impaired can include and not limited to: significant financial difficulty of the borrower or issuer, default or delinquency by a borrower, restructuring of a loan or advance by the Group on terms that the Group would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the Group, or economic conditions that correlate with defaults in the Group. In addition, for an investment in an equity security, a significant or prolonged decline in its fair value below its cost is an objective evidence of impairment.

Notes to the Financial Statements

3.4 Impairment of Non-financial Assets

The carrying amounts of the Group's non-financial assets, other than deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, or when annual impairment testing for an asset is required, the Group estimates the asset's recoverable amount. For goodwill and intangible assets that have indefinite useful lives or that are not yet available for use, the recoverable amount is estimated each year at the same time. An impairment loss is recognised if the carrying amount of an asset or its Cash Generating Unit (CGU) exceeds its estimated recoverable amount.

The recoverable amount of an asset or CGU is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or CGU.

For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generate cash inflows from continuing use that are largely independent of the cash inflows of other assets or CGU. Subject to an operating segment ceiling test, for the purposes of goodwill impairment testing, CGUs to which goodwill has been allocated are aggregated so that the level at which impairment testing is performed reflects the lowest level at which goodwill is monitored for internal reporting purposes. Goodwill acquired in a business combination is allocated to groups of CGUs that are expected to benefit from the synergies of the combination.

The Group's corporate assets do not generate separate cash inflows and are utilised by more than one CGU. Corporate assets are allocated to CGUs on a reasonable and consistent basis and tested for impairment as part of the testing of the CGU to which the corporate asset is allocated.

Impairment losses are recognised in the statement of profit or loss, except for property previously revalued where the gain or loss on revaluation was taken to equity. In this case, the impairment is also recognised in equity up to the extent of any previously recognised revaluation gains. Impairment losses recognised in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the CGU (group of CGUs) and then to reduce the carrying amount of the other assets in the CGU (group of CGUs) on a pro rata basis.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

4 FINANCIAL RISK MANAGEMENT

4.1 Introduction and Overview

The Bank manages its exposure to the risks integral to its activities through a process of proper risk identification, analysis, measurement and continuous monitoring. The Bank is exposed to the following risks arising from financial instruments:

- Credit risk
- Liquidity risk
- Market risk

The Bank's exposure to each of the above risks, objectives, policies and processes associated with measuring and managing such risks, and its strategy on capital management is detailed below. Since the Bank accounts for more than 95% of the total assets, liabilities, income and expenses of the Group, only the Bank's exposure has been discussed under this note.

4.2 Risk Management Framework

The Board of Directors has overall responsibility for the establishment and oversight of the Bank's risk management framework. In discharging its governance responsibility it operates through two key committees, the Board Integrated Risk Management Committee (BIRMC) and the Board Audit Committee (BAC).

The BIRMC provides the Board, the assurance that risk management strategies, policies and processes are in place to manage events / outcomes that have the potential to impact significantly on earnings performance, reputation and capital. The approach entails active monitoring of the level of risk exposure against the parameters set in the risk appetite. The BIRMC also assists the Board by assessing significant credit and other transactions beyond the discretion of executive management.

The following executive management sub - committees, each with specialised focus, support the BIRMC and are responsible for the co-ordination of risk matters for each of the areas of risk management:

- Operational Risk Steering Committee
- Asset and Liability Committee
- Credit Policy Committee
- Investment Committee
- IT Steering Committee

Internal Audit Department undertakes both regular and ad-hoc reviews of risk management controls and procedures, the results of which are reported to the BAC.

The BAC provides its assessment on the effectiveness of internal audit and external disclosure of accounting policies and financial reporting to the Board.

Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered.

4.3 Credit Risk

Credit risk is the risk of financial loss to the Bank if a customer or a counterparty to a financial instrument fails to meet its contractual obligations and arises principally from the Bank's loans and advances to customers, investment in debt and equity securities. For risk management reporting purposes, the Bank considers and consolidates all elements of credit risk exposure (such as individual obligor default risk, industry risk and geographical risk etc.).

For risk management purposes, credit risk arising on trading assets is managed independently and information thereon is disclosed below.

The credit risk policy plays a central role in managing daily business activities. The Bank has developed a policy which defines the principles encompassing client selection, due diligence, early warning signals, watch listing, tolerable levels of concentration risk and portfolio monitoring in line with Bank's risk appetite. The approach is to avoid a large credit risk on a counterparty or portfolio level by applying stringent underwriting standards combined with sound collateralisation where feasible. The policy is reviewed at least annually and approved by the Board Credit / Assets and Liabilities Committee (BC/ALC) ensuring consistency with the Bank's business strategy.

A monthly Credit Policy meeting chaired by the Chief Executive Officer, drives policy decisions and implementation plans.

Notes to the Financial Statements

4 FINANCIAL RISK MANAGEMENT (CONTD.)

4.3 Credit Risk (Contd.)

Bank manages credit risk by focusing on following stages:

The loan origination process comprises initial screening and credit appraisal. The evaluation focuses on the borrower's ability to meet its obligations in a timely manner. Efforts are made to ensure consistent standards are maintained in credit approval. Collateral and guarantees form an important part of the credit risk mitigation process and internal policy dictates margins in Bank's favour by type of security offered, standards for periodic valuations and assessment of realisable value of collateral.

A suite of internal risk rating models are in place for corporate and retail customer segments. The internal risk rating is an important part of the risk assessment of customers and is incorporated in the credit decision process. Significant strides have been made in internalising this approach with a view to giving due prominence to lending, based on cash flow repayment ability as distinct from collateral based lending.

The Bank has established clear guidelines for loan approvals / renewals by adopting a committee based approval structure, where all approval signatories carry equal responsibility for credit risk. Individual credit facilities beyond a minimum threshold require an independent risk signatory with no revenue targets in respective committees.

Bank's corporate banking loan portfolio is administered through a centralised credit administration division which ensures efficient and effective post sanction customer support including disbursement, settlements, processing renewal notices and advising customers on interest rate amendments. This division independently reports to the risk management unit to ensure the availability of clear segregation of duties from business origination. The unit further ensures that the disbursements happen only after stipulated conditions are met and relevant security documents are obtained.

To safeguard the Bank against possible losses, problem loans need to be identified early. The credit risk management division measures and tracks the status of the credit portfolio, undertakes impact studies and detects early warning signals and watch listing pointing to deterioration in the financial health of a borrower.

A credit risk dashboard is prepared monthly to review high level credit portfolio concentration and assesses performance against internal limits (Board risk appetite) and regulatory requirements. An internally developed business intelligence system ('KPI Wizard') is in place to evaluate credit risk indicators at branch, regional, zonal and Bank level. Accountability for credit risk performance is vested with individual business units and unhealthy trends addressed at all levels.

Problem loans are managed by the Credit Supervision and Recoveries Division. This unit is responsible for all aspects of an overdue facility, restructuring of the credit, monitoring the value of the applicable collateral and liquidation, scrutiny of legal documents and liaising with the customer until all recovery matters are finalised. This division's activities are seamlessly integrated with credit administration and credit risk management to ensure effective follow up and learning transfer.

Back office recovery functions representing problem loans classification, rescheduling, provisioning and valuation of collateral on delinquent assets is centralised to ensure standardisation and accuracy. The Bank strictly conforms to regulatory requirements in problem loan classification and management.

Regular audits of business units are undertaken by Internal Audit Division in order to ensure smooth functioning of each of these stages.

Impairment assessment

The methodology adopted by the Bank in respect of impairment assessment is given in Note 31 (b).

Derivative financial instruments

Credit risk arising from derivative financial instruments is, at any time, limited to those with positive fair values, as recorded on the statement of financial position. With gross-settled derivatives, the Bank is also exposed to a settlement risk, being the risk that the Bank honours its obligation, but the counterparty fails to deliver the counter value.

Credit related commitment risks

The Bank makes available to its customers, guarantees which may require that the Bank makes payments on their behalf and enters into commitments to extend credit lines to secure their liquidity needs. Letters of credit and guarantees (including standby letters of credit) commit the Bank to make payments on behalf of customers in the event of a specific act, generally related to the import or export of goods. Such commitments expose the Bank to risks similar to loans and are mitigated by the same control processes and policies.

4 FINANCIAL RISK MANAGEMENT (CONTD.)

4.3 Credit Risk (Contd.)

4.3.1 (a) Maximum Exposure to Credit Risk

The following table shows the maximum exposure to credit risk and net exposure to credit risk by class of financial asset.

As at 31st December	2016		2015	
	Maximum exposure to credit risk	Net exposure to credit risk	Maximum exposure to credit risk	Net exposure to credit risk
	Rs 000	Rs 000	Rs 000	Rs 000
Placements with banks	753,050	753,050	26,827	26,827
Reverse repurchase agreements	4,303,460	118,045	4,869,219	-
Derivative financial instruments	289,989	289,989	1,302,872	1,302,872
Financial investments - fair value through profit or loss	544,915	544,915	593,390	593,390
Loans and receivables to customers (gross)	595,513,919	216,949,035	509,525,467	195,574,504
Financial investments - available-for-sale	89,915,153	89,915,153	78,046,505	78,046,505
Financial investments - loans and receivables	99,260,698	99,260,698	84,206,702	83,013,332
Other assets	2,308,521	2,308,521	1,565,169	1,565,169
	792,889,705	410,139,406	680,136,151	360,122,599
Guarantees, letters of credit and acceptances	149,358,306	147,824,644	111,842,959	109,917,959

Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are in place covering the acceptability and valuation of each type of collateral.

The general creditworthiness of customers tends to be the most relevant indicator of credit quality of a loan. However, collateral provides additional security and the Bank generally requests large borrowers to provide same. The Bank may take collateral in the form of a first charge over real estate and residential properties, floating charges over all corporate assets and other liens and guarantees.

The Bank's policy is to pursue timely realisation of the collateral in an orderly manner. The proceeds are used to reduce or repay the outstanding claim. The Bank generally does not use non-cash collateral for its own operations.

4.3.1 (b) Credit Quality by Class of Financial Assets

The Bank manages the credit quality of loans and receivables based on an internal credit rating system while the other financial assets are managed based on the external credit ratings of the counterparty. The table below shows the credit quality by class of asset for all financial assets exposed to credit risk based on the credit ratings.

As at 31st December 2016	Neither Past Due nor Impaired								Total
	High Grade	Standard Grade	Sub-Standard Grade	Unrated	Exposures not Subject to Rating	Past Due but not Impaired	Past Due and Impaired	Individually Impaired	
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	
Financial Assets									
Cash and cash equivalents	17,511,446	-	-	-	-	-	-	-	17,511,446
Balances with									
Central Bank of Sri Lanka	33,777,614	-	-	-	-	-	-	-	33,777,614
Placements with banks	-	-	-	753,050	-	-	-	-	753,050
Reverse repurchase agreements	4,303,460	-	-	-	-	-	-	-	4,303,460
Derivative financial instruments	260,927	11,387	26	17,649	-	-	-	-	289,989

Notes to the Financial Statements

4 FINANCIAL RISK MANAGEMENT (CONTD.)

4.3 Credit Risk (Contd.)

4.3.1 (b) Credit Quality by Class of Financial Assets (Contd.)

As at 31st December 2016	Neither Past Due nor Impaired					Past Due but not Impaired	Past Due and Impaired	Individually Impaired	Total
	High Grade	Standard Grade	Sub-Standard Grade	Unrated	Exposures not Subject to Rating				
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000				
Financial investments - fair value through profit or loss									
Equity securities	235,944	-	-	308,971	-	-	-	-	544,915
Loans and receivables to customers (gross)	114,696,550	92,172,162	4,143,986	206,102,196	49,058,659	113,391,068	7,060,081	8,889,217	595,513,919
Financial investments - available-for-sale									
Government securities	84,295,103	-	-	-	-	-	-	-	84,295,103
Equity securities - quoted	4,936,537	-	-	270,000	-	-	-	-	5,206,537
Equity securities - unquoted	-	-	-	413,513	-	-	-	-	413,513
Financial investments - loans and receivables									
Government securities	84,786,207	-	-	-	-	-	-	-	84,786,207
Debt securities - quoted	12,338,128	2,136,363	-	-	-	-	-	-	14,474,491
Other assets	-	-	-	-	2,308,521	-	-	-	2,308,521
	357,141,916	94,319,912	4,144,012	207,865,379	51,367,180	113,391,068	7,060,081	8,889,217	844,178,765

As at 31st December 2015	Neither Past Due nor Impaired					Past Due but not Impaired	Past Due and Impaired	Individually Impaired	Total
	High Grade	Standard Grade	Sub-Standard Grade	Unrated	Exposures not Subject to Rating				
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000				
Financial Assets									
Cash and cash equivalents	14,909,598	-	-	-	-	-	-	-	14,909,598
Balances with Central Bank of Sri Lanka	20,096,090	-	-	-	-	-	-	-	20,096,090
Placements with banks	26,827	-	-	-	-	-	-	-	26,827
Reverse repurchase agreements	4,869,219	-	-	-	-	-	-	-	4,869,219
Derivative financial instruments	1,256,294	18,843	-	27,735	-	-	-	-	1,302,872
Financial investments - fair value through profit or loss									
Equity securities	319,995	-	-	273,395	-	-	-	-	593,390
Loans and receivables to customers (gross)	107,390,276	98,307,805	12,916,156	113,268,931	48,842,861	116,121,689	7,404,485	5,273,264	509,525,467
Financial investments - available-for-sale									
Government securities	70,911,843	-	-	-	-	-	-	-	70,911,843
Equity securities - quoted	6,635,079	-	-	280,800	-	-	-	-	6,915,879
Equity securities - unquoted	-	-	-	218,783	-	-	-	-	218,783
Financial investments - loans and receivables									
Government securities	71,848,102	-	-	-	-	-	-	-	71,848,102
Debt securities - quoted	9,887,898	1,981,702	-	-	-	-	-	-	11,869,600
Debt securities - unquoted	489,000	-	-	-	-	-	-	-	489,000
Other assets	-	-	-	-	1,565,169	-	-	-	1,565,169
	308,640,221	100,308,350	12,916,156	114,069,644	50,408,030	116,121,689	7,404,485	5,273,264	715,141,839

4 FINANCIAL RISK MANAGEMENT (CONTD.)

4.3 Credit Risk (Contd.)

4.3.1 (c) Loans and Receivables to Other Customers

Allowances for impairment

The Bank established an allowance for impairment losses on assets carried at amortised cost and financial investments - available-for-sale that represents its estimate of incurred losses in its loans and investments in debt/equity securities portfolio. The main components of this allowance are a specific loss component that relates to individually significant exposures and for assets measured at amortised cost, a collective loan loss allowance established for groups of homogeneous assets, as well as for individually significant exposures that were subject to individual assessment for impairment, but not found to be individually impaired and exposures found to be impaired but not provided. Assets carried at fair value through profit or loss are not subject to impairment testing as the measure of fair value reflects the credit quality of each asset.

The Bank regards an individually significant loan and advance or a debt security as impaired, where there is an objective evidence that a loss event has occurred since initial recognition and such loss event has an impact on future estimated cash flows from the asset.

Movement of the impairment provision during the year, is given in Note 31 (b) to the financial statements.

Past due but not impaired loans

Past due but not impaired loans are those for which contractual interest or principal payments are past due, but the Bank believes that impairment is not appropriate on the basis of the stage of collection of amounts owed to the Bank.

4.3.1 (d) Age Analysis of Financial Assets that are Past Due but not Impaired

As at 31st December	2016	2015
	Rs 000	Rs 000
Past due but not impaired		
1-30 days	87,031,345	92,620,707
31-60 days	24,050,226	21,459,343
61-90 days	1,376,933	910,628
91-120 days	439,232	386,006
121-150 days	239,126	500,810
151-180 days	254,206	244,195
	113,391,068	116,121,689

Rescheduled loans

Rescheduled loans are loans that have been restructured due to deterioration in the borrower's financial position, where the Bank has made concessions, by agreeing to terms and conditions that are more favourable to the borrower compared to the original contract. The Bank implements forbearance policy in order to maximise collection opportunities and minimise the risk of default. Under the Bank's forbearance policy, loan forbearance is granted on a selective basis in situations where the debtor is currently in default on its debt, or where there is a high risk of default, there is evidence that the debtor made all the reasonable efforts to pay under the original contractual terms and they are expected to be able to meet the revised terms. The revised terms usually include extending maturity, changing timing of interest payments and amendments to the terms of loan covenants. Both retail and corporate loans are subject to the forbearance policy. Once the loan is restructured, it remains in this category independent of satisfactory performance after restructuring. At the time of restructuring the loan, the Bank determines the fair value of the loan and carrying value is brought down to reflect the fair value charging the difference if any, to the statement of profit or loss under impairment for loans and other losses.

During the year ended 31st December 2016, the Bank restructured loans and advances with a carrying value of Rs 8,428.81 Mn (2015 - Rs 5,528.04 Mn) and recognised an impairment of Rs 9.66 Mn (2015 - Rs 40.55 Mn) in the statement of profit or loss.

The Board Audit Committee regularly reviews reports on forbearance activities.

Write-off policy

The Bank writes off a loan or an investment in debt / equity security balance and any related allowances for impairment losses, when it determines that the loan or security is uncollectible. This determination is made after considering information such as the occurrence of significant changes in the borrower's / issuer's financial position, such that the borrower / issuer can no longer pay the obligation or that proceeds from collateral will not be sufficient to pay back the entire exposure. For standardised loans with smaller balances, write-off decisions generally are based on a product-specific past due status.

Notes to the Financial Statements

4 FINANCIAL RISK MANAGEMENT (CONTD.)

4.3 Credit Risk (Contd.)

4.3.1 (e) Concentrations of Credit Risk

The Bank monitors concentration of credit risk by sector and by geographic location. An analysis of risk concentration of financial asset by industry is given below.

4.3.1 (e) i Concentration by Sector

As at 31st December 2016	Agriculture and fishing	Manufacturing	Tourism	Transport	Construction	Traders	New Economy	Financial and Business Services	Infrastructure	Other Services	Other	Total
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Financial Assets												
Cash and cash equivalents	-	-	-	-	-	-	-	17,511,446	-	-	-	17,511,446
Balances with												
Central Bank of Sri Lanka	-	-	-	-	-	-	-	33,777,614	-	-	-	33,777,614
Placements with banks	-	-	-	-	-	-	-	753,050	-	-	-	753,050
Reverse repurchase agreements	-	-	-	-	-	-	-	4,303,460	-	-	-	4,303,460
Derivative financial instruments	-	-	-	-	-	-	-	289,989	-	-	-	289,989
Financial investments - fair value through profit or loss	50,855	52,240	36,622	-	354	17,253	-	179,435	47,355	160,801	-	544,915
Loans and receivables to customers (gross)	54,101,769	69,188,984	43,708,242	11,645,488	85,885,286	117,378,942	6,560,378	71,151,207	41,002,795	57,842,020	37,048,808	595,513,919
Financial investments - available-for-sale	-	-	-	-	-	-	-	89,915,153	-	-	-	89,915,153
Financial investments - loans and receivables	-	3,144,562	-	-	-	500,738	-	93,904,248	1,518,534	192,616	-	99,260,698
Other assets	-	-	-	-	-	-	-	2,308,521	-	-	-	2,308,521
	54,152,624	72,385,786	43,744,864	11,645,488	85,885,640	117,896,933	6,560,378	314,094,123	42,568,684	58,195,437	37,048,808	844,178,765

As at 31st December 2015	Agriculture and fishing	Manufacturing	Tourism	Transport	Construction	Traders	New Economy	Financial and Business Services	Infrastructure	Other Services	Other	Total
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Financial Assets												
Cash and cash equivalents	-	-	-	-	-	-	-	14,909,598	-	-	-	14,909,598
Balances with												
Central Bank of Sri Lanka	-	-	-	-	-	-	-	20,096,090	-	-	-	20,096,090
Placements with banks	-	-	-	-	-	-	-	26,827	-	-	-	26,827
Reverse repurchase agreements	-	-	-	-	-	-	-	4,869,219	-	-	-	4,869,219
Derivative financial instruments	-	-	-	-	-	-	-	1,302,872	-	-	-	1,302,872
Financial investments - fair value through profit or loss	-	135,722	130,519	17,244	330	13,982	-	198,241	8,700	88,652	-	593,390
Loans and receivables to customers (gross)	46,969,592	61,730,842	35,180,590	11,455,385	75,857,189	98,073,956	3,721,347	63,769,572	32,661,197	43,955,289	36,150,508	509,525,467
Financial investments - available-for-sale	-	-	-	-	-	-	-	78,046,505	-	-	-	78,046,505
Financial investments - loans and receivables	-	2,509,590	-	-	-	500,000	-	79,011,112	2,000,000	186,000	-	84,206,702
Other assets	-	-	-	-	-	-	-	1,565,169	-	-	-	1,565,169
	46,969,592	64,376,154	35,311,109	11,472,629	75,857,519	98,587,938	3,721,347	263,795,205	34,669,897	44,229,941	36,150,508	715,141,839

4 FINANCIAL RISK MANAGEMENT (CONTD.)

4.3 Credit Risk (Contd.)

4.3.1 (e) ii Concentration by Location

Concentration of loans and advances by location is given below.

As at	31st December 2016		31st December 2015	
	Rs 000	%	Rs 000	%
Western	428,736,278	71.99	369,605,337	72.54
Southern	27,501,951	4.62	22,558,498	4.43
Uva	8,504,380	1.43	7,588,602	1.49
North Central	10,023,284	1.68	8,604,336	1.69
North Western	28,081,752	4.72	24,586,758	4.83
Eastern	15,892,029	2.67	12,867,433	2.53
Northern	16,016,453	2.69	12,351,575	2.42
Sabaragamuwa	12,761,719	2.14	12,243,551	2.4
Central	32,209,039	5.41	28,707,819	5.63
Overseas	15,787,034	2.65	10,411,558	2.04
	595,513,919	100	509,525,467	100

Concentration by location for loans and advances is measured based on the location of the customer centre that granted the facility, which has a high correlation with the location of the borrower, except for loans granted by the Foreign Currency Banking Unit (FCBU).

Significant foreign exposures

Gross and net carrying values of significant foreign lendings are given below. All these loans have been considered as significant loans and analysed individually. When the Bank has identified objective evidence of impairment of these loans, future cash flows have been estimated giving due consideration for specific industry, country risk factors etc. and availability of collateral.

As at 31st December	Cambodia		Maldives	
	2016	2015	2016	2015
	Rs 000	Rs 000	Rs 000	Rs 000
Gross carrying value	6,371,813	6,405,650	5,338,160	1,808,186
Provision for impairment	(17,399)	(19,363)	(387,418)	(461,328)
Net carrying value	6,354,414	6,386,287	4,950,742	1,346,858

Total unutilised overdrafts approved to above customers as at 31st December 2016 amounts to Rs 899.55 Mn (2015 : Rs 864.66 Mn).

4.3.1 (f) Commitments and Guarantees

The Bank enters into various irrevocable commitments and contingent liabilities in order to meet the financial needs of the customer. These obligations contain credit risk and form part of the overall risk of the Bank even though those are not recognised on the statement of financial position.

The table below shows the Bank's maximum credit risk exposure for commitments and guarantees.

The maximum exposure to credit risk relating to acceptances, documentary credit and guarantees, is the amount the Bank would have to pay in the event those are called upon. The maximum exposure to credit risk relating to loan commitments, is the full amount of the commitment. In both cases, the maximum risk exposure is significantly greater than the amount recognised as a liability in the statement of financial position.

As at 31st December	2016	2015
	Rs 000	Rs 000
Acceptances	15,827,724	10,865,852
Documentary credit	24,629,974	21,730,162
Guarantees	108,900,608	79,246,945
Commitments for unutilised facilities - direct	114,244,896	101,817,026
Commitments for unutilised facilities - indirect	100,901,909	41,946,000
	364,505,111	255,605,985

Notes to the Financial Statements

4 FINANCIAL RISK MANAGEMENT (CONTD.)

4.4 Liquidity Risk

Liquidity risk is the risk that the Bank is unable to meet its debt obligations associated with its financial liabilities due to lack of funds or having to meet these obligations at excessive cost.

4.4.1 Management of Liquidity Risk

The Bank manages liquidity risk, in accordance with regulatory guidelines and international best practices. The objective of the Bank's liquidity and funding framework is to ensure that funding commitments and deposit withdrawals can be met when due and that market access remains cost effective. A Board approved liquidity policy to manage liquidity on a day-to-day basis and a contingency funding plan to deal with crisis situations are in place. Contractual maturity of assets and liabilities, key liquidity ratios and monthly liquidity forecasts and gaps are reviewed at Assets and Liability Committee (ALCO) meetings. The main sources of the Bank's funding are capital, core deposits from retail and commercial clients, wholesale deposits and access to borrowed funds from the interbank money market. The Bank also maintains a portfolio of readily marketable securities to further strengthen its liquidity position. Liquidity risk exposure is managed by treasury with limits and triggers set to ensure that sufficient liquidity surplus and reserves are available to meet daily business requirements and also to deal with a sudden liquidity shock. Treasury reports the Bank's overall liquidity position to management on a daily basis.

4.4.1 (a) Exposure to Liquidity Risk

The Bank monitors the following liquidity ratios to assess funding requirements.

	2016	2015
Net loans / total assets	68.04%	68.72%
Gross loans / customer deposits	95.51%	96.66%
Liquid Asset Ratio (LAR)		
As at 31st December	24.23%	25.09%
Average for the year	23.64%	24.31%
Maximum for the year	24.51%	26.48%
Minimum for the year	21.96%	21.94%

Components of the Bank's liquid assets portfolio used for the purpose of statutory liquid asset ratio calculation as at 31st December 2016 (average balance for the month of December) is given below.

As at 31st December	2016	2015
	Rs 000	Rs 000
Cash	15,994,207	13,947,385
Balances with licensed commercial banks	156,486	156,736
Money at call in Sri Lanka	1,096,323	3,695,742
Treasury bills and securities issued or guaranteed by the Government of Sri Lanka which have a maturity not exceeding one year	154,671,263	130,779,418
Import bills	-	15,862
Export bills	1,733,589	1,859,146
Cash items in the process of collection	1,008,177	1,074,133
Balances with the banks abroad	1,706,249	1,635,933
Total average liquid assets for the month of December	176,366,293	153,164,355

Monthly liquidity gap is reported to ALCO by Treasury for each currency, together with the overall gap position. Liquidity gap is based on the expected realisation of the assets and liabilities which have been determined based on historical behaviour. Net liquidity position reported for the month is monitored against the pre-set limits which have been approved by the ALCO.

The Bank also holds debt and equity securities which are not considered as liquid assets but for which there is an active and liquid market. These assets can be readily sold to meet any unexpected liquidity requirements. Detailed analysis of the debt and equity securities held by the Bank as at 31st December 2016 is presented under credit risk. No assets have been pledged as collateral for borrowings other than treasury bills and bonds which are pledged against repurchase transactions. Details of treasury bills and bonds pledged as collateral against repurchase transactions are disclosed under Note 33 (k) to the financial statements.

4 FINANCIAL RISK MANAGEMENT (CONTD.)

4.4 Liquidity Risk (Contd.)

4.4.1 (b) Analysis of Financial Assets and Liabilities by Remaining Contractual Maturities

The table below summarises the maturity profile of undiscounted cash flows of the Bank's financial assets and liabilities as at 31st December. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Bank expects that many customers will not request repayment on the earliest date it could be required to pay and the table does not reflect the expected cash flows indicated by its deposit retention history.

Contractual maturities of undiscounted cash flows of financial assets and financial liabilities.

31st December 2016	Upto 3 months Rs 000	3 - 12 months Rs 000	1 - 3 years Rs 000	3 - 5 years Rs 000	More than 5 years Rs 000	Total Rs 000
Financial Assets						
Cash and cash equivalents	17,511,446	-	-	-	-	17,511,446
Balances with Central Bank of Sri Lanka	-	-	-	-	33,777,614	33,777,614
Placements with banks	753,050	-	-	-	-	753,050
Reverse repurchase agreements	4,304,494	-	-	-	-	4,304,494
Derivative financial instruments	152,566	137,423	-	-	-	289,989
Financial investments-fair value through profit or Loss	544,915	-	-	-	-	544,915
Loans and receivables to customers	248,793,756	121,203,976	186,798,226	89,217,633	83,139,982	729,153,573
Financial investments - available-for-sale	6,652,784	34,901,127	33,636,104	22,771,358	13,837,326	111,798,699
Financial investments - loans and receivables	18,445,161	26,949,649	27,342,764	39,660,236	49,979	112,447,789
Other assets	-	-	2,455,967	-	-	2,455,967
Total undiscounted financial assets	297,158,172	183,192,175	250,233,061	151,649,227	130,804,901	1,013,037,536
Financial Liabilities						
Due to banks	25,135,863	18,587,927	20,352,562	10,892,549	594,016	75,562,917
Derivative financial instruments	429,084	236,806	-	-	-	665,890
Securities sold under repurchase agreements	8,733,218	4,910,733	-	-	-	13,643,951
Due to customers	445,559,576	173,725,972	14,615,437	6,298,701	-	640,199,686
Dividends payable	1,007,075	-	-	-	-	1,007,075
Other borrowings	1,062,167	3,019,231	14,080,343	11,209,294	1,708,333	31,079,368
Debt securities issued	-	549,818	3,508,661	334,001	2,424,716	6,817,196
Other liabilities	403,851	-	-	-	-	403,851
Subordinated term debts	793,973	2,459,759	8,761,185	19,071,077	7,229,821	38,315,815
Total undiscounted financial liabilities	483,124,807	203,490,246	61,318,188	47,805,622	11,956,886	807,695,749
Net undiscounted financial assets/(liabilities)	(185,966,635)	(20,298,071)	188,914,873	103,843,605	118,848,015	205,341,787

The table below shows the contractual expiry by maturity of the Bank's contingent liabilities and commitments.

	Upto 3 months Rs 000	3 - 12 months Rs 000	1 - 3 years Rs 000	3 - 5 years Rs 000	More than 5 years Rs 000	Total Rs 000
Acceptances	11,111,376	4,650,939	65,409	-	-	15,827,724
Documentary credit	19,771,633	4,836,075	22,266	-	-	24,629,974
Guarantees	18,094,646	35,573,737	39,747,563	10,820,265	4,664,397	108,900,608
Undrawn commitments to lend - direct facilities	114,244,896	-	-	-	-	114,244,896
Undrawn commitments to lend - indirect facilities	100,901,909	-	-	-	-	100,901,909
	264,124,460	45,060,751	39,835,238	10,820,265	4,664,397	364,505,111

Notes to the Financial Statements

4 FINANCIAL RISK MANAGEMENT (CONTD.)

4.4 Liquidity Risk (Contd.)

4.4.1 (b) Analysis of Financial Assets and Liabilities by Remaining Contractual Maturities (Contd.)

31st December 2015	Upto 3 months	3 - 12 months	1 - 3 years	3 - 5 years	More than 5 years	Total
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Financial Assets						
Cash and cash equivalents	14,909,598	-	-	-	-	14,909,598
Balances with Central Bank of Sri Lanka	-	-	-	-	20,096,090	20,096,090
Placements with banks	26,827	-	-	-	-	26,827
Reverse repurchase agreements	4,870,068	-	-	-	-	4,870,068
Derivative financial instruments	278,361	1,024,511	-	-	-	1,302,872
Financial investments - fair value through profit or loss	593,390	-	-	-	-	593,390
Loans and receivables to customers	189,579,911	112,239,271	146,092,981	74,930,958	73,880,756	596,723,877
Financial investments - available-for-sale	14,038,553	24,383,411	16,297,711	18,479,192	19,204,245	92,403,112
Financial investments - loans and receivables	14,419,556	13,779,143	32,622,517	35,731,034	-	96,552,250
Other assets	-	471,866	1,093,303	-	-	1,565,169
Total undiscounted financial assets	238,716,264	151,898,202	196,106,512	129,141,184	113,181,091	829,043,253
Financial Liabilities						
Due to banks	13,063,401	23,664,773	18,687,149	7,084,231	985,145	63,484,699
Derivative financial instruments	157,154	147,331	-	-	-	304,485
Securities sold under repurchase agreements	16,487,390	183,732	-	-	-	16,671,122
Due to other customers	372,110,420	147,243,100	12,316,092	6,346,352	-	538,015,964
Dividends payable	764,771	-	-	-	-	764,771
Other borrowings	59,787	45,487	61,543	9,954,572	21,625,494	31,746,883
Debt securities issued	-	391,607	930,997	3,295,560	2,592,029	7,210,193
Other liabilities	278,584	-	-	-	-	278,584
Subordinated term debts	-	1,170,262	6,766,190	4,571,267	4,978,004	17,485,723
Total undiscounted financial liabilities	402,921,507	172,846,292	38,761,971	31,251,982	30,180,672	675,962,424
Net undiscounted financial assets/(liabilities)	(164,205,243)	(20,948,090)	157,344,541	97,889,202	83,000,419	153,080,829

The table below shows the contractual expiry by maturity of the Bank's contingent liabilities and commitments.

	Upto 3 months	3 - 12 months	1 - 3 years	3 - 5 years	More than 5 years	Total
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Acceptances	8,540,327	2,263,053	62,472	-	-	10,865,852
Documentary credit	17,826,795	3,453,886	449,481	-	-	21,730,162
Guarantees	17,618,025	23,749,445	26,129,432	5,350,007	6,400,036	79,246,945
Undrawn commitments to lend						
- direct facilities	101,817,027	-	-	-	-	101,817,027
Undrawn commitments to lend						
- indirect facilities	41,946,000	-	-	-	-	41,946,000
	187,748,174	29,466,384	26,641,385	5,350,007	6,400,036	255,605,986

The Bank expects that not all of the contingent liabilities or commitments will be drawn before expiry of the commitments.

4 FINANCIAL RISK MANAGEMENT (CONTD.)

4.5 Market Risk

Market risk is the risk that changes in market prices, such as interest rates, equity prices, foreign exchange rates and credit spreads (not relating to changes in the obligor's or issuer's credit standing) which will affect the Bank's income or the value of its holdings of financial instruments. The objective of the Bank's market risk management is to manage and control market risk exposures within acceptable parameters in order to ensure the Bank's solvency while optimising the return on risk.

4.5.1 Management of Market Risk

The Bank separates its exposure to market risk between trading and non-trading portfolios. Trading portfolio includes financial assets and liabilities that are managed on a fair value basis. All foreign exchange positions within the Bank are treated as part of the Bank's trading portfolios for risk management purposes. Non trading portfolio is managed in accordance with the purpose and strategic benefits of such investments, rather than purely on fair value basis.

The Bank has a board approved treasury policy. Treasury middle office monitors the Bank's compliance with the above policy and ensures that the Bank's market risk limits are in line with the level of risk acceptable to the Board. The Bank employs a range of tools to monitor and limit market risk exposures which are discussed below.

4.5.2 Exposure to Market Risk

The principal tool used to measure and control market risk exposure within the Bank is Value at Risk (VaR). The VaR of a portfolio is the estimated loss that will arise on the portfolio over a specified period of time (holding period) from an adverse market movement with a specified probability (confidence level). The VaR model used, by the Bank is based upon a 99 percent confidence level and assumes 1-day and a 10-day holding period. The VaR model used is based mainly on historical simulation. Taking account of market data from the previous two years and observed relationships between different markets and prices, the model generates a wide range of plausible future scenarios for market price movements.

Although VaR is an important tool for measuring market risk, the assumptions on which the model is based give rise to some limitations, including the following:

The 1-day and 10-day holding periods assumes that it is possible to hedge or dispose of positions within those periods. This may not be the case for illiquid assets or in situations in which there is severe general market liquidity.

A 99 percent confidence level does not reflect losses that may occur beyond this level. Even within the model used, there is a one percent probability that losses could exceed the VaR.

VaR is calculated on an end-of-day basis and does not reflect exposures that may arise on positions during the trading day.

The use of historical data as a basis for determining the possible range of future outcomes, may not always cover all possible scenarios, especially those of an exceptional nature.

The VaR measure is dependent upon the Bank's position and the volatility of market prices. The VaR of an unchanged position reduces if market price volatility declines and vice versa.

The Bank uses VaR limits for foreign exchange and equity risks. The overall structure of VaR limits is subject to review and approval by ALCO. VaR limits are allocated to portfolios. VaR is measured at least monthly and reported to ALCO.

The Bank's VaR models are subject to regular validation by Treasury Mid Office (TMO) to ensure that they continue to perform as expected and that assumptions used in model development are still appropriate.

A summary of the VaR position of the Bank as at 31st December and during the period is as follows:

	As at 31st December	Average	Maximum	Minimum
	Rs 000	Rs 000	Rs 000	Rs 000
2016				
Foreign currency risk (USD NOP)*	16,639	13,324	17,592	7,416
Equity risk	32,280	30,176	32,710	26,150
2015				
Foreign currency risk (USD NOP)*	12,647	4,788	12,647	1,059
Equity risk	26,471	27,618	32,432	23,365

* Only USD exposure has been considered as it represents over 98.52% of the foreign currency transactions.

Notes to the Financial Statements

4 FINANCIAL RISK MANAGEMENT (CONTD.)

4.4 Liquidity Risk (Contd.)

4.5.2 Exposure to Market Risk (Contd.)

The limitations of the VaR methodology are recognised by supplementing VaR limits with other risk measures. The Bank uses a wide range of stress tests to model the financial impact of a variety of exceptional market scenarios such as changes in exchange rates, interest rates and prices of financial instruments such as equities and bonds. The results of the stress tests are reviewed by ALCO.

4.5.3 Exposure to Interest Rate Risk

The principal risk to which non-trading portfolios are exposed is the risk of loss from fluctuations in the future cash flows or fair values of financial instruments because of a change in market interest rates. The Bank manages the interest rate risk against interest rate gap limits, which is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to various rate scenarios. Net interest yields are also calculated for each product, to ensure adequate margins are kept.

The Bank holds treasury bills and bonds with shorter maturities, thus the impact of interest rate changes on treasury bill and bond prices are very minimal. Modified duration of both the trading and non-trading portfolios as at 31st December is given below.

As at 31st December	2016	2015
Trading	-	-
Non trading	2.5166	2.4342

Modified duration follows the concept that the interest rates and bond prices move in opposite directions. This determines the effect that a 100 basis point (1%) change in interest rates will have on the price of a bond.

An analysis of the Bank's sensitivity to an increase or decrease in market interest rates based on rate sensitive assets and rate sensitive liabilities as at 31st December 2016 is as follows.

	Decrease of 100 bps	Decrease of 200 bps	Increase of 100 bps	Increase of 200 bps
LKR Portfolio (Rs 000)	(794,843)	(1,630,310)	755,947	1,474,800
USD Portfolio (USD 000)	(4,636)	(9,607)	4,332	8,387

4.6 Capital Management

The Bank's capital management objectives can be summarised as follows:

- Maintain sufficient capital to meet minimum regulatory capital requirements
- Hold sufficient capital to support the Bank's risk appetite
- Allocate capital to businesses to support the Bank's strategic objectives
- Ensure that the Bank maintains capital in order to achieve debt rating objectives and to withstand the impact of potential stress events

Regulatory capital

The Bank manages its capital considering regulatory capital requirements. The Central Bank of Sri Lanka (CBSL) sets and monitors capital requirements for licensed banks in Sri Lanka based on the Basel Framework. Thus the Bank's operations are directly supervised by the CBSL and the Bank is required to comply with the provisions of the Basel II framework in respect of regulatory capital and capital to cover any additional risk. Commercial banks in Sri Lanka need to maintain a minimum Capital Adequacy Ratio (CAR) of 10% and a core capital ratio (Tier 1) of at least 5%. Historically the Bank has been maintaining CAR well above the regulatory minimum.

5 FAIR VALUE OF ASSETS AND LIABILITIES

Accounting Policy

Determination of Fair Value

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- in the principal market for the asset or liability or
- in the absence of a principal market, in the most advantageous market for the asset or liability.

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorised within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- Level 1 - Valuation technique using quoted market price: financial instruments with quoted prices for identical instruments in active markets
- Level 2 - Valuation technique using observable inputs: financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.
- Level 3 - Valuation technique with significant unobservable inputs: financial instruments valued using valuation techniques where one or more significant inputs are unobservable.

Level 1

When available, the Group measures the fair value of an instrument using quoted prices in an active market for that instrument or dealer price quotations (assets and long positions are measured at a bid price, liabilities and short positions are measured at an asking price), without any deduction for transaction costs.

A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm's length basis.

Level 2

If a market for a financial instrument is not active, then the Group establishes fair value using a valuation technique. Valuation techniques include using recent arm's length transactions between knowledgeable, willing parties (if available), reference to the current fair value of other instruments that are substantially the same, discounted cash flow analysis and option pricing models. The chosen valuation technique makes maximum use of market inputs, relies as little as possible on estimates specific to the Group, incorporates all factors that market participants would consider in setting a price and is consistent with accepted economic methodologies for pricing financial instruments. Inputs to valuation techniques reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument. The Group calibrates valuation techniques and tests them for validity using prices from observable current market transactions in the same instrument, or based on other available observable market data.

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price, i.e. the fair value of the consideration given or received, unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument, i.e. without modification or repackaging, or based on a valuation technique whose variables include only data from observable markets. When a transaction price provides the best evidence of fair value at initial recognition, the financial instrument is initially measured at the transaction price and any difference between this price and the value initially obtained from a valuation model, is subsequently recognised in profit or loss on an appropriate basis over the life of the instrument, but not later than when the valuation is supported wholly by observable market data or the transaction is closed out.

Level 3

Certain financial instruments are recorded at fair value using valuation techniques, in which current market transactions or observable market data are not available. Their fair value is determined using a valuation model that has been tested against prices or inputs to actual market transactions and using the Bank's best estimate of the most appropriate model assumptions. Models are adjusted to reflect the spread for bid and ask prices to reflect costs to close out positions, credit and debit valuation adjustments, liquidity spread and limitations in the models. Also, profit or loss calculated when such financial instruments are first recorded (day-1 profit or loss) is deferred and recognised only when the inputs become observable or on de-recognition of the instrument.

Fair values reflect the credit risk of the instrument and include adjustments to take account of the credit risk of the Group entity and the counterparty where appropriate. Fair value estimates obtained from models are adjusted for any other factors, such as liquidity risk or model uncertainties; to the extent that the Group believes a third-party market participant would take them into account in pricing a transaction.

Notes to the Financial Statements

5 FAIR VALUE OF ASSETS AND LIABILITIES (CONTD.)

5.1 Assets and Liabilities Recorded at Fair Value

A description of how fair values are determined for assets and liabilities that are recorded at fair value using valuation techniques is summarised below, which incorporates the bank's estimate of assumptions that a market participant would make when valuing the instruments.

Derivative financial instruments

Derivative financial instruments such as forward foreign exchange contracts and currency swaps are valued, using a valuation technique with market observable inputs (Level 2). The most frequently applied valuation technique is forward pricing model which incorporates various inputs, including foreign exchange spot and forward premiums.

Financial investments - available for sale

Government debt securities classified as financial investments - available-for-sale are valued using current yield rates or market rates published by the Central Bank of Sri Lanka. Quoted equities and units classified as financial investments - available-for-sale are valued using quoted market prices in the active markets as at the reporting date (Level 1). Unquoted units classified as financial investments - available-for-sale are valued using manager's selling price. Unquoted shares classified as financial investments - available-for-sale are valued at cost.

Financial investments fair value through profit or loss

Government debt securities classified as financial investments fair value through profit or loss are valued using yield curves published by the Central Bank of Sri Lanka, while quoted equities classified as financial investments fair value through profit or loss are valued using quoted market prices in active markets as at the reporting date (Level 1). Unquoted units classified as financial investments fair value through profit or loss are valued using manager's selling price.

Freehold land and buildings

Fair value of freehold land and buildings (revalued amount) is determined using the depreciated replacement cost basis of valuation and market comparable method (Level 3), which as a basis of valuation is the sum of:

- 1). The open market value of the land for its existing use plus
- 2). The current gross replacement cost of the buildings and their site works less an allowance for all appropriate factors such as age, condition, functional and environmental obsolescence which result in the existing property being worthless than a new replacement.

5.2 Valuation Model

The fair values are measured using the fair value hierarchy.

For all financial instruments where fair values are determined by reference to externally quoted prices or observable pricing inputs to models, independent price determination or validation is obtained. In an inactive market, direct observation of a traded price may not be possible. In these circumstances, the Bank uses alternative market information to validate the financial instrument's fair value, with greater weight given to information that is considered to be more relevant and reliable.

The independent valuers provide the fair value of the Bank's freehold land and buildings at least once in every three years according to the Bank's policy. The Bank carried out a revaluation of its freehold land and buildings in 2016. The methods used to determine the fair value of freehold land and buildings are explained in Note 38 (b) to the financial statements.

5 FAIR VALUE OF ASSETS AND LIABILITIES (CONTD.)

5.3 Assets and Liabilities Measured at Fair Value - Fair Value Hierarchy

The following table shows an analysis of assets and liabilities recorded at fair value by level of fair value hierarchy, into which the fair value measurement is categorised. The amounts are based on the values recognised in the statement of financial position.

As at 31st December 2016	Bank				Group			
	Level 1 Rs 000	Level 2 Rs 000	Level 3 Rs 000	Total Rs 000	Level 1 Rs 000	Level 2 Rs 000	Level 3 Rs 000	Total Rs 000
Financial assets measured at fair value								
Derivative financial instruments								
Currency swaps	-	255,902	-	255,902	-	255,902	-	255,902
Forward foreign exchange contracts	-	34,087	-	34,087	-	34,087	-	34,087
	-	289,989	-	289,989	-	289,989	-	289,989
Financial investments fair value through profit or loss								
Quoted shares	544,915	-	-	544,915	690,094	-	-	690,094
Quoted units	-	-	-	-	10,296	-	-	10,296
Unquoted units	-	-	-	-	-	1,036	-	1,036
Government of Sri Lanka treasury bonds	-	-	-	-	14,583	-	-	14,583
	544,915	-	-	544,915	714,973	1,036	-	716,009
Financial investments available-for-sale								
Quoted shares	4,936,537	-	-	4,936,537	5,079,477	-	-	5,079,477
Quoted units	270,000	-	-	270,000	270,000	-	-	270,000
Unquoted shares	-	-	25,405	25,405	-	-	37,835	37,835
Unquoted units	-	388,108	-	388,108	-	388,108	-	388,108
Government of Sri Lanka treasury bills	31,579,089	-	-	31,579,089	32,881,462	-	-	32,881,462
Government of Sri Lanka treasury bonds	52,716,014	-	-	52,716,014	57,140,260	-	-	57,140,260
	89,501,640	388,108	25,405	89,915,153	95,371,199	388,108	37,835	95,797,142
Non-financial assets measured at fair value								
Freehold land and buildings								
	-	-	11,413,989	11,413,989	-	-	25,374,381	25,374,381
	-	-	11,413,989	11,413,989	-	-	25,374,381	25,374,381
Financial liabilities measured at fair value								
Derivative financial instruments								
Currency swaps	-	586,229	-	586,229	-	586,229	-	586,229
Forward foreign exchange contracts	-	79,661	-	79,661	-	79,661	-	79,661
	-	665,890	-	665,890	-	665,890	-	665,890
As at 31st December 2015								
Financial assets measured at fair value								
Derivative financial instruments								
Currency swaps	-	1,163,561	-	1,163,561	-	1,163,561	-	1,163,561
Forward foreign exchange contracts	-	139,311	-	139,311	-	139,311	-	139,311
	-	1,302,872	-	1,302,872	-	1,302,872	-	1,302,872
Financial investments fair value through profit or loss								
Quoted shares	593,390	-	-	593,390	829,689	-	-	829,689
Quoted units	-	-	-	-	10,708	-	-	10,708
Unquoted units	-	-	-	-	-	229,699	-	229,699
Government of Sri Lanka treasury bonds	-	-	-	-	878,676	-	-	878,676
	593,390	-	-	593,390	1,719,073	229,699	-	1,948,772
Financial investments available for sale								
Quoted shares	6,635,080	-	-	6,635,080	6,835,384	-	-	6,835,384
Quoted units	280,800	-	-	280,800	280,800	-	-	280,800
Unquoted shares	-	-	25,405	25,405	-	-	37,835	37,835
Unquoted units	-	193,377	-	193,377	-	193,377	-	193,377
Government of Sri Lanka treasury bills	31,557,730	-	-	31,557,730	31,606,222	-	-	31,606,222
Government of Sri Lanka treasury bonds	39,354,113	-	-	39,354,113	40,764,613	-	-	40,764,613
	77,827,723	193,377	25,405	78,046,505	79,487,019	193,377	37,835	79,718,231
Non-financial assets measured at fair value								
Freehold land and buildings								
	-	-	9,138,545	9,138,545	-	-	19,729,723	19,729,723
Non current assets held for sale								
	-	-	20,151	20,151	-	-	20,151	20,151
	-	-	9,158,696	9,158,696	-	-	19,749,874	19,749,874
Financial liabilities measured at fair value								
Derivative financial instruments								
Currency swaps	-	91,491	-	91,491	-	91,491	-	91,491
Forward foreign exchange contracts	-	212,994	-	212,994	-	212,994	-	212,994
	-	304,485	-	304,485	-	304,485	-	304,485

There have been no transfers between Level 1 and Level 2 during the period.

Notes to the Financial Statements

5 FAIR VALUE OF ASSETS AND LIABILITIES (CONTD.)

5.4 Level 3 Fair Value Measurement

5.4 (a) Reconciliation of Fair Value of Assets Classified as "Level 3" in the Fair Value Hierarchy

5.4 (a) i Unquoted Equity Securities accounted as Financial Investments - Available-for-sale

	2016 Rs 000	2015 Rs 000
Balance as at 1st January	25,405	34,644
Impairment provision during the year	-	(12,384)
Investments made during the year	-	3,145
Balance as at 31st December	25,405	25,405

Rs 12.4 Mn impairment provision was made during 2015 in respect of investments in Lanka Rating Agency Ltd and S.W.I.F.T. which is recorded in Note 14 'Impairment charge for loans and other losses'.

5.4 (a) ii Property, Plant and Equipment

The reconciliation of property, plant and equipment is given in Note 38 to the financial statements.

5.4 (b) Unobservable Inputs used in Measuring Fair Value

The information about significant unobservable inputs used in measuring financial instruments categorised as Level 3 in the fair value hierarchy as at 31st December 2016 is given in Note 38 (b) to the financial statements.

5.5 Fair value of assets and liabilities not measured at fair value

The following table summarises the carrying amounts and the Group's estimate of fair values of those assets and liabilities not presented in the statement of financial position at fair value. The fair values in the table below may be different from the actual amounts that will be received / paid on the settlement or maturity of the asset or liability. For certain instruments, the fair value may be determined, using assumptions which are not observable in the market.

As at 31st December 2016	Carrying Value Rs 000	Bank				Fair Value Total Rs 000	Carrying Value Rs 000	Group				Fair Value Total Rs 000
		Level 1 Rs 000	Level 2 Rs 000	Level 3 Rs 000	Fair Value Rs 000			Level 1 Rs 000	Level 2 Rs 000	Level 3 Rs 000	Fair Value Rs 000	
Assets												
Loans and receivables to customers	584,412,727	-	556,802,087	-	556,802,087	597,467,460	-	569,792,300	-	-	569,792,300	
Financial investments - Held to maturity	-	-	-	-	-	465,081	468,138	-	-	-	468,138	
Financial investments - Loans and receivables	99,260,699	-	98,772,966	-	98,772,966	102,063,229	-	101,288,303	-	-	101,288,303	
Investment properties	403,959	-	-	3,538,583	3,538,583	1,054,300	-	-	2,097,500	-	2,097,500	
Liabilities												
Due to customers	623,494,969	-	622,724,013	-	624,724,013	635,371,097	-	635,598,540	-	-	635,598,540	
Debt securities issued	4,653,057	-	4,244,179	-	4,244,179	5,115,801	-	5,102,460	-	-	5,102,460	
Subordinated term debts	26,153,476	-	26,215,790	-	26,215,790	25,901,110	-	25,889,460	-	-	25,889,460	

5 FAIR VALUE OF ASSETS AND LIABILITIES (CONTD.)

5.5 Fair value of assets and liabilities not measured at fair value (Contd.)

As at 31st December 2015	Carrying Value Rs 000	Bank				Carrying Value Rs 000	Group			
		Level 1 Rs 000	Level 2 Rs 000	Level 3 Rs 000	Total Fair Value Rs 000		Level 1 Rs 000	Level 2 Rs 000	Level 3 Rs 000	Total Fair Value Rs 000
Assets										
Loans and receivables to customers	498,341,628	-	495,961,362	-	495,961,362	507,244,329	-	504,864,063	-	504,864,063
Financial investments - Held to maturity	-	-	-	-	-	1,257,433	1,274,963	-	-	1,274,963
Financial investments - Loans and receivables	84,206,702	-	84,152,729	-	84,152,729	87,087,206	-	86,989,529	-	86,989,529
Investment properties	386,643	-	-	2,390,400	2,390,400	1,041,797	-	-	1,850,780	1,850,780
Liabilities										
Due to customers	527,126,181	-	529,280,510	-	529,280,510	536,132,789	-	538,430,241	-	538,430,241
Debt securities issued	4,490,742	-	4,615,375	-	4,615,375	4,913,751	-	4,972,240	-	4,972,240
Subordinated term debts	12,064,370	-	13,809,598	-	13,809,598	12,085,598	-	13,766,240	-	13,766,240

Fair values of the following assets and liabilities are estimated for the purpose of disclosure as described below:

Loans and receivables to customers

The loans and receivables to customers comprise of both fixed rate loans and floating rate loans. Majority of the floating rate loans can be re-priced either quarterly or semi-annually while for fixed rate loans, the loan contract allows the Bank to change the contracted rate if there is a material difference between the contracted rate and the market rate. The carrying value of floating rate loans generally approximates the fair value due to the effect of re-pricing while the fair value of loans and receivables to customers with a residual maturity of less than one year generally approximates the carrying value, subject to any significant movement in credit spreads.

The estimated fair value of loans and receivables with a residual maturity of more than one year, is the present value of future cash flows expected to be received from such loans and receivables calculated based on interest rates at the reporting date for similar types of loans and receivables.

Financial investments - Loans and receivables

Financial investments - loans and receivables comprise of investments in Sri Lanka development bonds, Sri Lanka sovereign bonds, long term non-negotiable bond, quoted and unquoted debentures.

Sri Lanka development bonds are variable rate instruments where the re-pricing happens semi-annually. Thus the carrying value of these bonds approximates to their fair value as at the reporting date. The fair values of Sri Lanka sovereign bonds are valued using quoted market prices while the fair value of unquoted debentures are estimated as the present value of future cash flows expected to be received from such investments calculated based on interest rates at the reporting date for similar instruments.

Financial investments - Held to maturity

Financial investments - Held to maturity comprise of Government debt securities. These are valued using current yield rates or market rates published by the Central Bank of Sri Lanka.

Due to customers

The fair value of customer deposits which are repayable on demand or have a remaining contractual maturity of less than one year, approximates to the carrying value of such deposits.

The fair value of customer deposits with a contractual maturity of more than one year, is estimated as the present value of future cash flows expected from such deposits calculated based on interest rates at the reporting date for similar types of deposits.

Debt securities issued

The fair value of debt securities issued has been determined by discounting the future cash flows by the interest rates prevailing as at the reporting date for similar instruments.

Notes to the Financial Statements

5 FAIR VALUE OF ASSETS AND LIABILITIES (CONTD.)

5.5 Fair value of assets and liabilities not measured at fair value (Contd.)

Subordinated term debts

Subordinated term debts include the subordinated debentures and the subordinated loan obtained from German Development Financial Institution (DEG). The subordinated loan has a variable interest rate, resulting in a carrying value approximating to fair value as at the reporting date.

In respect of fixed rate subordinated debentures, fair value has been determined by discounting the future cash flows by the interest rates prevailing as at the reporting date for similar instruments.

Investment properties

Fair value of the investment properties is determined using the income approach, market comparable method and depreciated replacement cost basis.

The carrying values of assets and liabilities listed below are reasonable approximation of their fair values since, those are short term in nature or re-priced to current market rates frequently:

Assets	Liabilities
Cash and cash equivalents	Due to banks
Balances with Central Bank of Sri Lanka	Securities sold under repurchase agreements
Placements with banks	Other borrowings
Securities purchased under resale agreements	Dividends payable
Other assets	Other liabilities

Reclassification of financial assets

There have been no reclassifications during 2016 and 2015.

6 NEW ACCOUNTING STANDARDS ISSUED BUT NOT EFFECTIVE AS AT REPORTING DATE

The following new accounting standards/amendments were issued by the Institute of Chartered Accountants in Sri Lanka which are not yet effective as at 31 December 2016. Accordingly these accounting standards have not been applied in the preparation of the financial statements for the year ended 31 December 2016.

Sri Lanka Accounting Standard - SLFRS 9 "Financial Instruments"

In July 2014, the Institute of Chartered Accountants of Sri Lanka issued SLFRS 9 "Financial Instruments" (on par with International Accounting Standards Board), the standard that will replace LKAS 39 "Financial Instruments - Recognition and measurement" for annual periods beginning on or after 1st January 2018, with early adoption permitted.

Bank performed the diagnostic phase (impact assessment exercise) and identified the gaps. Bank is yet to commence the implementation phase based on the diagnostic findings.

Impairment of Financial Assets

SLFRS 9 will fundamentally change the loan loss impairment methodology. The standard will replace incurred loss approach of LKAS 39 - "Financial Instruments - Recognition" with a forward-looking expected loss (ECL) approach. The bank will be required to record an allowance for expected losses for all loans and other debt instruments not held at fair value through profit or loss, together with loan commitments and financial guarantee contracts.

The impairment methodology under SLFRS 9 requires impairment to be assessed under 3 stages.

Stage 01

In accordance with LKAS 39 the bank has been recording an allowance for Incurred But Not Identified (IBNI) impairment losses. These are designed to reflect impairment losses that had been incurred in the performing portfolio but have not been identified. In accordance with SLFRS 9, the impairment of financial assets that are not considered to have suffered a significant increase in their credit risk, will be measured on a 12 month expected credit loss (12 month ECL) basis.

6 NEW ACCOUNTING STANDARDS ISSUED BUT NOT EFFECTIVE AS AT REPORTING DATE (CONTD.)

Stage 02

SLFRS 9 requires financial assets to be classified in stage 2, when their credit risk has increased significantly since the initial recognition. For these assets, a loss allowance needs to be recognised based on their lifetime Expected Credit Losses (lifetime ECLs). Since this is a new concept compared to LKAS 39, it will result in increased allowance, as most of such assets are not considered to be credit-impaired under LKAS 39.

Stage 03

Financial assets will be included in stage 3 when there is objective evidence that the loan is credit impaired.

Loans in stage 3, where the bank calculated the LKAS 39 impairment on an individual basis are not expected to be significantly different, but collateral values will be adjusted to reflect the amounts that can be expected to be realised.

Classification and measurement

From a classification and measurement perspective, the new standard will require all financial assets, except equity instruments and derivatives, to be assessed based on a combination of the entity's business model for managing the assets and the instruments' contractual cash flow characteristics. The LKAS 39 measurement categories will be replaced by: Fair Value through Profit or Loss (FVPL), Fair Value through Other Comprehensive Income (FVOCI) and amortised cost.

The accounting for financial liabilities will largely be the same as the requirements of LKAS 39, except for the treatment of gains or losses arising from an entity's own credit risk relating to liabilities designated at FVPL.

SLFRS 15 Sri Lanka Accounting Standard - "Revenue from Contracts with Customers"

SLFRS 15 is effective for periods beginning on or after 1st January 2018 with early adoption permitted. SLFRS 15 defines principles for recognising revenue and will be applicable to all contracts with customers. However, interest and fee income integral to financial instruments and leases will continue to fall outside the scope of SLFRS 15 and will be regulated by the other applicable standards (e.g., SLFRS 9 and SLFRS 16).

Revenue under SLFRS 15 will need to be recognised as goods and services are transferred, to the extent that the transferor anticipates entitlement to goods and services. The standard will also specify a comprehensive set of disclosure requirements regarding the nature, extent and timing, as well as any uncertainty of revenue and corresponding cash flows with customers. The bank does not anticipate early adoption of SLFRS 15.

A preliminary evaluation of the existing contracts which falls mainly under fee and commission income of the bank has been performed in relation to the adoption of SLFRS 15. The bank's current assessment has not revealed a significant change to the revenue recognition pattern. However, the bank is currently in the process of evaluating and quantifying the accounting impact and the current systems and processes will be modified where necessary.

SLFRS 16 Sri Lanka Accounting Standard - "Leases"

SLFRS 16 provides a single lessee accounting model, requiring lessees to recognise assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value even though lessor's accounting remains similar to current practice. This supersedes: Sri Lanka Accounting Standard LKAS 17 "Leases", IFRIC 4 "Determining whether an Arrangement Contains a Lease", SIC 15 "Operating Leases - Incentives"; and SIC 27 "Evaluating the substance of Transactions Involving the Legal form of a Lease". Earlier application is permitted for entities that apply SLFRS 15 "Revenue from Contracts with Customers".

SLFRS 16 is effective for annual reporting periods beginning on or after 1 January 2019. The impact on the implementation of the above standard has not been quantified yet by the Group.

Amendments to Sri Lanka Accounting Standard - LKAS 12 Recognition of Deferred Tax Assets for Unrealized Losses

The amendments clarify that an entity needs to consider whether tax law restricts the sources of taxable profits against which it may make deductions on the reversal of that deductible temporary difference. Furthermore, the amendments provide guidance on how an entity should determine future taxable profits and explain the circumstances in which taxable profit may include the recovery of some assets for more than the carrying amount.

Notes to the Financial Statements

6 NEW ACCOUNTING STANDARDS ISSUED BUT NOT EFFECTIVE AS AT REPORTING DATE (CONTD.)

Entities are required to apply the amendments retrospectively. However, on initial application of the amendments, the change in the opening equity of the earliest comparative period may be recognised in opening retained earnings (or in another component of equity, as appropriate), without allocating the change between opening retained earnings and other components of equity. Entities applying this relief must disclose that fact.

These amendments are effective for annual periods beginning on or after 1 January 2017 with early application permitted. If an entity applies the amendments for an earlier period, it must disclose that fact. This amendment is not expected to have a material impact on the Group/Bank

Amendments to Sri Lanka Accounting Standard - LKAS 7 Disclosure Initiative "Statement of Cash Flows"

The amendments to LKAS 7 "Statement of Cash Flows" are part of the Institute of Chartered Accountants of Sri Lanka's Disclosure Initiative and require an entity to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes. On initial application of the amendment, entities are not required to provide comparative information for preceding periods. These amendments are effective for annual periods beginning on or after 1 January 2017, with early application permitted. Application of amendments will result in additional disclosures to be provided by the Group.

Amendments to Sri Lanka Accounting Standard - SLFRS 2 "Classification and Measurement of Share-based Payment Transactions"

The Institute of Chartered Accountants of Sri Lanka issued amendments to SLFRS 2 "Share based Payment" that address three main areas: the effects of vesting conditions on the measurement of a cash-settled share-based payment transaction; the classification of a share-based payment transaction with net settlement features for withholding tax obligations; and accounting where a modification to the terms and conditions of a share-based payment transaction changes its classification from cash settled to equity settled.

On adoption, entities are required to apply the amendments without restating prior periods, but retrospective application is permitted if elected for all three amendments and other criteria are met. The amendments are effective for annual periods beginning on or after 1 January 2018, with early application permitted. The impact on the implementation of the above standard has not been quantified yet by the Group.

6.1 Amendments to existing accounting standards effective from 1st January 2016

SLFRS 14 Sri Lanka Accounting Standard "Regulatory Deferral Account"

The objective of this standard is to specify the financial reporting requirements for regulatory deferral account balances that arise when an entity provides goods or services to customers at a price or rate that is subject to rate regulation.

SLFRS 14 was effective from 1st January 2016. This standard did not have any impact on the financial statements of the Group.

Amendments to Existing Accounting Standards Effective From 1st January 2016

Amendments to existing accounting standards effective from 1st January 2016 as published by the Institute of Chartered Accountants of Sri Lanka did not have any material impact on the financial statements of the Group.

7 GROSS INCOME

Accounting Policy

Gross revenue is recognised to the extent that it is probable that the economic benefits will flow to the Bank and the revenue can be reliably measured. The specific recognition criteria, for each type of gross income, are given under the respective income notes.

For the year ended 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Interest income [Note 8 (a)]	75,608,193	52,615,463	81,533,502	56,893,956
Fee and commission income (Note 9)	7,139,253	5,874,928	7,905,879	6,426,080
Net gain / (loss) from trading (Note 10)	(1,795,691)	196,993	(1,824,452)	212,364
Net gain from financial investments (Note 11)	111,713	253,858	103,165	297,978
Net insurance premium income (Note 12)	-	-	5,490,712	4,679,897
Other operating income (Note 13)	3,287,355	2,212,224	2,781,965	1,516,423
	84,350,823	61,153,466	95,990,771	70,026,698

8 NET INTEREST INCOME

Accounting Policy

Interest income and expenses are allocated over the relevant period using the Effective Interest Rate (EIR) method, for all financial instruments measured at amortised cost, interest bearing financial assets classified as available-for-sale and financial instruments at fair value through profit or loss.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, an entity shall estimate cash flows considering all contractual terms of the financial instrument but will not consider future credit losses. The calculation includes all fees and points received or paid between parties to the contract that are an integral part of the effective interest rate.

The carrying amount of the financial asset or financial liability is adjusted, if the Bank revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original EIR and the change in carrying amount is recorded as interest income for financial assets and interest expense for financial liabilities. However, for a reclassified financial asset for which the Bank subsequently increases its estimates of future cash receipts as a result of increased recoverability of those cash receipts, the effect of that increase is recognised as an adjustment to the EIR from the date of the change in estimate.

Once the recorded value of a financial asset or a group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognised, using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

8 (a) Interest Income

For the year ended 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Cash and cash equivalents	17,355	15,308	38,062	24,208
Placements with banks	150,222	57,791	272,508	172,399
Securities purchased under resale agreements	172,388	359,740	336,660	598,848
Interest income accrued on impaired financial assets	25,202	37,787	25,202	37,787
Loans and receivables to customers	61,127,471	43,647,464	65,912,111	47,081,333
Financial investments - available for sale	8,664,720	5,476,808	9,164,289	5,621,962
Financial investments - fair value through profit or loss	18	706	7,828	9,555
Financial investments - held to maturity	-	-	76,253	70,146
Financial investments - loans and receivables	5,396,078	2,958,752	5,697,782	3,268,218
Other interest income	54,739	61,107	2,807	9,500
	75,608,193	52,615,463	81,533,502	56,893,956

Notes to the Financial Statements

8 NET INTEREST INCOME (CONTD.)

8 (b) Interest Expenses

For the year ended 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Due to banks	2,654,793	1,637,739	2,655,424	1,643,354
Deposits from customers (due to customers)	32,622,175	21,216,749	33,705,430	22,031,573
Debt securities issued	437,802	430,942	544,907	513,805
Securities sold under repurchase agreements	2,222,760	889,104	2,222,760	889,104
Subordinated term debts	2,004,159	1,238,902	2,021,206	1,255,902
Other borrowings	1,282,050	844,599	1,282,050	844,599
Other interest expenses	12,866	21,899	12,866	21,899
	41,236,605	26,279,934	42,444,643	27,200,236

8 (c) Net Interest Income from Sri Lanka Government Securities

For the year ended 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Interest income	13,034,389	8,137,779	13,846,507	8,678,537
Less : Interest expenses	2,222,760	889,104	2,222,760	889,104
Net interest income from Sri Lanka Government Securities	10,811,629	7,248,675	11,623,747	7,789,433

Notional tax credit for withholding tax on government securities on secondary market transactions.

Section 137 of the Inland Revenue Act No 10 of 2006 provides that a company which derives interest income from the secondary market transactions in government securities be entitled to a notional tax credit (being one ninth of the net interest income) provided such interest income forms part of the statutory income of the company for that year of assessment.

Accordingly, net income earned from secondary market transactions in government securities for the year by the Bank / Group has been grossed up in the financial statements and the resulting notional tax credit amounted to Rs 664 Mn (2015 : Rs 486.8 Mn) for the Bank and Rs 720.5 Mn (2015 : Rs 523.44 Mn) for the Group.

9 NET FEE AND COMMISSION INCOME

Accounting policy

The Group earns fee and commission income from a diverse range of services it provides to its customers which can be divided in to the following two categories.

- (a) Fee and commission income earned from services that are provided over a certain period of time

Fee and commission earned for the provision of services over a period of time are accrued over that period.

- (b) Fee and commission income from providing transaction services

Fee and commission income arising from renegotiating or participating in the negotiation of a transaction for a third party are recognised on completion of the underlying transaction. Fees or components of fees that are linked to a certain performance are recognised as the related services are performed.

Fees and commission expenses relating to transaction and service fees are expensed as the services are received. Fee and commission expenses are recognised on an accrual basis.

9 NET FEE AND COMMISSION INCOME (CONTD.)

For the year ended 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Fee and commission income	7,139,253	5,874,928	7,905,879	6,426,080
Less: Fee and commission expenses	90,594	98,622	180,531	182,093
Net fee and commission income	7,048,659	5,776,306	7,725,348	6,243,987
Comprising				
Loans	1,379,067	1,017,821	2,007,816	1,468,930
Cards	1,952,300	1,530,098	1,952,300	1,530,098
Trade and remittances	1,467,683	1,370,938	1,467,683	1,370,938
Deposits	759,647	667,229	667,772	583,362
Guarantees	850,965	699,330	850,965	699,330
Currency	77,975	86,570	77,975	86,570
Others	561,022	404,320	700,837	504,759
Net fee and commission income	7,048,659	5,776,306	7,725,348	6,243,987

10 NET GAIN / (LOSS) FROM TRADING

Accounting policy

Results arising from trading activities include all gains and losses from realised and unrealised fair value changes, related capital gains and losses, dividend income of financial assets "held for trading" and gains/(losses) from revaluation of derivative financial instruments.

Dividend income is recognised when the Group's right to receive the dividend is established.

Derivative financial instruments are fair valued at each reporting date. Gains and losses arising from changes in fair value are included in the statement of profit or loss in the period in which they arise.

For the year ended 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Financial investments - Held for trading				
Fixed income				
Net marked to market gain / (loss)	-	(52)	(11,000)	12,926
Net capital gain / (loss)	323	13,898	323	(3,014)
Equities				
Net marked to market loss	(44,604)	(8,773)	(52,732)	(16,990)
Net capital gain / (loss)	4,389	18,846	(13,042)	18,898
Dividend income	19,578	18,117	27,376	45,587
Derivative financial instruments				
Gain / (loss) on revaluation of foreign currency derivatives				
- With banks	(1,789,930)	158,482	(1,789,930)	158,482
- With customers	14,553	(3,525)	14,553	(3,525)
Total net gain / (loss) from trading	(1,795,691)	196,993	(1,824,452)	212,364

Notes to the Financial Statements

11 NET GAIN FROM FINANCIAL INVESTMENTS

Accounting policy

Net gain from financial investments includes capital gains / (losses) and dividend income of financial investments - available-for-sale.

Dividend income is recognised when the Group's right to receive the dividend is established.

For the year ended 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Fixed income				
Net capital gain / (loss)	-	-	(14,466)	30,358
Equities				
Net capital gain	-	-	-	13,708
Dividend income	111,713	253,858	117,631	253,912
Total net gain from financial investments	111,713	253,858	103,165	297,978

12 NET INSURANCE PREMIUM INCOME

Accounting Policy

Insurance Premiums

Life Insurance Business

Gross recurring premiums on life insurance contracts are recognised as revenue when payable by the policyholder (policies within the 30 day grace period are considered as due). Premiums received in advance, are not recorded as revenue and recorded as liability until the premium is due, unless otherwise the relevant policy conditions require such premiums to be recognised as income. Benefits and expenses are provided against such revenue to recognise profits over the estimated life of the policies.

For single premium business, revenue is recognised on the date on which the policy is effective.

General Insurance Business

Gross general insurance written premiums comprise the total premiums received /receivable for the whole period of cover provided by contracts entered into during the accounting period. Gross written premium generally recognised is written upon inception of the policy. Upon inception of the contract, premiums are recorded as written and are earned primarily on a pro-rata basis over the term of the related policy coverage.

Rebates that form part of the premium rate, such as no-claim rebates, are deducted from the gross premium.

Unearned premiums are those proportions of premiums written in a year that relate to periods of risk after the reporting date. Unearned premiums are calculated on 1/24th basis except for the marine policies which are computed on a 60-40 basis, in accordance with the Regulation of Insurance Industry Act, No. 43 of 2000. However, for those contracts for which the period of risk differs significantly from the contract period, premiums are earned over the period of risk in proportion to the amount of insurance protection provided. The proportion attributable to subsequent periods, is deferred as a provision for unearned premiums which is included under liabilities.

Reinsurance Premiums

Gross reinsurance premiums on insurance contracts are recognised as an expense on the earlier of the date when premiums are payable or when the policy becomes effective. Reinsurance premiums are decided based on rates agreed with reinsurers.

Unearned reinsurance premiums are those proportions of premiums written in a year, that relate to periods of risk after the reporting date. Unearned reinsurance premiums are deferred over the term of the underlying direct insurance policies for risks-attaching contracts (using 1/24th basis except for the marine policies which are computed on a 60-40 basis in accordance with the Regulation of Insurance Industry Act, No 43 of 2000).

12 NET INSURANCE PREMIUM INCOME (CONTD.)

For the year ended 31st December	Group	
	2016 Rs 000	2015 Rs 000
Gross insurance premium income	6,549,527	5,401,658
Reinsurers' share of gross insurance premium income	(877,713)	(599,084)
Net written premium	5,671,814	4,802,574
Net change in reserves for unearned premium	(181,102)	(122,677)
Net insurance premium income	5,490,712	4,679,897

13 OTHER OPERATING INCOME

Accounting Policy

Other operating income includes rental income, dividend income from group entities, gains on disposal of property, plant and equipment and foreign exchange gains and losses.

Rental income

Rental income is recognised on an accrual basis.

Dividend income from subsidiaries and joint venture

Dividend income from subsidiaries and joint venture is recognised when the Group's right to receive the dividend is established.

Gains and losses on disposal of assets

Net gains and losses of a revenue nature arising from the disposal of property, plant and equipment and other non-current assets including investments in subsidiaries, joint ventures and associates are accounted for, in the statement of profit or loss after deducting from the proceeds on disposal, the carrying amount of such assets and the related selling expenses.

Foreign exchange gain

Foreign currency positions are revalued at each reporting date. Gains and losses arising from changes in fair value are included in the statement of profit or loss in the period in which they arise.

For the year ended 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Auditorium hire income	3,550	2,627	3,550	2,627
Dividend income from subsidiaries and joint venture	757,061	964,859	-	-
Foreign exchange gain / (loss)				
- With banks	1,142,176	3,888	1,150,994	15,833
- With customers	1,219,536	1,105,084	1,219,536	1,105,084
Gain on disposal of non-current assets held for sale	3,556	763	3,556	763
Gain on disposal of property, plant and equipment (net)	4,379	14,805	1,807	14,722
Loss on disposal of investment properties	-	-	(550)	-
Rental income	8,821	10,211	190,821	195,829
Rental income from investment properties	92,293	80,978	112,697	101,403
Recovery of loans written off in prior years	34,014	19,989	52,881	33,267
Recovery of operational losses provided for in prior years	788	526	788	526
Miscellaneous	21,181	8,494	45,885	46,369
	3,287,355	2,212,224	2,781,965	1,516,423

Notes to the Financial Statements

14 IMPAIRMENT CHARGE / (REVERSAL) FOR LOANS AND OTHER LOSSES

Accounting Policy

The Group recognise the changes in the impairment provisions for loans and receivables, which are assessed as per Sri Lanka Accounting Standard - LKAS 39 on "Financial Instruments : Recognition and Measurement". The methodology adopted for impairment is explained in Note 31 (b) to the financial statements. The Bank also makes provisions/(write-backs) for impairment of financial investments - available-for-sale and financial investments - loans and receivables when there is a permanent diminution in the carrying value of these investments. Further, Group recognises an impairment loss when the carrying amount of a non-financial asset exceeds the estimated recoverable amount from that asset.

For the year ended 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Loans and receivables to customers				
Individual impairment	250,783	700,325	250,783	700,325
Collective impairment	12,333	137,386	278,959	227,572
Direct write offs	727	2,421	727	2,421
Others	9,669	40,551	9,669	40,648
Financial investments - available-for-sale	-	12,384	4,373	12,384
Financial investments - loans and receivables	397	(711)	397	(711)
Property, plant and equipment (Note 38)	(41,219)	39,569	(41,219)	39,472
Charge / (reversal) of impairment write-off	4,470	-	4,470	-
	237,160	931,925	508,159	1,022,111

15 PERSONNEL EXPENSES

Accounting policy

Personnel expenses include salaries and bonus, terminal benefit charges and other related expenses. Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognised for the amount expected to be paid under short term cash bonus or profit-sharing plans, if the Group has a present legal or constructive obligation to pay this amount, as a result of past service provided by the employee and the obligation can be estimated reliably.

Employees are eligible for Employees' Provident Fund (EPF) contributions and Employees' Trust Fund (ETF) contributions in accordance with the respective statutes and regulations.

Defined benefit plan contributions and changes in the liabilities for EPF interest guarantee and accumulated leave are recognised in the statement of profit or loss based on actuarial valuations carried out in accordance with Sri Lanka Accounting Standard - LKAS 19 on "Employee Benefits".

The Group's net obligation to the pension fund, gratuity, EPF interest guarantee and unutilised accumulated annual leave is disclosed under Note 53 to the financial statements.

For the year ended 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Salaries and bonus	7,238,790	6,552,778	8,733,832	7,604,361
Contributions to Employees' Provident Fund	542,246	519,905	666,323	615,905
Contributions to Employees' Trust Fund	138,681	129,965	169,661	153,965
Contribution to defined benefit plan [Note 15 (a)]	419,438	404,951	475,863	460,833
Increase in liability for EPF interest guarantee	3,197	15,877	3,197	15,877
Increase / (decrease) in liability for accumulated leave	4,030	(3,244)	4,030	(3,244)
Others	357,193	307,463	363,193	307,463
	8,703,575	7,927,695	10,416,099	9,155,160

15 PERSONNEL EXPENSES (CONTD.)**15 (a) Contribution to Defined Benefit Plan**

For the year ended 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Current service cost	527,676	546,842	527,676	546,842
Net interest on defined benefit asset	(108,238)	(141,891)	(108,238)	(141,891)
Provision for gratuities	-	-	56,425	55,882
	419,438	404,951	475,863	460,833

16 BENEFITS, CLAIMS AND UNDERWRITING EXPENDITURE**Accounting Policy****Gross Benefits and Claims****Life Insurance Business**

Claims by death and maturity are charged against revenue on notification of death or on expiry of the term. The interim payments and surrenders are accounted for only at the time of settlement.

Expenses on life insurance relates to the acquisition expenses and expenses for maintenance of life insurance business, investment related expenses not treated as part of the capital cost of investment, etc. which are accounted on accrual basis.

General Insurance Business

General insurance claims include all claims occurring during the year, whether reported or not, together with claims handling costs that are directly related to the processing and settlement of claims, a reduction for the value of salvage and other recoveries, and any adjustments to claims outstanding from previous years. Claims outstanding are assessed by review of individual claim files and estimating changes in the ultimate cost of settling claims.

The provision in respect of Claims Incurred But Not Reported (IBNR) and Claims Incurred But Not Enough Reported (IBNER) is actuarially valued to ensure a more realistic estimation of the future liability, based on the past experience and trends. Actuarial valuations are performed on a semi-annual basis.

Whilst the directors of HNB Assurance PLC, subsidiary of the Bank consider that the provisions for claims are fairly stated on the basis of information currently available, the ultimate liability will vary as a result of subsequent information and events. This may result in adjustments to the amounts provided. Such amounts are reflected in the financial statements for that period.

The methods used to estimate claims and the estimates made are reviewed regularly.

Reinsurance Claims

Reinsurance claims are recognised when the related gross insurance claim is recognised according to the terms of the relevant contract.

Deferred Acquisition Expenses

Acquisition expenses, representing commissions, which vary with and are directly related to the production of business, are deferred and amortised over the period in which the related written premiums are earned.

Reinsurance commission is also treated in the same manner within deferred acquisition costs.

	Group	
	2016 Rs 000	2015 Rs 000
Net insurance benefits and claims paid	1,966,759	1,984,358
Net change in insurance claims outstanding	(19,114)	133,431
Change in contract liabilities - Life fund	1,708,285	1,462,100
Underwriting and net acquisition costs	915,459	632,107
	4,571,389	4,211,996

Notes to the Financial Statements

17 OTHER EXPENSES

Accounting Policy

Other operating expenses are recognised in the statement of profit or loss on the basis of a direct association between the cost incurred and the earning of specific items of income. All expenditure incurred in the running of the business and maintaining the property, plant and equipment in a state of efficiency has been charged to the statement of profit or loss in arriving at the profit of the year. Provisions in respect of other expenses are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

For the year ended 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Advertising and related expenses	263,156	270,024	305,483	372,254
Auditors' remuneration [Note 17 (a)]	18,906	14,793	27,070	24,872
Amortisation of intangible assets (Note 39)	220,138	220,613	260,357	244,835
Business promotion and product expenses	631,952	482,584	631,952	482,584
Depreciation of investment property (Note 37)	5,471	5,445	4,813	4,810
Depreciation of property, plant and equipment (Note 38)	810,321	740,538	1,128,658	1,001,399
Direct operating expenses on investment property	1,257	3,562	7,380	4,982
Debenture issue expenses	35,233	-	35,233	-
Deposit insurance premium	664,611	448,503	680,775	460,218
Directors' emoluments	95,514	86,905	110,090	96,581
Donations	20,451	12,819	24,751	19,110
Crop insurance levy	113,473	108,379	133,541	118,288
Legal expenses and professional fees	88,814	79,188	98,662	84,374
Operational risk event losses	28,526	81,397	28,526	81,397
Office administration and establishment expenses	5,562,306	4,908,351	5,600,631	4,979,948
Other overhead expenses	1,024,175	587,128	1,707,222	1,117,484
	9,584,304	8,114,040	10,785,144	9,093,136
17 (a) Auditors' Remuneration				
Audit fees and expenses	10,899	10,283	18,410	19,709
Audit related fee and expenses	2,262	1,458	2,915	2,111
Non-audit expenses	5,745	3,052	5,745	3,052
	18,906	14,793	27,070	24,872

18 VALUE ADDED TAX (VAT) AND NATION BUILDING TAX (NBT) ON FINANCIAL SERVICES

The base of the calculation of Value Added Tax (VAT) and Nation Building Tax (NBT) on financial services is the operating profit before value added tax and nation building tax on financial services adjusted for emoluments of employees and economic depreciation.

VAT rates applied during 2016 were as follows (2015 - 11%):

Period	Rate
1st January 2016 - 1st May 2016	11%
2nd May 2016 - 11th July 2016	15%
12th July 2016 - 30th October 2016	11%
1st November 2016 - 31st December 2016	15%

The NBT rate applied in 2016 is 2% (2015 - 2%)

For the year ended 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Value Added Tax on financial services	3,787,448	2,381,359	4,114,963	2,590,622
Nation Building Tax on financial services	565,308	432,975	619,986	471,161
	4,352,756	2,814,334	4,734,949	3,061,783

19 SHARE OF PROFIT OF JOINT VENTURE (NET OF INCOME TAX)**Accounting Policy**

The aggregate of the Group's share of profit or loss of the joint venture is shown on the face of the statement of profit or loss outside operating profit and represents profit or loss after tax and non-controlling interests in the subsidiaries of the joint venture.

For the year ended 31st December	Group	
	2016 Rs 000	2015 Rs 000
Share of profit of joint venture before income tax	165,967	75,072
Income tax on share of operating results of joint venture	(17,177)	(14,987)
Share of profit of joint venture (net of income tax) [Note 35 (b)]	148,790	60,085

20 INCOME TAX EXPENSE**Accounting Policy**

As per Sri Lanka Accounting Standard - LKAS 12 on "Income taxes", tax expense is the aggregate amount included in determination of profit or loss for the period in respect of current and deferred taxes. Income tax expense is recognised in the statement of profit or loss, except to the extent it relates to items recognised directly in Other Comprehensive Income (OCI), in which case it is recognised in OCI.

Current Taxation

Current tax assets and liabilities consist of amounts expected to be recovered from or paid to the taxation authorities in respect of the current as well as prior years. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted on the reporting date.

Current income tax relating to items recognised directly in equity, is recognised in equity and not in the statement of profit or loss. Management periodically evaluates positions taken in the tax returns, with respect to situations in which applicable tax regulations are subject to interpretation and establishes provisions where appropriate.

Management has used its judgement on the application of tax law including transfer pricing regulation involving identification of associated undertaking estimation of respective arm's length prices and selection of appropriate pricing mechanism.

Economic Service Charges (ESC)

ESC was payable at 0.25% on exempt turnover of the Bank until 31st March 2016. From 1st April 2016 onwards ESC is payable at 0.50% on total turnover of the Bank. ESC is deductible from the income tax payable.

Deferred Tax

Deferred tax is provided on temporary differences at the reporting date between the tax base of assets and liabilities and their carrying amounts for financial reporting purposes for all Group entities.

Deferred tax liabilities are recognised for all taxable temporary differences, except:

- When the deferred tax liability arises from the initial recognition of goodwill or an asset or liability in a transaction that is not a business combination and at the time of the transaction, affects neither the accounting profit nor taxable profit or loss
- In respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, when the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets are recognised for all deductible temporary differences, carry forward of unused tax credits and unused tax losses (if any), to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and the unused tax credits and unused tax losses carried forward can be utilised except:

- When the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction, that is not a business combination and at the time of the transaction, affects neither the accounting profit nor taxable profit or loss
- In respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are recognised only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

Notes to the Financial Statements

20 INCOME TAX EXPENSE (CONTD.)

The carrying amount of deferred tax asset is reviewed at each reporting date, and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Un-recognised deferred tax assets are re-assessed at each reporting date and are recognised to the extent that it has become probable that future taxable profits will allow the deferred tax asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates, that are expected to apply in the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the reporting date. The rates applicable as at reporting date are given in Note 20 to the financial statements.

Deferred tax relating to items recognised directly in equity are also recognised in equity, through other comprehensive income and not in the statement of profit or loss deferred taxation.

Deferred tax assets and deferred tax liabilities are offset if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

Accordingly, provision for taxation is made on the basis of the accounting profit for the year as adjusted for taxation purposes in accordance with the provisions of the Inland Revenue Act No 10 of 2006 and the amendments thereto, at the rates specified below.

Applicable Income Tax Rates

Hatton National Bank PLC	28%
HNB Assurance PLC and its subsidiary HNB General Insurance Ltd	28%
HNB Grameen Finance Ltd	28%

Sithma Development (Pvt) Ltd

In accordance with the BOI agreement dated 18th June 1999, the profits and income of Sithma Development (Pvt) Ltd (company) are exempt from income tax until 24th January 2018. After the expiration of the said tax exemption period, the provisions of the Inland Revenue regulations for the time being in force shall apply to the company. However the company pays tax for the interest income earned from its investments at the rate of 28%.

The deferred tax liabilities / assets are disclosed under Note 49 to the financial statements.

20 (a) Current Tax Expense

For the year ended 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Current tax on profit for the year	5,798,826	3,888,177	6,284,983	4,208,488
Notional tax unutilised during the year	-	-	56,512	29,383
Over provision in previous years	-	-	(3,064)	-
	5,798,826	3,888,177	6,338,431	4,237,871

20 (b) Deferred Tax Expense

Recognition of deferred tax liability [Note 49 (a) i and 49 (a) ii]	174,698	665,240	357,834	798,092
Recognition of deferred tax asset [Note 49 (b)]	28,899	47,814	137,420	28,461
	203,597	713,054	495,254	826,553
Total income tax expense [Note 20 (d)]	6,002,423	4,601,231	6,833,685	5,064,424
Effective tax rate	29.79%	30.57%	30.37%	31.34%
Effective tax rate (excluding deferred tax)	28.78%	25.84%	28.17%	26.22%

20 INCOME TAX EXPENSE (CONTD.)**20 (c) Current Tax on Profit for the year - Subsidiaries**

For the year ended 31st December	Group	
	2016 Rs 000	2015 Rs 000
Sithma Development (Pvt)Ltd	5,437	4,941
HNB Assurance PLC	59,812	29,383
HNB Grameen Finance Ltd	474,356	315,370
Total	539,605	349,694

20 (d) Reconciliation of Effective Tax Rate

For the year ended 31st December	Bank				Group			
	2016		2015		2016		2015	
	%	Rs 000	%	Rs 000	%	Rs 000	%	Rs 000
Profit before income tax		20,145,829		15,050,017		22,498,647		16,160,268
Tax using the corporate tax rate	28.00	5,640,832	28.00	4,214,005	28.00	6,299,622	28.00	4,524,874
Disallowable expenses	12.03	2,422,898	10.66	1,604,802	14.97	3,366,995	11.71	1,891,762
Tax effects on:								
Allowable expenses	(20.61)	(4,151,094)	(25.56)	(3,846,713)	(21.10)	(4,748,215)	(26.20)	(4,233,463)
Tax exempt income	(9.21)	(1,856,408)	(8.52)	(1,282,583)	(10.02)	(2,253,918)	(8.31)	(1,343,639)
Adjustments for leasing	18.58	3,742,598	21.25	3,198,666	16.63	3,742,598	19.79	3,198,666
Tax loss incurred during the year	-	-	-	-	-	-	1.89	306,006
Tax loss utilised	-	-	-	-	(0.54)	(122,099)	(0.84)	(135,718)
Current tax on profits for the year	28.78	5,798,826	25.84	3,888,177	27.93	6,284,983	26.04	4,208,488
Notional tax unutilised during the year	-	-	-	-	0.25	56,512	0.18	29,383
Over provision in prior years	-	-	-	-	(0.01)	(3,064)	-	-
Current tax expense [Note 20 (a)]	28.78	5,798,826	25.84	3,888,177	28.17	6,338,431	26.22	4,237,871
Recognition of deferred tax liability								
on temporary differences	0.87	174,698	4.42	665,240	1.59	357,834	4.94	798,092
Recognition of deferred tax asset								
on temporary differences	0.14	28,899	0.32	47,814	0.61	137,420	0.81	28,461
Total income tax expense [Note 20 (b)]	29.79	6,002,423	30.57	4,601,231	30.37	6,833,685	31.34	5,064,424

20 (e) Tax Losses Brought Forward and Utilised during the Year

For the year ended 31st December	Group	
	2016 Rs 000	2015 Rs 000
Balance as at 1st January	4,223,016	326,125
Adjustment for brought forward tax losses	(53,644)	2,804,013
Tax losses incurred during the year	974,797	1,092,878
Tax losses utilised during the year	(436,068)	-
Tax losses carried forward	4,708,101	4,223,016

Notes to the Financial Statements

21 EARNINGS PER SHARE

The Bank/Group presents basic and diluted Earnings per Share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss for the year attributable to ordinary shareholders of the Bank by the weighted average number of ordinary shares outstanding during the year. Diluted EPS is determined by adjusting the profit or loss attributable to the ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, which comprise share options granted to employees as per Sri Lanka Accounting Standard - LKAS 33 on "Earnings per Share".

21 (a) Basic Earnings per Share

	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Amount used as the numerator				
Profit attributable to equity holders of the Bank (Rs 000)	14,143,406	10,448,786	14,755,634	10,553,568
Number of ordinary shares used as the denominator				
Weighted average number of ordinary shares outstanding during the year used as the denominator for basic EPS ('000)	412,970	411,176	412,970	411,176
Basic earnings per ordinary share (Rs)	34.25	25.41	35.73	25.67

21 (b) Diluted Earnings per Share

	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Amount used as the numerator				
Profit attributable to equity holders of the Bank (Rs 000)	14,143,406	10,448,786	14,755,634	10,553,568
Number of ordinary shares used as the denominator				
Weighted average number of ordinary shares outstanding during the year used as the denominator for basic EPS ('000)	412,970	411,176	412,970	411,176
Effect of dilution:				
Weighted average number of potential ordinary shares outstanding under ESOP ('000)	2,730	4,649	2,730	4,649
Weighted average number of potential ordinary shares that would have been issued at average market price ('000)	(1,786)	(2,953)	(1,786)	(2,953)
Weighted average number of potential ordinary shares that would have been issued for zero consideration under ESOP	944	1,696	944	1,696
Weighted average number of ordinary shares outstanding during the year used as the denominator for diluted EPS ('000)	413,914	412,872	413,914	412,872
Diluted earnings per ordinary share (Rs)	34.17	25.31	35.65	25.56

22 DIVIDENDS PAID AND PROPOSED

	2016			2015		
	Gross Dividend Rs 000	Dividend Tax Rs 000	Net Dividend Rs 000	Gross Dividend Rs 000	Dividend Tax Rs 000	Net Dividend Rs 000
Interim dividends paid						
Rs 1.50 cash dividend per share declared and paid in 2015	-	-	-	608,548	-	608,548
Rs 1.50 cash dividend per share declared and paid in 2016	620,387	10,721	609,666	-	-	-
Final dividends paid						
Rs 7.00 cash dividend per share declared in 2014 and paid in 2015	-	-	-	2,827,776	278,995	2,548,781
Rs 3.50 cash dividend per share declared in 2015 and paid in 2016	1,421,200	79,122	1,342,078	-	-	-
Rs 3.50 scrip dividend per share declared in 2015 and paid in 2016	1,421,200	142,120	1,279,080	-	-	-
Total dividends paid	3,462,787	231,963	3,230,824	3,436,324	278,995	3,157,329

22 (a) Proposed Dividends

The directors recommend that a final dividend of Rs 7.00 per share by way of Rs 3.50 cash and Rs 3.50 scrip (2015 : Rs 7.00 per share by way of Rs 3.50 cash and Rs 3.50 scrip) on both voting and non-voting shares of the Bank, be paid for the financial year ended 31st December 2016.

Further this dividend is to be approved at the Annual General Meeting to be held on 30th March 2017. In accordance with Sri Lanka Accounting Standard - LKAS 10 on "Events after the reporting period", this proposed final dividend has not been recognised as a liability as at 31st December 2016. An interim dividend of Rs 1.50 per share (2015 : Rs 1.50) was paid to the shareholders on 16th December 2016. Final dividends proposed for the year 2016 amounts to Rs 2,896.7 Mn (2015 : Rs 2,842.2 Mn).

23 ANALYSIS OF FINANCIAL INSTRUMENTS BY MEASUREMENT BASIS

The carrying amounts of financial instruments by category as defined in Sri Lanka Accounting Standard - LKAS 39 on "Financial Instruments - Recognition and Measurement" under headings of the statement of financial position are summarised below.

Notes to the Financial Statements

23 ANALYSIS OF FINANCIAL INSTRUMENTS BY MEASUREMENT BASIS (CONTD.)

23 (a) Analysis of Financial Instruments by Measurement Basis - Bank

As at 31st December 2016	Fair Value Through Profit or Loss	Loans and Receivable	Available- for-Sale	Total Carrying Amount
	Rs 000	Rs 000	Rs 000	Rs 000
Assets				
Cash and cash equivalents	-	17,511,446	-	17,511,446
Balances with Central Bank of Sri Lanka	-	33,777,614	-	33,777,614
Placements with banks	-	753,050	-	753,050
Reverse repurchase agreements	-	4,303,460	-	4,303,460
Derivative financial instruments	289,989	-	-	289,989
Financial investments - fair value through profit or loss	544,915	-	-	544,915
Loans and receivables to customers	-	584,412,727	-	584,412,727
Financial investments - loans and receivables	-	99,260,698	-	99,260,698
Financial investments - available-for-sale	-	-	89,915,153	89,915,153
Other assets	-	2,308,521	-	2,308,521
Total financial assets	834,904	742,327,516	89,915,153	833,077,573
Liabilities				
Due to banks	-	69,928,789	-	69,928,789
Derivative financial instruments	665,890	-	-	665,890
Securities sold under repurchase agreements	-	13,458,127	-	13,458,127
Due to customers	-	623,494,969	-	623,494,969
Dividends payable	-	1,007,075	-	1,007,075
Other borrowings	-	27,130,358	-	27,130,358
Debt securities issued	-	4,653,057	-	4,653,057
Other liabilities	-	403,851	-	403,851
Subordinated term debts	-	26,153,476	-	26,153,476
Total financial liabilities	665,890	766,229,702	-	766,895,592
As at 31st December 2015				
	Fair Value Through Profit or Loss	Loans and Receivable	Available- for-Sale	Total Carrying Amount
	Rs 000	Rs 000	Rs 000	Rs 000
Assets				
Cash and cash equivalents	-	14,909,598	-	14,909,598
Balances with Central Bank of Sri Lanka	-	20,096,090	-	20,096,090
Placements with banks	-	26,827	-	26,827
Reverse repurchase agreements	-	4,869,219	-	4,869,219
Derivative financial instruments	1,302,872	-	-	1,302,872
Financial investments - fair value through profit or loss	593,390	-	-	593,390
Loans and receivables to customers	-	498,341,628	-	498,341,628
Financial investments - loans and receivables	-	84,206,702	-	84,206,702
Financial investments - available-for-sale	-	-	78,046,505	78,046,505
Other assets	-	1,565,169	-	1,565,169
Total financial assets	1,896,262	624,015,233	78,046,505	703,958,000

23 ANALYSIS OF FINANCIAL INSTRUMENTS BY MEASUREMENT BASIS (CONTD.)

23 (a) Analysis of Financial Instruments by Measurement Basis - Bank (Contd.)

As at 31st December 2015	Fair Value Through Profit or Loss	Loans and Receivable	Available- for-Sale	Total Carrying Amount
	Rs 000	Rs 000	Rs 000	Rs 000
Liabilities				
Due to banks	-	58,232,034	-	58,232,034
Derivative financial instruments	304,485	-	-	304,485
Securities sold under repurchase agreements	-	16,630,201	-	16,630,201
Due to customers	-	527,126,181	-	527,126,181
Dividends payable	-	764,771	-	764,771
Other borrowings	-	26,833,109	-	26,833,109
Debt securities issued	-	4,490,742	-	4,490,742
Other liabilities	-	278,585	-	278,585
Subordinated term debts	-	12,064,370	-	12,064,370
Total financial liabilities	304,485	646,419,993	-	646,724,478

23 (b) Analysis of Financial Instruments by Measurement Basis - Group

As at 31st December 2016	Fair Value Through Profit or Loss	Held to Maturity	Loans and Receivable	Available- for-Sale	Total Carrying Amount
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Assets					
Cash and cash equivalents	-	-	18,668,703	-	18,668,703
Balances with Central Bank of Sri Lanka	-	-	33,777,614	-	33,777,614
Placements with banks	-	-	2,198,446	-	2,198,446
Reverse repurchase agreements	-	-	5,756,794	-	5,756,794
Derivative financial instruments	289,989	-	-	-	289,989
Financial investments - fair value through profit or loss	716,008	-	-	-	716,008
Loans and receivables to customers	-	-	597,467,460	-	597,467,460
Financial investments - loans and receivables	-	-	102,063,229	-	102,063,229
Financial investments - available-for-sale	-	-	-	95,797,141	95,797,141
Financial investments - held to maturity	-	465,081	-	-	465,081
Other assets	-	-	3,175,431	-	3,175,431
Total financial assets	1,005,997	465,081	763,107,677	95,797,141	860,375,896
Liabilities					
Due to banks	-	-	69,964,380	-	69,964,380
Derivative financial instruments	665,890	-	-	-	665,890
Securities sold under repurchase agreements	-	-	13,458,127	-	13,458,127
Due to customers	-	-	635,371,097	-	635,371,097
Dividends payable	-	-	1,015,463	-	1,015,463
Other borrowings	-	-	27,130,358	-	27,130,358
Debt securities issued	-	-	5,115,801	-	5,115,801
Other liabilities	-	-	1,295,848	-	1,295,848
Subordinated term debts	-	-	25,901,110	-	25,901,110
Total financial liabilities	665,890	-	779,252,184	-	779,918,074

Notes to the Financial Statements

23 ANALYSIS OF FINANCIAL INSTRUMENTS BY MEASUREMENT BASIS (CONTD.)

23 (b) Analysis of Financial Instruments by Measurement Basis - Group (Contd.)

As at 31st December 2015	Fair Value Through Profit or Loss	Held to Maturity	Loans and Receivable	Available- for-Sale	Total Carrying Amount
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Assets					
Cash and cash equivalents	-	-	15,419,654	-	15,419,654
Balances with Central Bank of Sri Lanka	-	-	20,096,090	-	20,096,090
Placements with banks	-	-	1,174,326	-	1,174,326
Reverse repurchase agreements	-	-	7,782,374	-	7,782,374
Derivative financial instruments	1,302,872	-	-	-	1,302,872
Financial investments - fair value through profit or loss	1,948,772	-	-	-	1,948,772
Loans and receivables to customers	-	-	507,244,329	-	507,244,329
Financial investments - loans and receivables	-	-	87,087,205	-	87,087,205
Financial investments - available-for-sale	-	-	-	79,718,231	79,718,231
Financial investments - held to maturity	-	1,257,433	-	-	1,257,433
Other assets	-	-	1,703,598	-	1,703,598
Total financial assets	3,251,644	1,257,433	640,507,576	79,718,231	724,734,884
Liabilities					
Due to banks	-	-	58,283,838	-	58,283,838
Derivative financial instruments	304,485	-	-	-	304,485
Securities sold under repurchase agreements	-	-	16,630,201	-	16,630,201
Due to customers	-	-	536,132,789	-	536,132,789
Dividends payable	-	-	764,771	-	764,771
Other borrowings	-	-	26,833,109	-	26,833,109
Debt securities issued	-	-	4,913,751	-	4,913,751
Other liabilities	-	-	715,537	-	715,537
Subordinated term debts	-	-	12,085,598	-	12,085,598
Total financial liabilities	304,485	-	656,359,594	-	656,664,079

24 CASH AND CASH EQUIVALENTS

Accounting Policy

Cash and cash equivalents include cash in hand and balances with banks. These are subject to an insignificant risk of changes in their fair value and are used by the Group in the management of its short term commitments. These are brought to financial statements at their face values or gross values. Cash and cash equivalents are carried at amortised cost in the statement of financial position.

As at 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Local currency in hand	15,856,178	11,473,785	15,910,825	11,543,049
Foreign currency in hand	786,709	1,083,074	786,709	1,087,975
Balances with banks	868,559	2,352,739	1,971,169	2,788,630
	17,511,446	14,909,598	18,668,703	15,419,654

All cash and cash equivalent balances held by the Group entities were available for use by the Group.

25 BALANCES WITH CENTRAL BANK OF SRI LANKA

Balances with Central Bank of Sri Lanka represent the cash balance that is required to be maintained as per the provisions of Section 93 of the Monetary Law Act. The minimum cash reserve requirement on rupee deposit liabilities was 7.5% as at 31st December 2016 (2015 : 6%).

There are no reserve requirements for deposit liabilities of the Foreign Currency Banking Unit (FCBU) and foreign currency deposit liabilities in the Domestic Banking Unit (DBU).

As at 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Statutory balance with Central Bank of Sri Lanka	33,777,614	20,096,090	33,777,614	20,096,090
	33,777,614	20,096,090	33,777,614	20,096,090

26 PLACEMENTS WITH BANKS

Placements with banks include money at call and short notice that are subject to an insignificant risk of changes in the fair value, and are used by the Group and the Bank in the management of its short term commitments. These are brought to financial statements at the face values or gross values.

As at 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Placements - within Sri Lanka	-	-	1,445,396	1,147,499
Placements - outside Sri Lanka	753,050	26,827	753,050	26,827
	753,050	26,827	2,198,446	1,174,326

27 REVERSE REPURCHASE AGREEMENTS

Accounting Policy

Securities purchased under agreements to resell at a specified future date are not recognised in the statement of financial position. The consideration paid, including accrued interest, is recorded in the statement of financial position, within "reverse repurchase agreements", reflecting the transaction's economic substance as a loan by the Group. The difference between the purchase and resale prices is recorded in net interest income and is accrued over the life of the agreement using the Effective Interest Rate (EIR).

As at 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Securities purchased under reverse repurchase agreements				
With banks	4,119,909	4,809,802	4,146,527	4,809,802
With customers	183,551	59,417	1,610,267	2,972,572
	4,303,460	4,869,219	5,756,794	7,782,374

Notes to the Financial Statements

28 DERIVATIVE FINANCIAL INSTRUMENTS

Accounting Policy

Derivatives are financial instruments that derive their value in response to changes in interest rates, financial instrument prices, commodity prices, foreign exchange rates, credit risk and indices. Derivatives are categorised as trading unless they are designated as hedging instruments. The Bank uses derivatives such as forward foreign exchange contracts and currency swaps. Bank has not designated any derivatives as hedging instruments and has not followed hedge accounting as at the reporting date. All derivatives are initially recognised and subsequently measured at fair value, with all revaluation gains or losses recognised in the statement of profit or loss under "Net gain / (loss) from trading" (Note 10). Derivatives are recorded at fair value and carried as assets when their fair value is positive and as liabilities when their fair value is negative. Fair value is determined using the forward market rates ruling on the reporting date.

The table below shows the fair values of derivative financial instruments, recorded as assets or liabilities.

As at 31st December	Bank/Group			
	2016		2015	
	Assets Rs 000	Liabilities Rs 000	Assets Rs 000	Liabilities Rs 000
Currency swaps				
Sales	3,389	14,548	537	21,815
Purchases	252,513	571,681	1,163,024	69,676
Forward foreign exchange contracts				
Sales	20,090	75,248	5,857	208,417
Purchases	13,997	4,413	133,454	4,577
	289,989	665,890	1,302,872	304,485

29 FINANCIAL INVESTMENTS - FAIR VALUE THROUGH PROFIT OR LOSS

Accounting Policy

A financial asset is classified as fair value through profit or loss if it is held for trading or is designated at fair value through profit or loss.

Financial assets are classified as held for trading if they are acquired principally for the purpose of selling or repurchasing in the near term or holds as a part of a portfolio that is managed together for short term profit or position taking.

Financial assets held for trading are recorded in the statement of financial position at fair value. Changes in fair value are recognised in "net gain / (loss) from trading" (Note 10). Interest income is recorded in "Interest income" and dividend income is recorded in "net gain / (loss) from trading" (Note 10) according to the terms of the contract, or when the right to receive the payment has been established.

The Group evaluates its financial assets held for trading, other than derivatives, to determine whether the intention to sell them in the near term is still appropriate. When the Group is unable to trade these financial assets due to inactive markets and management's intention to sell them in the foreseeable future significantly changes, the Group may elect to reclassify these financial assets.

Financial assets held for trading include instruments such as government securities, equity instruments etc. that have been acquired principally for the purpose of selling or repurchasing in the near term.

As at 31st December	2016	2015
	Fair Value Rs 000	Fair Value Rs 000
Quoted shares - Bank [Note 29 (a)]	544,915	593,390
Total financial investments - fair value through profit or loss - Bank	544,915	593,390
Quoted shares - Subsidiaries [Note 29 (b)]	145,179	236,299
Government of Sri Lanka treasury bonds - Subsidiaries [Note 29 (c)]	14,583	878,676
Quoted units in unit trusts - Subsidiaries [Note 29 (d)]	10,296	10,708
Unquoted units in unit trusts - Subsidiaries [Note 29 (e)]	1,036	229,699
Total financial investments - fair value through profit or loss - Subsidiaries	171,094	1,355,382
Total financial investments - fair value through profit or loss - Group	716,009	1,948,772

29 FINANCIAL INVESTMENTS - FAIR VALUE THROUGH PROFIT OR LOSS (CONTD.)

29 (a) Quoted Shares Held by the Bank

As at 31st December	2016				2015			
	No of Ordinary Shares	Cost of Investment Rs 000	% of Total Cost	Fair Value Rs 000	No of Ordinary Shares	Cost of Investment Rs 000	% of Total Cost	Fair Value Rs 000
Banks, Finance and Insurance								
Ceylinco Insurance PLC	34,000	23,035	3.79	24,820	34,000	23,035	3.76	27,200
Commercial Bank of Ceylon PLC	195,779	30,793	5.06	28,388	193,000	30,445	4.98	27,059
National Development Bank PLC	250,000	65,925	10.84	39,000	250,000	65,925	10.77	48,525
Peoples Insurance PLC	363,600	5,454	0.90	6,908	-	-	-	-
Peoples Leasing and Finance PLC	1,000,000	21,000	3.45	17,200	1,000,000	21,000	3.43	22,000
Sampath Bank PLC	242,389	59,750	9.83	63,118	296,201	73,120	11.95	73,458
Sector Total		205,957		179,434		213,525		198,242
Beverage, Food and Tobacco								
Cargills (Ceylon) PLC	73,982	12,207	2.01	14,382	73,982	12,207	2	13,983
Ceylon Cold Stores PLC	-	-	-	-	11,000	4,449	0.73	4,638
Distilleries Company of Sri Lanka PLC	-	-	-	-	274,019	60,591	9.9	67,409
Sector Total		12,207		14,382		77,247		86,030
Chemicals and Pharmaceuticals								
Chemical Industries (Colombo) PLC	556,396	47,850	7.87	50,855	616,396	53,010	8.66	61,825
Sector Total		47,850		50,855		53,010		61,825
Construction and Engineering								
Access Engineering PLC	14,275	472	0.08	354	14,275	472	0.08	330
Sector Total		472		354		472		330
Diversified Holdings								
Aitken Spence PLC	360,030	39,588	6.51	23,402	400,030	43,987	7.19	38,683
Ceylon Theatres PLC	-	-	-	-	25,000	4,013	0.66	3,500
CT Holdings PLC	25,000	4,013	0.66	3,130	-	-	-	-
Expolanka Holdings PLC	1,687,000	11,941	1.96	10,628	-	-	-	-
John Keells Holdings PLC	220,606	42,749	7.03	31,988	227,156	50,307	8.22	40,456
Melstacorp Ltd	900,076	53,352	8.78	53,375	-	-	-	-
Softlogic Holdings PLC	544,065	8,275	1.36	7,073	544,065	8,275	1.35	8,433
Sunshine Holdings PLC	669,661	31,809	5.23	31,206	669,661	31,809	5.2	35,626
Sector Total		191,727		160,802		138,391		126,698
Footwear and Textiles								
Hayleys Fabrics PLC	82,657	1,496	0.25	1,240	82,657	1,496	0.24	1,852
Sector Total		1,496		1,240		1,496		1,852
Hotels and Travels								
Aitken Spence Hotel Holdings PLC	575,301	45,998	7.57	24,795	575,301	45,998	7.52	39,120
Asian Hotels & Properties PLC	207,476	14,917	2.45	11,826	207,476	14,918	2.44	12,262
Sector Total		60,915		36,621		60,916		51,382
Manufacturing								
Alumex PLC	740,000	13,095	2.15	14,948	-	-	-	-
Tokyo Cement Company (Lanka) PLC - Non-voting	200,000	6,755	1.11	10,300	-	-	-	-
Tokyo Cement Company (Lanka) PLC - Voting	435,000	15,789	2.60	25,752	-	-	-	-
Sector Total		35,639		51,000		-		-

Notes to the Financial Statements

29 FINANCIAL INVESTMENTS - FAIR VALUE THROUGH PROFIT OR LOSS (CONTD.)

29 (a) Quoted Shares Held by the Bank (Contd.)

As at 31st December	2016				2015			
	No of	Cost of	% of	Fair	No of	Cost of	% of	Fair
	Ordinary	Investment	Total	Value	Ordinary	Investment	Total	Value
	Shares	Rs 000	Cost	Rs 000	Shares	Rs 000	Cost	Rs 000
Motors								
United Motors Lanka PLC	33,385	3,522	0.58	2,871	187,643	19,796	3.24	17,244
Sector Total		3,522		2,871		19,796		17,244
Power & Energy								
Vallibel Power Erathna PLC	-	-	-	-	977,555	6,122	1.00	8,700
Sector Total		-		-		6,122		8,700
Telecommunication								
Dialog Axiata PLC	4,510	48,195	7.93	47,356	3,840,000	40,876	6.68	41,087
Sector Total		48,195		47,356		40,876		41,087
Total		607,980	100.00	544,915		611,851	100.00	593,390
Unrealised loss from marked to market valuation		(63,065)				(18,461)		
Total quoted shares - Bank		544,915		544,915		593,390		593,390

29 (b) Quoted shares Held by Subsidiaries

As at 31st December	2016				2015			
	No of	Cost of	% of	Fair	No of	Cost of	% of	Fair
	Shares	Investment	Total	Value	Shares	Investment	Total	Value
	Rs 000	Cost	Rs 000		Rs 000	Cost	Rs 000	
Banks, Finance and Insurance								
National Development Bank PLC	11,299	1,600	1.23	1,763	78,200	9,519	4.64	15,179
Sampath Bank PLC	82,657	17,088	13.11	21,524	80,477	17,088	8.33	19,958
Nations Trust Bank PLC	97,674	6,768	5.19	7,902	253,261	17,120	8.35	21,856
DFCC Bank PLC	-	-	-	-	30,000	3,765	1.84	5,043
Peoples Leasing & Finance PLC	721,543	12,988	9.96	12,411	912,800	16,430	8.01	20,082
Seylan Bank PLC - (Non-Voting)	315,283	11,633	8.92	18,602	390,283	14,636	7.13	28,491
Sector Total		50,077		62,202		78,558		110,609
Beverage Food and Tobacco								
Distilleries Company of Sri Lanka PLC	-	-	-	-	60,000	10,648	5.19	14,760
Sector Total						10,648		14,760
Diversified Holdings								
John Keells Holdings PLC	48,274	7,865	6.03	7,000	54,278	10,185	4.96	9,667
Richard Peiris and Company PLC	722,851	10,342	7.93	5,783	962,851	13,457	6.56	8,184
Vallibel One PLC	375,000	6,764	5.19	6,975	375,000	6,764	3.3	8,063
Melstacorp Limited	240,000	14,226	10.91	14,232				
Sector Total		39,197		33,990		30,406		25,914
Manufacturing								
Royal Ceramic Lanka PLC	51,550	7,901	6.06	5,954	128,000	19,819	9.66	14,234
Dipped Products PLC	5,798	545	0.42	503	34,220	4,061	1.98	3,764
ACL Cables PLC	186,800	7,570	5.81	11,301	93,400	7,570	3.69	11,292
Tokyo Cement Company (Lanka) PLC	275,724	12,278	9.42	16,323	435,604	19,072	9.3	21,345
Kelani Cables PLC	-	-	-	-	44,300	5,035	2.45	5,679
Sector Total		28,294		34,081		55,557		56,314

29 FINANCIAL INVESTMENTS - FAIR VALUE THROUGH PROFIT OR LOSS (CONTD.)**29 (b) Quoted shares Held by Subsidiaries (Contd.)**

As at 31st December	2016				2015			
	No of Shares	Cost of Investment	% of Total	Fair Value	No of Shares	Cost of Investment	% of Total	Fair Value
	Rs 000	Cost	Rs 000		Rs 000	Cost	Rs 000	
Hotels and Travels								
Palm Garden Hotels PLC	-	-	-	-	23,000	4,537	2.21	876
Sector Total		-		-		4,537		876
Chemicals and Pharmaceuticals								
CIC Holdings PLC	163,085	12,817	9.83	14,906	185,000	15,731	7.67	18,556
Haycarb PLC	-	-	-	-	20,500	3,547	1.73	3,380
Sector Total		12,817		14,906		19,278		21,936
Construction and Engineering								
Access Engineering PLC	-	-	-	-	255,000	6,163	3	5,890
Sector Total						6,163		5,890
Total		130,385	-	145,179		205,147		236,299
Unrealised gain from marked to market valuation		14,794				31,152		
Total quoted shares - Subsidiaries		145,179		145,179		236,299		236,299

29 (c) Government of Sri Lanka Treasury Bonds Held by Subsidiaries

As at 31st December	Year of Maturity	2016		2015	
		Cost of Investment	Fair Value	Cost of Investment	Fair Value
		Rs 000	Rs 000	Rs 000	Rs 000
2018		-	-	685,695	699,014
2021		16,370	14,583	16,837	15,738
2022		-	-	182,108	163,924
Unrealised loss from marked to market valuation		(1,787)		(5,964)	
Total Government of Sri Lanka treasury bonds - Subsidiaries		14,583	14,583	878,676	878,676

29 (d) Quoted Units in Unit Trusts Held by Subsidiaries

As at 31st December	2016			2015		
	No of Units	Cost of Investment	Fair Value	No of Units	Cost of Investment	Fair Value
		Rs 000	Rs 000		Rs 000	Rs 000
Namal Acuity Value Fund	114,400	7,203	10,296	114,400	7,203	10,708
Unrealised gain from marked to market valuation		3,093			3,505	
Total quoted units - Subsidiaries		10,296	10,296		10,708	10,708

Notes to the Financial Statements

29 FINANCIAL INVESTMENTS - FAIR VALUE THROUGH PROFIT OR LOSS (CONTD.)

29 (e) Unquoted Units in Unit Trusts Held by Subsidiaries

As at 31st December	2016			2015		
	No of Units	Cost of Investment Rs 000	Fair Value Rs 000	No of Units	Cost of Investment Rs 000	Fair Value Rs 000
Cey Bank	-	-	-	1,800,000	18,000	18,577
Ceylon Income Fund	-	-	-	2,686,703	35,000	36,700
Comtrust Money Market Fund	-	-	-	383,877	4,000	4,498
Comtrust ADL Mudarbah Fund	96,781	1,000	1,036	96,781	1,000	976
Eagle Income Fund	-	-	-	989,198	10,000	10,331
FC Wealth Fund	-	-	-	56,111	64,000	67,437
Guardian Acuity Fixed Income Fund	-	-	-	4,155,034	45,000	51,772
Namal High Yield Fund	-	-	-	2,686,567	27,000	39,408
Total		1,000	1,036		204,000	229,699
Unrealised gain from marked to market valuation		36			25,699	
Total unquoted units in unit trusts - Subsidiaries		1,036	1,036		229,699	229,699

30 NON CURRENT ASSETS HELD FOR SALE

Accounting Policy

Non-current assets that are expected to be recovered primarily through sale rather than through continuing use are classified as "held-for-sale". These are assets which are available for immediate sale in their present condition, subject to only the terms that are usual and customary for sale of such assets. Their sale is highly probable and the management has committed to the sale and the sale is expected to be completed within one year from the date of classification.

Non-current assets held for sale are presented separately on the statement of financial position at the lower of its carrying amount and fair value less costs to sell. Thereafter, the Group assesses at each reporting date or more frequently, if events or changes in circumstances indicate that the investment is impaired. The Group recognises an impairment loss for any initial or subsequent write down of the assets to fair value less cost to sell while a gain for any subsequent increase in fair value less cost to sell of an asset is recognised, only to the extent of the cumulative impairment losses that have been recognised previously. Impairment losses on initial classification as held for sale and subsequent gains and losses on re-measurement are recognised in the statement of profit or loss.

Assets classified as non-current assets held for sale are neither amortised nor depreciated.

In the statement of profit or loss, income and expenses from discontinued operations (if any) are reported separately from income and expenses from continued operations, down to the level of profit after taxes, even when the Group retains a non-controlling interest in the subsidiary after the sale. The resulting profit or loss (after taxes) is reported separately in the statement of profit or loss.

As at 31st December	Bank/Group	
	2016 Rs 000	2015 Rs 000
Balance as at 1st January	20,151	30,238
Classified during the year	-	20,151
Disposed during the year	(20,151)	(30,238)
Balance as at 31st December	-	20,151

30 (a) Analysis of Non-current Assets held for sale

Freehold land and buildings

As at 31st December	Building sq.ft	Extent Perches	Carrying Value of Land Rs 000	Carrying Value of Buildings Rs 000	Bank/Group Total	
					2016 Rs 000	2015 Rs 000
Bank House No 88 & 90, Dimbula Road, Hatton	-	-	-	-	-	20,151
					-	20,151

31 LOANS AND RECEIVABLES TO CUSTOMERS

Accounting Policy

Loans and receivables include non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than:

- Those that the Group intends to sell immediately or in the near term and those that the Bank, upon initial recognition, designates as at fair value through profit or loss
- Those that the Group, upon initial recognition, designates as available-for-sale
- Those for which the Group may not recover substantially all of its initial investment, other than due to credit deterioration

After initial measurement, loans and receivables are subsequently measured at amortised cost using the Effective Interest Rate (EIR), less allowance for impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees and costs that are an integral part of the EIR. The amortisation is included in 'interest income' in the statement of profit or loss. The losses arising from impairment are recognised in 'impairment charge for loans and other losses' in the statement of profit or loss.

Write-off of loans and receivables

Loans (and the related impairment allowance accounts) are normally written off, either partially or in full, when there is no realistic prospect of recovery. Where loans are secured, this is generally after receipt of any proceeds from the realisation of security. If a write-off is later recovered, the recovery is credited to "Impairment charge for loans and other losses".

Collateral Valuation

The Group seeks to use collateral, where possible, to mitigate its risks on financial assets. The collateral comes in various forms such as cash, gold, securities, letters of credit, guarantees, real estate, receivables, inventories, other non-financial assets and credit enhancements such as netting arrangements. The fair value of collateral is generally assessed, at a minimum, at inception and based on the Bank's approved valuation policy.

To the extent possible, the Group uses active market data for valuing financial assets, held as collateral. Other financial assets which do not have a readily determinable market value are valued using models. Non-financial collateral, such as real estate, is valued based on data provided by third parties such as independent professional valuers.

Collaterals repossessed

The Bank / Group's policy is to sell the repossessed assets at the earliest possible opportunity. Such collaterals repossessed are held on a memorandum basis without de-recognising the underlying receivable.

Rescheduled Loans

Loans where original terms have been modified including those subject to forbearance strategies are considered as rescheduled loans. This may involve extending the payment arrangements and the agreement of new loan conditions. If the renegotiations are on terms that are not consistent with those readily available in the market, this provides objective evidence of impairment. Once the terms have been renegotiated, any impairment is measured using the EIR as calculated before the modification of terms and the loan/advance is no longer considered past due. Management continually reviews renegotiated loans and advances to ensure that all criteria are met and the future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the original EIR of the loan.

As at 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Gross loans and receivables [Note 31 (a)]	595,513,919	509,525,467	608,965,683	518,586,177
Less: Individual impairment [Note 31 (b) i]	3,366,278	3,345,714	3,366,278	3,345,714
Collective impairment [Note 31 (b) ii]	7,734,914	7,838,125	8,131,945	7,996,134
Net loans and receivables	584,412,727	498,341,628	597,467,460	507,244,329

Notes to the Financial Statements

31 LOANS AND RECEIVABLES TO CUSTOMERS (CONTD.)

31 (a) Analysis of Loans and Advances

31 (a) i By Product

As at 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Overdrafts	91,093,180	71,566,434	91,085,039	71,566,434
Bills of exchange	2,913,620	3,115,186	2,913,620	3,115,186
Commercial papers	153,972	161,270	153,972	161,270
Short term loans	60,562,111	50,881,880	60,682,052	50,973,872
Credit cards	6,061,567	4,548,111	6,061,567	4,548,111
Pawning advances	14,010,152	16,439,602	14,010,152	16,439,602
Trust receipts	24,885,713	23,669,721	24,885,713	23,669,721
Packing credit loans	10,893,772	9,416,979	10,893,772	9,416,979
Staff loans	11,430,637	10,875,391	11,975,374	11,339,787
Term loans	296,741,917	247,329,286	308,370,722	255,831,049
Lease and hire purchase receivable [Note 31 (c)]	42,621,900	40,341,596	43,788,322	40,344,155
Housing loans	33,966,019	30,808,329	33,966,019	30,808,329
Lease backed securities	179,359	371,682	179,359	371,682
Total gross loans and receivables (Note 31)	595,513,919	509,525,467	608,965,683	518,586,177

31 (a) ii By Currency

Sri Lankan Rupees	527,288,700	446,394,387	540,740,464	455,455,097
United States Dollars	66,722,374	61,821,575	66,722,374	61,821,575
Great Britain Pounds	388,411	473,270	388,411	473,270
Euros	1,018,384	558,902	1,018,384	558,902
Other currencies	96,050	277,333	96,050	277,333
Total gross loans and receivables (Note 31)	595,513,919	509,525,467	608,965,683	518,586,177

31 (b) Allowance for Impairment Losses

Accounting policy

The Group considers objective evidence of impairment for loans and advances to customers and held to maturity investments at both specific asset and collective level. All individually significant loans and advances to customers and held to maturity investments are first assessed for specific impairment. All individually significant loans and advances to customers and held to maturity investments found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Assets that are individually assessed for impairment and for which an impairment loss is recognised are not included in a collective assessment of impairment. Loans and advances to customers and held to maturity investments that are not individually significant are collectively assessed for impairment by grouping together loans and advances to customers and held to maturity investments with similar risk characteristics.

If there is an objective evidence that an impairment loss has been incurred, impairment losses on assets carried at amortised cost are measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at original effective interest rate of the asset. If the loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. If the Group has reclassified trading assets to loans and receivables, the discount rate for measuring any impairment loss is the new effective interest rate which is determined at the date of reclassification. The impairment allowances on individually significant accounts are reviewed more regularly when circumstances require. This normally encompasses re-assessment of the enforceability of any collateral held and the timing and amount of actual and anticipated receipts. Individually assessed impairment allowances are only released when there is a reasonable and objective evidence of a reduction in the established loss estimate. Interest on impaired assets continues to be recognised through the unwinding of the discount.

31 LOANS AND RECEIVABLES TO CUSTOMERS (CONTD.)

31 (b) Allowance for Impairment Losses (Contd.)

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from the foreclosure less costs of obtaining and selling the collateral, whether or not foreclosure is probable. The methodology and the assumptions used for estimating future cash flows are reviewed regularly to reduce any difference between loss estimates and actual loss experience.

The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the statement of profit or loss. Interest income continues to be accrued on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows, for the purpose of measuring the impairment loss and recorded as part of 'interest income'.

For the purpose of collective evaluation of impairment, financial assets are grouped on a basis, which takes into consideration credit risk characteristics such as asset type, industry, past due status and other relevant factors.

Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions on, which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

Estimates of changes in future cash flows reflect and are directionally consistent with, changes in related observable data from year to year (such as changes in unemployment rates, property prices, commodity prices, payment status, or other factors that are indicative of incurred losses in the group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between estimated loss and actual loss experience.

Details of impairment losses on financial assets carried at amortised cost are given in Note 14 to the financial statements.

Bank ceases the recognition of interest income on assets which are collectively impaired, when it is probable that the economic benefit associated will not continue to flow to the Bank.

Reversal of Impairment

If the amount of an impairment loss decreases in a subsequent period, and the decrease can be related objectively to an event occurring after the impairment was recognised, the excess is written back to the statement of profit or loss by reducing the financial asset impairment allowance account accordingly.

31 (b) i Movement in Individual Impairment Allowance for Loans and Advances

	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Balance as at 1st January	3,345,714	2,645,389	3,345,714	2,645,389
Net impairment charge for the year	225,581	662,538	225,581	662,538
Write-offs during the year	(230,219)	-	(230,219)	-
Interest accrued on impaired loans and receivables	25,202	37,787	25,202	37,787
Balance as at 31st December	3,366,278	3,345,714	3,366,278	3,345,714

31 (b) ii Movement in Collective Impairment Allowance for Loans and Advances

	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Balance as at 1st January	7,838,125	8,008,889	7,996,134	8,718,377
Net impairment charge for the year	12,333	137,386	278,959	227,572
Write-offs during the year	(115,544)	(308,150)	(143,148)	(949,815)
Balance as at 31st December	7,734,914	7,838,125	8,131,945	7,996,134

Notes to the Financial Statements

31 LOANS AND RECEIVABLES TO CUSTOMERS (CONTD.)

31 (b) iii Product wise Movement in Allowance for Impairment Losses - Bank

	2016				2015
	Lease and Hire Purchases	Loans and Receivables	Pawning	Total	Total
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Balance as at 1st January	1,077,909	10,016,038	89,892	11,183,839	10,654,277
Net impairment charge for the year	(41,625)	325,297	(45,758)	237,914	799,924
Write-offs during the year	(32,288)	(312,697)	(778)	(345,763)	(308,149)
Interest accrued on impaired loans and receivables	-	25,202	-	25,202	37,787
Balance as at 31st December	1,003,996	10,053,840	43,356	11,101,192	11,183,839

31 (b) iv Product wise Movement in Allowance for Impairment Losses - Group

	2016				2015
	Lease and Hire Purchases	Loans and Receivables	Pawning	Total	Total
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Balance as at 1st January	1,077,909	10,174,047	89,892	11,341,848	11,363,765
Net impairment charge for the year	(41,625)	591,922	(45,758)	504,539	890,111
Write-offs during the year	(32,288)	(340,300)	(778)	(373,366)	(949,815)
Interest accrued on impaired loans and receivables	-	25,202	-	25,202	37,787
Balance as at 31st December	1,003,996	10,450,871	43,356	11,498,223	11,341,848

31 (c) Lease and Hire Purchase Receivables

Accounting Policy

Assets leased to customers which transfer substantially all the risks and rewards associated with ownership other than legal title, are classified as finance leases. Amounts receivable under finance leases are classified as lease and hire purchase receivables and presented within loans and receivables to customers in the statement of financial position after deduction of unearned lease income and the impairment for rentals doubtful of recovery. Lease receivables are collectively assessed for impairment in accordance with "allowance for impairment losses" policy as given in Note 31 (b) to the financial statements.

As at 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Total lease and hire purchase rentals receivable	50,841,718	47,918,782	52,537,430	47,922,562
Unearned lease income	(8,219,818)	(7,577,186)	(8,749,108)	(7,578,407)
Gross lease and hire purchase receivable	42,621,900	40,341,596	43,788,322	40,344,155
Impairment allowance for				
lease and hire purchase receivable - Collective	(1,003,996)	(1,077,909)	(1,003,996)	(1,077,909)
Net lease and hire purchase receivable	41,617,904	39,263,687	42,784,326	39,266,246
Net lease and hire purchase receivables				
within one year [Note 31 (c) (i)]	14,540,693	12,777,028	14,820,410	12,777,623
Net lease and hire purchase receivables from				
one to five years [Note 31 (c) (ii)]	26,934,823	26,308,836	27,815,881	26,310,800
Net lease and hire purchase receivables after				
five years [Note 31 (c) (iii)]	142,388	177,823	148,035	177,823
	41,617,904	39,263,687	42,784,326	39,266,246

31 LOANS AND RECEIVABLES TO CUSTOMERS (CONTD.)**31 (c) i Net Lease and Hire Purchase Receivables within one year**

As at 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Total lease and hire purchase rentals receivable within one year from the reporting date	18,901,797	16,681,239	19,385,149	16,682,453
Unearned lease and hire purchase income	(4,010,322)	(3,553,443)	(4,213,942)	(3,554,062)
Impairment allowance for lease and hire purchase receivables	(350,782)	(350,768)	(350,797)	(350,768)
	14,540,693	12,777,028	14,820,410	12,777,623

31 (c) ii Net Lease and Hire Purchase Receivables from one to five years

As at 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Total lease and hire purchase rentals receivables from one to five years from the reporting date	31,782,286	31,042,158	32,965,906	31,044,724
Unearned lease and hire purchase income	(4,197,684)	(4,011,063)	(4,500,261)	(4,011,665)
Impairment allowance for lease and hire purchase receivables	(649,779)	(722,259)	(649,764)	(722,259)
	26,934,823	26,308,836	27,815,881	26,310,800

31 (c) iii Net Lease and Hire Purchase Receivables after five years

As at 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Total lease and hire purchase rentals receivable after five years from the reporting date	157,635	195,385	163,577	195,385
Unearned lease and hire purchase income	(11,812)	(12,680)	(12,107)	(12,680)
Impairment allowance for lease and hire purchase receivables	(3,435)	(4,882)	(3,435)	(4,882)
	142,388	177,823	148,035	177,823

32 FINANCIAL INVESTMENTS - LOANS AND RECEIVABLES**Accounting Policy**

Financial investments - loans and receivables are initially recognised and subsequently measured based on the accounting policy described in Note 31 to the financial statements. These assets are tested for impairment in accordance with the criteria given in Note 31 (b) to the financial statements.

As at 31st December	2016 Rs 000	2015 Rs 000
Sri Lanka development bonds - Bank [Note 32 (a)]	76,443,803	71,191,194
Sri Lanka sovereign bonds - Bank [Note 32 (b)]	8,342,404	656,908
Foreign government bonds - Bank [Note 32 (c)]	-	-
Quoted debentures - Bank [Note 32 (d)]	14,474,491	11,869,600
Other long term investments - Bank [Note 32 (e)]	-	489,000
Total financial investments - loans and receivables - Bank	99,260,698	84,206,702
Quoted debentures - Subsidiaries [Note 32 (f)]	2,802,531	2,814,616
Unquoted debentures - Subsidiaries [Note 32 (g)]	-	65,887
Total financial investments - loans and receivables - Subsidiaries	2,802,531	2,880,503
Total financial investments - loans and receivables - Group	102,063,229	87,087,205

Notes to the Financial Statements

32 FINANCIAL INVESTMENTS - LOANS AND RECEIVABLES (CONTD.)

32 (a) Sri Lanka Development Bonds Held by the Bank

As at 31st December Year of Maturity	2016 Rs 000	2015 Rs 000
2016	-	24,006,577
2017	40,095,572	12,316,205
2018	13,653,532	13,080,141
2020	22,694,699	21,788,271
Total Sri Lanka development bonds - Bank	76,443,803	71,191,194

32 (b) Sri Lanka Sovereign Bonds Held by the Bank

As at 31st December Year of Maturity	2016 Rs 000	2015 Rs 000
2019	5,065,452	656,908
2021	3,276,952	-
Total Sri Lanka sovereign bonds - Bank	8,342,404	656,908

32 (c) Foreign Government Bonds Held by the Bank

As at 31st December Year of Maturity	2016 Rs 000	2015 Rs 000
2042	49,980	49,582
Allowance for impairment	(49,980)	(49,582)
Total foreign government bonds - Bank	-	-

These bonds were issued by the Government of Greece.

32 (d) Quoted Debentures Held by the Bank

As at 31st December	2016		2015	
	No of Debentures	Carrying Value Rs 000	No of Debentures	Carrying Value Rs 000
Abans PLC (9% debentures redeemable on 26th December 2019)	5,000,000	500,738	5,000,000	523,178
Access Engineering PLC (10.25% debentures redeemable on 18th November 2020)	15,000,000	1,518,534	15,000,000	1,518,534
Alliance Finance Company PLC (9.35% debentures redeemable on 29th December 2019)	3,000,000	328,203	3,000,000	328,204
Central Finance PLC (9.52% debentures redeemable on 01st June 2020)	2,000,000	219,040	2,000,000	211,163
Commercial Leasing & Finance PLC (9.75% debentures redeemable on 21st July 2020)	10,000,000	1,097,500	10,000,000	1,043,808
DFCC Bank PLC (9.10% debentures redeemable on 10th June 2020)	5,000,000	525,361	5,000,000	525,430
Hayleys PLC (7.85% debentures redeemed on 06th March 2020)	5,000,000	512,582	5,000,000	512,582
HDFC Bank of Sri Lanka (14.5% debentures redeemable on 23rd October 2016)	-	-	284,900	29,531
Lanka Orix Leasing Company PLC (9% debentures redeemable on 24th November 2019)	5,000,000	511,311	5,000,000	511,342

32 FINANCIAL INVESTMENTS - LOANS AND RECEIVABLES (CONTD.)**32 (d) Quoted Debentures Held by the Bank**

As at 31st December	2016		2015	
	No of Debentures	Carrying Value Rs 000	No of Debentures	Carrying Value Rs 000
LB Finance PLC (14% debentures redeemable on 28th November 2018)	4,408,600	446,088	4,408,600	446,102
Lion Brewery Ceylon PLC (7.85% debentures redeemable on 08th December 2019)	4,686,000	477,872	4,686,000	477,872
Mercantile Investment and Finance PLC (10.5% debentures redeemable on 05th November 2018)	418,650	42,539	418,650	42,539
MTD Walkers PLC (10.25% debentures redeemable on 30th September 2020)	5,000,000	512,918	5,000,000	513,058
Nawaloka Hospitals PLC (14.15% debentures redeemable on 30th September 2018)	1,860,000	192,616	1,860,000	192,634
Orient Finance PLC (9.05% debentures redeemable on 26th December 2019)	2,500,000	261,374	2,500,000	261,405
People's Leasing and Finance PLC (9.625% debentures redeemable on 23rd September 2018)	201,200	22,057	201,200	22,057
People's Leasing and Finance PLC (9.95% debentures redeemable on 12th November 2020)	20,000,000	2,026,715	20,000,000	2,026,715
People's Leasing and Finance PLC (12.60% debentures redeemable on 16th November 2021)	20,000,000	2,031,759	-	-
Richard Pieris and Company PLC (10.75% debentures redeemable on 16th May 2017)	1,409,900	144,810	1,409,900	144,810
Sanasa Development Bank PLC (9.6% debentures redeemable on 31st December 2018)	9,433,700	988,899	9,433,700	943,619
Senkadagala Finance PLC (13.75% debentures redeemable on 09th November 2020)	3,000,000	305,877	-	-
Singer (Sri Lanka) PLC (8.25% debentures redeemable on 22nd December 2017)	9,000,000	974,250	9,000,000	974,250
Singer (Sri Lanka) PLC (8.60% debentures redeemable on 07th June 2018)	5,000,000	522,130	5,000,000	521,678
Singer Finance (Lanka) PLC (14% debentures redeemed on 16th September 2016)	-	-	957,120	99,089
Siyapatha Finance PLC (13.5% debentures redeemable on 20th September 2021)	3,000,000	311,318	-	-
Quoted debentures - Bank		14,474,491		11,869,600

32 (e) Other Long Term Investments Held by the Bank

As at 31st December	2016 Rs 000	2015 Rs 000
Long term non-negotiable bond matured on 14th November 2016	-	489,000
Total other long term investments - Bank	-	489,000

Notes to the Financial Statements

32 FINANCIAL INVESTMENTS - LOANS AND RECEIVABLES (CONTD.)

32 (f) Quoted Debentures Held by Subsidiaries

As at 31st December	2016		2015	
	No of Debentures	Carrying Value Rs 000	No of Debentures	Carrying Value Rs 000
Abans PLC				
(14.00% debentures redeemed on 20th December 2016)	-	-	100,000	10,702
(14.25% debentures redeemable on 20th December 2017)	750,000	80,373	750,000	80,358
(14.50% debentures redeemable on 20th December 2018)	550,000	59,009	550,000	58,998
(09.00% debentures redeemable on 26th December 2019)	450,000	47,092	450,000	45,055
		186,474		195,113
Access Engineering PLC				
(10.25% debentures redeemable on 18th November 2020)	1,250,000	126,509	125,000	126,509
		126,509		126,509
Bank of Ceylon				
(11.00% debentures redeemed on 07th December 2016)	-	-	150,000	15,163
(16.00% debentures redeemable on 29th November 2017)	1,100,000	111,783	1,100,000	111,495
(08.00% debentures redeemable on 21st September 2019)	140,000	14,310	140,000	14,307
(13.25% debentures redeemable on 29th December 2021)	400,000	40,029	-	-
		166,122		140,965
Central Finance Company PLC				
(14.25% debentures redeemed on 17th June 2016)	-	-	11,400	11,809
(14.75% debentures redeemable on 17th June 2018)	29,000	30,078	29,000	30,078
		30,078		41,887
Commercial Bank of Ceylon PLC				
(12.00% debentures redeemable on 27th October 2021)	289,500	29,559	-	-
(12.25% debentures redeemable on 27th October 2026)	135,700	13,861	-	-
		43,420		-
Commercial Credit and Finance PLC				
(10.50% debentures redeemable on 01st June 2020)	1,100,000	112,903	1,100,000	112,879
(10.40% debentures redeemable on 10th December 2020)	1,000,000	100,598	1,000,000	100,599
		213,501		213,478
Commercial Leasing and Finance PLC				
(9.75% debentures redeemable on 21st July 2020)	600,000	65,850	600,000	62,612
		65,850		62,612
DFCC Bank PLC				
(14.00% debentures redeemed on 26th September 2016)	-	-	5,000	5,698
(08.50% debentures redeemable on 18th August 2017)	427,700	44,115	427,700	44,115
(09.40% debentures redeemable on 10th June 2020)	405,500	42,680	405,500	42,680
(12.15% debentures redeemable on 09th June 2021)	100,000	10,173	-	-
(12.75% debentures redeemable on 09th June 2023)	700,000	71,272	-	-
		168,240		92,493
Hayleys PLC				
(14.25% debentures redeemed on 09th July 2016)	-	-	45,000	46,617
		-		46,617
HDFC Bank				
(15.50% debentures redeemable on 23rd October 2018)	600,000	69,300	600,000	68,679
		69,300		68,679
Hemas Holdings PLC				
(11.00% debentures redeemable on 29th April 2019)	557,900	57,504	557,900	57,553
		57,504		57,553
Lanka Orix Leasing Company PLC				
(11.90% debentures redeemed on 30th June 2016)	-	-	750,000	79,499
(09.00% debentures redeemable on 24th November 2019)	550,000	56,244	550,000	56,235
		56,244		135,734
LB Finance PLC				
(15.00% debentures redeemable on 28th November 2018)	851,000	97,865	851,000	97,830
		97,865		97,830

32 FINANCIAL INVESTMENTS - LOANS AND RECEIVABLES (CONTD.)

32 (f) Quoted Debentures Held by Subsidiaries (Contd.)

As at 31st December	2016		2015	
	No of Debentures	Carrying Value Rs 000	No of Debentures	Carrying Value Rs 000
Lion Brewery (Ceylon) PLC				
(13.50% debentures redeemed on 17th June 2016)	-	-	28,800	29,780
(13.75% debentures redeemable on 17th June 2017)	28,800	29,806	28,800	29,798
(14.00% debentures redeemable on 17th June 2018)	38,400	39,766	38,400	39,755
		69,572		99,333
Mercantile Investment & Finance PLC				
(10.50% debentures redeemable on 05th November 2018)	114,100	11,597	114,100	11,594
		11,597		11,594
Merchant Bank of Sri Lanka & Finance PLC				
(14.25% debentures redeemable on 16th December 2017)	400,000	47,123	750,000	94,183
(17.50% debentures redeemable on 27th March 2018)	112,600	13,231	197,100	23,150
(16.70% debentures redeemable on 27th March 2018)	112,600	11,729	112,600	12,192
(08.75% debentures redeemable on 12th November 2019)	150,000	15,658	150,000	15,658
(09.00% debentures redeemable on 12th November 2019)	410,000	44,690	410,000	44,680
		132,431		189,863
National Development Bank PLC				
(13.00% debentures redeemable on 19th December 2018)	125,900	13,413	125,900	13,411
(13.40% debentures redeemable on 19th December 2018)	84,200	9,496	84,200	9,493
(09.40% debentures redeemable on 24th June 2020)	217,200	15,845	-	-
(09.40% debentures redeemable on 24th June 2020)	253,000	27,678	470,200	41,076
(13.90% debentures redeemable on 19th December 2023)	187,500	21,409	187,500	21,402
		87,841		85,382
Nations Trust Bank PLC				
(13.00% debentures redeemable on 19th December 2018)	331,500	35,317	331,500	35,311
(12.65% debentures redeemable on 08th December 2021)	357,400	36,396	-	-
(12.80% debentures redeemable on 08th December 2021)	210,200	21,411	-	-
		93,124		35,311
Nawaloka Hospitals PLC				
(14.15% debentures redeemable on 30th September 2018)	550,000	56,940	550,000	56,940
		56,940		56,940
Pan Asia Banking Corporation PLC				
(09.52% debentures redeemable on 30th October 2019)	207,340	21,069	207,340	21,069
(09.75% debentures redeemable on 30th October 2019)	458,517	46,611	458,517	46,611
		67,680		67,680
People's Leasing & Finance PLC				
(08.75% debentures redeemable on 23rd September 2017)	16,300	1,773	16,300	1,772
(17.00% debentures redeemable on 26th March 2018)	300,000	35,100	300,000	35,086
(09.625% debentures redeemable on 23rd September 2018)	59,400	6,512	59,400	6,510
(09.60% debentures redeemable on 12th November 2019)	450,000	45,580	450,000	45,568
(09.95% debentures redeemable on 12th November 2020)	290,000	29,387	290,000	29,380
(12.60% Debentures redeemable on 16th November 2021)	500,000	50,777	-	-
		169,129		118,316
Richard Pieris and Company PLC				
(10.75% debentures redeemable on 16th May 2017)	31,100	3,194	31,100	3,193
(11.00% debentures redeemable on 16th May 2018)	124,000	12,744	124,000	12,740
(11.25% debentures redeemable on 16th May 2019)	408,800	42,403	408,800	42,721
		58,341		58,654
Sampath Bank PLC				
(16.50% debentures redeemable on 11th October 2017)	283,100	33,451	283,100	32,971
(13.40% debentures redeemable on 04th December 2018)	363,400	41,210	363,400	41,196
(08.25% debentures redeemable on 14th December 2019)	750,000	81,187	750,000	81,171
(09.90% debentures redeemable on 18th November 2020)	1,642,200	166,180	1,642,200	166,135
		322,028		321,473
Seylan Bank PLC				
(15.50% debentures redeemable on 21st February 2018)	900,000	101,963	900,000	101,924
(08.60% debentures redeemable on 22nd February 2019)	300,000	32,644	300,000	32,637
(08.75% debentures redeemable on 23rd December 2020)	500,000	54,483	500,000	54,471
(13.00% debentures redeemable on 15th July 2021)	215,800	22,879	-	-
		211,969		189,032

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32 FINANCIAL INVESTMENTS - LOANS AND RECEIVABLES (CONTD.)

32 (f) Quoted Debentures Held by Subsidiaries (Contd.)

As at 31st December	2016		2015	
	No of Debentures	Carrying Value Rs 000	No of Debentures	Carrying Value Rs 000
Singer (Sri Lanka) PLC (14.50% debentures redeemed on 29th May 2016)	-	-	270,000	27,987
(08.25% debentures redeemable on 23rd December 2019)	270,000	29,227	270,000	29,222
		29,227		57,209
Siyapatha Finance PLC (08.90% debentures redeemable on 24th December 2019)	1,000,000	108,900	1,000,000	108,875
(13.50% debentures redeemable on 20.09.2021)	244,200	25,341	-	-
		134,241		108,875
Softlogic Finance PLC (10.00% debentures redeemable on 29th August 2019)	303,900	31,154	303,900	31,148
		31,154		31,148
Softlogic Holdings PLC (15.75% debentures redeemed on 09th September 2016)	-	-	550,000	58,186
		-		58,186
Vallibel Finance PLC (10.25% debentures redeemable on 31st March 2020)	450,000	46,150	450,000	46,150
	-	46,150		46,150
Total quoted debentures - Subsidiaries		2,802,531		2,814,616

32 (g) Unquoted Debentures Held by Subsidiaries

As at 31st December	2016		2015	
	No of Debentures	Carrying Value Rs 000	No of Debentures	Carrying Value Rs 000
Abans PLC (13.50% debentures redeemed on 01st March 2016)	-	-	25,000	25,842
National Development Bank PLC (3 months gross T.Bill +1% debentures redeemed on 30th June 2016)	-	-	40,000	40,045
Total unquoted debentures held by - Subsidiaries		-		65,887

33 FINANCIAL INVESTMENTS - AVAILABLE-FOR-SALE

Accounting Policy

Available-for-sale investments include equity and debt securities. Equity investments classified as 'available-for-sale' are those which are neither classified as 'held for trading' nor 'designated at fair value through profit or loss'. Debt securities in this category are intended to be held for an indefinite period of time and may be sold in response to needs for liquidity or in response to changes in the market conditions. The Group has not designated any loans or receivables as available-for-sale.

After initial measurement, available-for-sale financial investments are subsequently measured at fair value.

Unrealised gains and losses are recognised directly in equity via 'other comprehensive income' in the 'available-for-sale reserve'. When the investment is disposed of, the cumulative gain or loss previously recognised in equity is recognised in the statement of profit or loss in 'net gain / (loss) from financial investments'. Where the Bank holds more than one investment in the same security, they are deemed to be disposed of on a first in first out basis. Interest earned whilst holding available-for-sale financial investments is reported as 'interest income' using the Effective Interest Rate (EIR). Dividends earned whilst holding available-for-sale financial investments are recognised in the statement of profit or loss as 'net gain / (loss) from financial investments' when the right to receive the dividend has been established. The losses arising from impairment of such investments are recognised in the statement of profit or loss in 'impairment losses on financial investments' and are removed from the 'available-for-sale reserve'.

33 FINANCIAL INVESTMENTS - AVAILABLE-FOR-SALE (CONTD.)

Impairment of Financial Investments - Available-for-sale

For available-for-sale financial investments, the Group assesses at each reporting date whether there is an objective evidence that an investment is impaired.

In case of debt instruments classified as available-for-sale, the Group assesses individually whether there is an objective evidence of impairment based on the same criteria as used for the measurement of impairment relating to loans and advances as mentioned in Note 31 (b) to the financial statements. However, the amount recorded for impairment is the cumulative loss measured as the difference between the amortised cost and the current fair value, less any impairment loss on that investment previously recognised in the statement of profit or loss. Future interest income is based on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded as part of interest income as 'financial investments - available-for-sale'. If, in a subsequent period, the fair value of a debt instrument increases and the increase could be objectively related to a credit event occurring after the impairment loss was recognised in the statement of profit or loss, the impairment loss is reversed through the statement of profit or loss.

In case of equity investments classified as available-for-sale, objective evidence would also include a 'significant' or 'prolonged' decline in the fair value of the investment below its cost. Where there is an evidence of impairment, the cumulative loss measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognised in the statement of profit or loss is removed from equity and recognised in the statement of profit or loss. Impairment losses on equity investments are not reversed through the statement of profit or loss, increases in the fair value after impairment are recognised in 'other comprehensive income'.

The Group writes off certain financial investments – available-for-sale when they are determined to be uncollectible.

As at 31st December	Fair Value 2016 Rs 000	Fair Value 2015 Rs 000
Quoted shares - Bank [Note 33 (a)]	4,936,537	6,635,080
Quoted units - Bank [Note 33 (b)]	270,000	280,800
Unquoted shares - Bank [Note 33 (c)]	25,405	25,405
Unquoted units - Bank [Note 33 (d)]	388,108	193,377
Government of Sri Lanka treasury bonds - Bank [Note 33 (e)]	52,716,014	39,354,113
Government of Sri Lanka treasury bills - Bank [Note 33 (f)]	31,579,089	31,557,730
Total financial investments - available-for-sale - Bank	89,915,153	78,046,505
Government of Sri Lanka treasury bonds - Subsidiaries [Note 33 (g)]	4,424,246	1,410,500
Government of Sri Lanka treasury bills - Subsidiaries [Note 33 (h)]	1,302,373	48,492
Quoted shares - Subsidiaries [Note 33 (i)]	142,940	200,304
Unquoted shares - Subsidiaries [Note 33 (j)]	12,430	12,430
Total financial investments - available-for-sale - Subsidiaries	5,881,989	1,671,726
Total financial investments - available-for-sale - Group	95,797,142	79,718,231

33 (a) Quoted Shares Held by the Bank

As at 31st December	No of Ordinary Shares	2016 Cost of Investment Rs 000	Fair Value Rs 000	No of Ordinary Shares	2015 Cost of Investment Rs 000	Fair Value Rs 000
DFCC Bank	32,396,140	942,651	3,968,527	32,396,140	942,651	5,471,708
National Development Bank PLC	4,282,200	694,519	668,023	4,282,200	694,519	839,312
Nations Trust Bank PLC	3,703,543	383,236	299,987	3,703,543	383,236	324,060
Total quoted shares - Bank		2,020,406	4,936,537		2,020,406	6,635,080

33 (b) Quoted Units in Unit Trusts Held by the Bank

As at 31st December	No of Ordinary Shares	2016 Cost of Investment Rs 000	Fair Value Rs 000	No of Ordinary Shares	2015 Cost of Investment Rs 000	Fair Value Rs 000
Namal Acuity Value Fund	3,000,000	150,000	270,000	3,000,000	150,000	280,800
Total quoted units in unit trusts - Bank		150,000	270,000		150,000	280,800

Notes to the Financial Statements

33 FINANCIAL INVESTMENTS - AVAILABLE-FOR-SALE (CONTD.)

33 (c) Unquoted Shares Held by the Bank

As at 31st December	2016			2015		
	No of Ordinary Shares	Cost of Investment Rs 000	Fair Value Rs 000	No of Ordinary Shares	Cost of Investment Rs 000	Fair Value Rs 000
Credit Information Bureau of Sri Lanka	5,300	530	530	5,300	530	530
Fitch Ratings Lanka Ltd	62,500	625	625	62,500	625	625
Lanka Clear (Pvt) Ltd	2,200,000	22,000	22,000	2,200,000	22,000	22,000
Lanka Financial Services Bureau	225,000	2,250	2,250	225,000	2,250	2,250
Lanka Rating Agency Limited*	1,379,182	16,550	-	1,379,182	16,550	-
Magpek Exports Ltd**	359,000	14,360	-	359,000	14,360	-
S.W.I.F.T*	27	5,196	-	27	5,196	-
Allowance for impairment		(36,106)			(36,106)	
Total Unquoted shares - Bank		25,405	25,405		25,405	25,405

* Directors carried out an impairment assessment of the unquoted share investments held by the Bank as at 31st December 2016 and concluded that no further impairment provision is required in 2016, while in 2015 an impairment charge of Rs. 9.24 Mn and Rs 3.14 Mn was made against the investment in Lanka Rating Agency Limited and S.W.I.F.T. respectively.

** Delisted shares

33 (d) Unquoted Units in Unit Trusts Held by the Bank

As at 31st December	2016			2015		
	No of Ordinary Shares	Cost of Investment Rs 000	Fair Value Rs 000	No of Ordinary Shares	Cost of Investment Rs 000	Fair Value Rs 000
JB Vantage Value Equity Fund	19,455,327	400,000	388,108	9,596,825	200,000	193,377
Total unquoted units in unit trusts - Bank		400,000	388,108		200,000	193,377

33 (e) Government of Sri Lanka Treasury Bonds Held by the Bank

As at 31st December Year of Maturity	2016		2015	
	Cost of Investment Rs 000	Fair Value Rs 000	Cost of Investment Rs 000	Fair Value Rs 000
2016	-	-	2,968,456	2,963,085
2017	3,943,085	3,921,073	3,955,380	3,926,537
2018	10,116,422	9,919,799	6,277,602	6,262,922
2019	15,262,833	14,576,141	12,543,239	12,405,902
2020	3,016,946	2,826,830	3,007,214	2,995,669
2021	15,352,639	15,058,456	6,594,498	6,516,790
2022	280,525	252,941	284,298	277,383
2023	3,300,389	2,950,166	3,335,082	3,242,764
2024	2,542,757	2,523,189	-	-
2025	758,881	687,419	756,939	763,061
Total government of Sri Lanka treasury bonds - Bank	54,574,477	52,716,014	39,722,708	39,354,113

33 (f) Government of Sri Lanka Treasury Bills Held by the Bank

As at 31st December Year of Maturity	2016		2015	
	Cost of Investment Rs 000	Fair Value Rs 000	Cost of Investment Rs 000	Fair Value Rs 000
2016	-	-	31,582,588	31,557,730
2017	31,526,681	31,579,089	-	-
Total government of Sri Lanka treasury bills - Bank	31,526,681	31,579,089	31,582,588	31,557,730

33 FINANCIAL INVESTMENTS - AVAILABLE-FOR-SALE (CONTD.)**33 (g) Government of Sri Lanka Treasury Bonds Held by Subsidiaries**

As at 31st December Year of Maturity	2016		2015	
	Cost of Investment Rs 000	Fair Value Rs 000	Cost of Investment Rs 000	Fair Value Rs 000
2016	-	-	193,486	203,891
2017	360,253	361,528	108,344	102,642
2018	116,389	120,773	44,974	49,017
2019	500,308	490,960	211,580	214,833
2020	421,653	425,409	-	-
2021	1,089,786	1,071,214	132,357	132,827
2022	646,373	611,859	194,301	181,971
2023	253,697	247,214	-	-
2024	474,639	478,171	57,064	56,799
2026	166,179	166,336	-	-
2028	48,755	48,558	-	-
2029	135,191	103,644	135,191	120,396
2044	143,435	101,954	143,435	123,036
2045	222,302	196,626	222,302	225,088
Total government of Sri Lanka treasury bonds - Subsidiaries	4,578,960	4,424,246	1,443,034	1,410,500

33 (h) Government of Sri Lanka Treasury Bills Held by Subsidiaries

As at 31st December Year of Maturity	2016		2015	
	Cost of Investment Rs 000	Fair Value Rs 000	Cost of Investment Rs 000	Fair Value Rs 000
2016	-	-	47,045	48,492
2017	1,224,348	1,302,373	-	-
Total government of Sri Lanka treasury bills - Subsidiaries	1,224,348	1,302,373	47,045	48,492

33 (i) Quoted Shares Held by Subsidiaries

As at 31st December	2016			2015		
	No of Ordinary Shares	Cost of Investment Rs 000	Fair Value Rs 000	No of Ordinary Shares	Cost of Investment Rs 000	Fair Value Rs 000
Banks, Finance and Insurance						
Seylan Bank PLC - (Non-Voting)	241,000	12,347	14,219	241,000	12,347	17,593
Sampath Bank PLC	109,749	24,877	28,579	108,802	25,352	26,983
Central Finance Company PLC	206,743	25,370	20,674	100,037	25,370	25,309
Sector Total		62,594	63,472		63,069	69,885
Diversified Holdings						
Vallibel One PLC	-	-	-	301,877	7,860	6,490
Melstacorp Limited	39,532	2,343	2,344	-	-	-
Sector Total		2,343	2,344		7,860	6,490
Hotels and Travels						
Aitken Spence Hotels Holdings PLC	-	-	-	80,112	6,805	5,448
Palm Garden Hotels PLC	-	-	-	69,000	3,795	2,629
Sector Total		-	-		10,600	8,077

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33 FINANCIAL INVESTMENTS - AVAILABLE-FOR-SALE (CONTD.)

33 (i) Quoted Shares Held by Subsidiaries (Contd.)

As at 31st December	2016			2015		
	No of Ordinary Shares	Cost of Investment Rs 000	Fair Value Rs 000	No of Ordinary Shares	Cost of Investment Rs 000	Fair Value Rs 000
Investment Trusts						
Renuka Holdings PLC	-	-	-	425,000	15,408	11,433
Sector Total	-	-	-		15,408	11,433
Manufacturing						
Tokyo Cement Company (Lanka) PLC	388,568	22,074	23,003	408,568	23,004	20,020
Royal Ceramic Lanka PLC	83,000	10,072	9,586	83,000	10,072	9,230
Textured Jersey Lanka PLC	453,681	10,817	19,418	863,681	20,118	30,661
Sector Total		42,963	52,007		53,194	59,911
Beverage, Food and Tobacco						
Distilleries Company of Sri Lanka PLC	-	-	-	9,883	2,048	2,431
Sector Total	-	-	-		2,048	2,431
Chemicals And Pharmaceuticals						
CIC Holdings PLC - (Non-Voting)	141,915	9,698	9,650	141,915	9,698	11,523
Sector Total	141,915	9,698	9,650		9,698	11,523
Power and Energy						
Lanka IOC PLC	-	-	-	340,000	19,703	12,614
Sector Total					19,703	12,614
Land and Property						
Overseas Reality (Ceylon) PLC	773,335	19,640	15,467	773,335	19,564	17,940
Sector Total	773,335	19,640	15,467		19,564	17,940
Total quoted shares - Subsidiaries		137,238	142,940		201,144	200,304

33 (j) Unquoted Shares Held by Subsidiaries

As at 31st December	2016			2015		
	No of Ordinary Shares	Cost of Investment Rs 000	Fair Value Rs 000	No of Ordinary Shares	Cost of Investment Rs 000	Fair Value Rs 000
Credit Information Bureau of Sri Lanka	100	234	234	100	234	234
UB Finance	1,742,326	12,196	12,196	1,742,326	12,196	12,196
Standard Credit Lanka (Formerly Ceylinco Investment and Reality Ltd)	38,458,474	38,692	-	38,458,474	38,692	-
Allowance for impairment		(38,692)			(38,692)	
Total unquoted shares - Subsidiaries		12,430	12,430		12,430	12,430

33 (k) Assets Pledged as Security

The following amounts of financial investments - available-for-sale are pledged as security for re-purchase agreements entered into by the Group.

As at 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Treasury bills	9,384,179	13,797,976	9,384,179	13,797,976
Treasury bonds	4,926,410	2,791,821	4,926,410	2,791,821
	14,310,589	16,589,797	14,310,589	16,589,797

34 FINANCIAL INVESTMENTS - HELD-TO-MATURITY

Accounting Policy

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity that the Group has the positive intention and ability to hold till maturity and which are not designated as at fair value through profit or loss or as available-for-sale.

After initial measurement, held-to-maturity investments are subsequently measured at amortised cost using the Effective Interest Rate (EIR) less impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the EIR. The amortisation is included in 'interest income' in the statement of profit or loss. The losses arising from impairment of such investments are recognised in 'impairment charge for loans and other losses' in the statement of profit or loss.

A sale or a reclassification of more than an insignificant amount of held-to-maturity investments would result in the reclassification of all held-to-maturity investments as available-for-sale, and would prevent the Group from classifying investment securities as held-to-maturity for the current and the following two financial years. However, sales and reclassifications in any of the following circumstances would not trigger a reclassification:

- sales or reclassifications that are so close to maturity that changes in the market rate of interest would not have a significant effect on the financial asset's fair value
- sales or reclassifications after the Group has collected substantially all of the asset's original principal and
- sales or reclassifications attributable to non-recurring isolated events beyond the Group's control that could not have been reasonably anticipated.

As at 31st December	Group	
	2016 Rs 000	2015 Rs 000
Government of Sri Lanka treasury bills - Subsidiaries [Note 34 (a)]	291,056	784,868
Government of Sri Lanka treasury bonds - Subsidiaries [Note 34 (b)]	174,025	472,565
Total financial investments - Held-to-maturity - Group	465,081	1,257,433

34 (a) Government of Sri Lanka Treasury Bills Held by Subsidiaries

As at 31st December Year of Maturity	2016	2015
	Rs 000	Rs 000
2016	-	784,868
2017	291,056	-
Total government of Sri Lanka treasury bills - Subsidiaries	291,056	784,868

34 (b) Government of Sri Lanka Treasury Bonds Held by Subsidiaries

As at 31st December Year of Maturity	2016	2015
	Rs 000	Rs 000
2016	-	304,278
2018	174,025	168,287
Total government of Sri Lanka treasury bonds - Subsidiaries	174,025	472,565

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35 INVESTMENT IN JOINT VENTURE

Accounting Policy

Joint venture is a type of joint arrangement, whereby the parties that have joint control of the arrangement have rights to the net assets of the joint venture. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require unanimous consent of the parties sharing control.

The Group determines joint control, by taking into account similar considerations necessary, to determine control over subsidiaries.

The Group's investment in a joint venture is accounted for, using the equity method and is recognised initially at cost. The carrying amount of the investment is adjusted to recognise changes in the Group's share of net assets of the joint venture since the acquisition date. Goodwill relating to a joint venture is included in the carrying amount of the investment and is not tested for impairment individually.

The statement of profit or loss reflects Group's share of the results of operations of the joint venture. Any change in 'other comprehensive income' of the joint venture is presented as part of the Group's 'other comprehensive income'. In addition, when there has been a change recognised directly in the equity of the joint venture, the Group recognises its share of any changes, when applicable, in the statement of changes in equity. Unrealised gains and losses resulting from transactions between the Group and the joint venture are eliminated to the extent of the interest in the joint venture.

The aggregate of the Group's share of profit or loss of a joint venture is shown on the face of the statement of profit or loss outside operating profit and includes profit or loss after tax and non-controlling interests in the subsidiaries of the joint venture.

The financial statements of the joint venture are prepared for the same reporting period as the Group. When necessary, adjustments are made to bring the accounting policies in line with those of the Group.

At each reporting date, the Group determines whether there is an objective evidence that the investment in joint venture is impaired. If there is such an evidence, the Group calculates the amount of impairment as the difference between the recoverable amount of the joint venture and its carrying value, and then recognises the loss in impairment for loans and other losses in the statement of profit or loss.

The Group discontinues the use of equity method from the date that it ceases, to have joint control over the joint venture and accounts for the investment in accordance with the Group's accounting policy for financial instruments. Any difference between the carrying amount of the joint venture upon loss of joint control and the fair value of the retained investment and proceeds from disposal, is recognised in the statement of profit or loss.

35 (a) Investment in Joint Venture - Bank

As at 31st December			2016			2015		
	Principal	Principal	%	Cost of	Directors'	%	Cost of	Directors'
	Activity	Place of	Holding	Investment	Valuation	Holding	Investment	Valuation
		Business		Rs 000	Rs 000		Rs 000	Rs 000
Acuity Partners (Pvt) Ltd	Investment banking	Sri Lanka	50.00	755,000	755,000	50.00	655,000	655,000
Total				755,000			655,000	

Bank received Rs 30.2 Mn of dividend income from Acuity Partners (Pvt) Ltd for the year ended 31st December 2016 (2015 : Rs 30.1 Mn).

35 INVESTMENT IN JOINT VENTURE (CONTD.)**35 (b) Investment in Joint Venture - Group**

	2016 Rs 000	2015 Rs 000
Investment in joint venture (at cost) as at 1st January	655,000	655,000
Group's share of joint venture profit as at 1st January	710,508	653,682
Group's share of net assets of joint venture company as at 1st January	1,365,508	1,308,682
Share of unrealised profit on disposal of investments	(112,138)	(112,138)
Group's share of net assets of joint venture company as at 1st January (net of unrealised profit)	1,253,370	1,196,544
Additional investment during the year	100,000	-
Share of profit of joint venture (net of income tax) (Note 19)	148,790	60,085
Share of other comprehensive income of equity accounted joint venture	(21,154)	17,041
Deemed disposal gain through joint venture	-	9,830
Dividend received during the year	(30,200)	(30,130)
Group's share of net assets of joint venture company as at 31st December	1,450,806	1,253,370

35 (c) Summarised Financial Position of Joint Venture - Acuity Partners (Pvt) Ltd and its Subsidiaries

For the year ended 31st December	2016 Rs 000	2015 Rs 000
Current assets	4,085,610	5,703,694
Non-current assets	7,488,395	3,413,100
Current liabilities	(6,098,930)	(4,348,747)
Non-current liabilities	(1,063,494)	(945,056)
Non controlling interest	(1,285,694)	(1,091,976)
Equity	3,125,887	2,731,015
Group carrying amount of the investment	1,562,944	1,365,508
Share of unrealised profit on disposal of investments	(112,138)	(112,138)
Group's carrying amount of the investment - Net	1,450,806	1,253,370

35 (d) Summarised statement of profit or loss of Joint Venture - Acuity Partners (Pvt) Ltd and its Subsidiaries

For the year ended 31st December	2016 Rs 000	2015 Rs 000
Revenue	1,233,881	853,971
Administration and distribution expenses	(468,489)	(385,656)
Finance cost	(166,309)	(91,922)
Profit from operations	599,083	376,393
VAT and NBT on financial services	(2,699)	(1,664)
Profit before tax	596,384	374,729
Income tax expenses	(61,499)	(68,749)
Profit for the year	534,885	305,980
Other comprehensive income	(48,143)	64,450
Total comprehensive income for the year	486,742	370,430
Non controlling interest	(230,252)	(203,025)
Total comprehensive income for the year	256,490	167,405
Group's share of profit for the year	127,636	77,126

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36 INVESTMENT IN SUBSIDIARIES

Accounting Policy

Subsidiaries are entities that are controlled by the Group. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect the returns of those investees through its power over the investee. Specifically, the Group controls an investee if, and only if, the Group has:

- power over the investee
- exposure or rights to variable returns from its involvement with the investee
- the ability to use its power over the investee to affect its returns

Generally, there is a presumption that a majority of voting rights results in control. To support this presumption and when the Group has less than a majority of the voting or similar rights of an investee, the Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including:

- the contractual arrangement with other vote holders of the investee
- rights arising from other contractual arrangements
- the Group's voting rights and potential voting rights

The Group reassesses whether or not it controls an investee, if facts and circumstances indicate that there are changes to one or more of the above.

The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences, until the date that control ceases. Where Subsidiaries have been sold or acquired during the year, assets, liabilities, income and expenses of the said subsidiary are included in the consolidated financial statements, from the date the Group gains control until the date the Group ceases to control the subsidiary.

When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies in line with the Group's accounting policies. All intra-group assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of Group are eliminated in full on consolidation.

Non-controlling interests represent the portion of profit or loss and net assets of the subsidiaries, not owned directly or indirectly by the Bank. The non-controlling interest is presented in the consolidated statement of financial position within equity, separately from the equity attributable to the equity holders of the Bank. Non-controlling interests in the profit or loss of the Group, is disclosed separately in the consolidated statement of profit or loss.

A change in the ownership interest of a subsidiary without a loss of control, is accounted for as an equity transaction. Upon the loss of control, the Group de-recognises the assets (including goodwill) and liabilities of the subsidiary, any non-controlling interests and the other components of equity related to the subsidiary. Any surplus or deficit arising on the loss of control, is recognised in the statement of changes in equity. If the Group retains any interest in the previous subsidiary, then such interest is measured at fair value at the date that control is lost. Subsequently, it is accounted for as an equity-accounted investee or in accordance with the Group's accounting policy for financial instruments depending on the level of influence retained.

There are no significant restrictions on the ability of the subsidiaries to transfer funds to the Bank in the form of cash dividends or repayment of loans and advances. All subsidiaries of the Bank as at the reporting date have been incorporated in Sri Lanka.

36 INVESTMENT IN SUBSIDIARIES (CONTD.)**36 (a) Investment in Subsidiary - Quoted**

As at 31st December			2016			2015		
Principal Activity	Principal Place of Business	% Holding	Cost of Investment Rs 000	Directors' Valuation Rs 000	% Holding	Cost of Investment Rs 000	Directors' Valuation Rs 000	
HNB Assurance PLC (29,993,000 shares)	Insurance	Sri Lanka	60.00	384,285	1,778,585	60.00	384,285	2,249,475
Total quoted subsidiaries			384,285			384,285		

36 (b) Investment in Subsidiary - Unquoted

As at 31st December			2016			2015		
Principal Activity	Principal Place of Business	% Holding	Cost of Investment Rs 000	Directors' Valuation Rs 000	% Holding	Cost of Investment Rs 000	Directors' Valuation Rs 000	
Sithma Development (Pvt) Ltd (206,000,000 ordinary shares)	Property development	Sri Lanka	100.00	1,973,000	1,973,000	100.00	1,973,000	1,973,000
HNB Grameen Finance Ltd (724,904,118 ordinary shares)	Micro-finance	Sri Lanka	42.16	660,000	660,000	42.16	660,000	660,000
Total unquoted subsidiaries			2,633,000			2,633,000		
Total for the Bank [36 (a) and 36 (b)]			3,017,285			3,017,285		

HNB Grameen Finance Ltd

Bank holds a stake of 51% in the voting rights of Prime Grameen Micro Finance Ltd (subsequently rebranded as HNB Grameen Finance Ltd). Accordingly, the said investment is accounted for as an investment in subsidiary. Since the Bank does not hold non-voting shares of HNB Grameen Finance Ltd, Bank's holding in the said company is 42.16%.

36 (c) Subsidiary Held through HNB Assurance PLC

As at 31st December			2016			2015		
Principal Activity	Principal Place of Business	% Holding	Cost of Investment Rs 000	Directors' Valuation Rs 000	% Holding	Cost of Investment Rs 000	Directors' Valuation Rs 000	
HNB General Insurance Limited (115,000,000 ordinary shares)	General Insurance	Sri Lanka	100.00	1,150,000	1,150,000	100.00	1,150,000	1,150,000
			1,150,000	1,150,000		1,150,000	1,150,000	

Notes to the Financial Statements

36 INVESTMENT IN SUBSIDIARIES (CONTD.)

36 (d) Non-Controlling Interests (NCI) in Subsidiaries

Subsidiary	% of Ownership Interest held by NCI	% of Voting Rights held by NCI	Share of Total Comprehensive Income of NCI for the Year Ended 31st December		NCI as at 31st December		Dividends Paid to NCI	
			2016	2015	2016	2015	2016	2015
			Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
HNB Assurance PLC	40.00	40.00	237,260	65,982	1,086,409	889,105	40,000	75,000
HNB Grameen Finance Ltd	57.84	49.00	753,882	466,725	1,934,614	1,290,183	109,407	-
			991,142	532,707	3,021,023	2,179,288	149,407	75,000

36 (e) Summarised Financial Information of Subsidiaries

As at 31st December	HNB Assurance PLC		Sithma Development (Pvt) Ltd Finance Ltd		HNB Grameen	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Assets	14,528,854	11,640,830	10,203,235	10,231,547	18,614,934	13,490,777
Liabilities	11,831,797	9,356,885	625,296	609,327	15,292,385	11,400,853
Equity	2,697,057	2,283,945	9,577,944	9,622,220	3,322,549	2,089,924
For the year ended 31st December	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Revenue	6,896,816	5,775,631	940,575	922,156	5,784,350	4,024,608
Profit after tax	647,413	196,591	555,720	576,159	1,280,661	981,518
Total comprehensive income	647,892	185,878	555,720	576,159	1,421,778	972,311
For the year ended 31st December	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Cash flows from operating activities	1,292,190	1,169,770	717,134	712,160	(248,916)	792,988
Cash flows from investing activities	(953,592)	(767,836)	(84,534)	(3,638)	992,446	(665,479)
Cash flows from financing activities	(100,000)	(188,250)	(600,000)	(832,600)	(382,056)	(46,751)

37 INVESTMENT PROPERTIES

Accounting Policy

Basis of Recognition

An investment property is recognised, if it is probable that future economic benefits that are associated with the investment property will flow to the Group and cost of the investment property can be reliably measured.

When a portion of the property is held to earn rentals or for capital appreciation and another portion that is held for use in the production or supply of goods or services or for administrative purposes, the Group accounts for the portions separately if these portions could be sold separately (or leased out separately under a finance lease). If the portions could not be sold separately, the property is treated as investment property, only if an insignificant portion is held for use in the production or supply of goods or services or for administrative purposes.

Where the Group provides ancillary services to the occupants of a property it holds, the Group treats such a property as investment property if the services are insignificant to the arrangement as a whole.

Measurement

An investment property is measured initially at its cost. The cost of a purchased investment property comprises of its purchase price and any directly attributable expenditure. The cost of a self-constructed investment property, is its cost at the date when the construction or development is completed.

37 INVESTMENT PROPERTIES (CONTD.)

The Group applies the cost model for investment properties in accordance with Sri Lanka Accounting Standard - LKAS 40 on "Investment Property". Accordingly, land classified as investment properties are stated at cost less any accumulated impairment losses and buildings classified as investment properties are stated at cost, less any accumulated depreciation and any accumulated impairment loss.

The Group obtains the services of independent valuers who are not connected with the Bank, in order to determine the fair value of its investment properties annually for disclosure purposes and such fair values have been disclosed as required by Sri Lanka Accounting Standard - LKAS 40 on "Investment Property".

Depreciation

Depreciation is provided on a straight line basis over the estimated life of the class of asset from the date of purchase up to the date of disposal.

Class of Asset	% per annum
Hatton National Bank PLC	
Freehold buildings [Refer Note 37 (a)]	2.5
Sithma Development (Pvt) Ltd*	
Freehold buildings [Refer Note 37 (b)]	
HNB Tower	1
Others	2.5
Plant, machinery and equipment integral to freehold buildings referred to above	20

*** Sithma Development (Pvt) Ltd**

The HNB towers which is owned by Sithma Development (Pvt) Ltd ("Sithma"), is leased to occupants including the Bank. This building was classified as property, plant and equipment in the financial statements of Sithma, since the ancillary services provided by Sithma to the occupants of HNB towers, is a significant, component of the arrangement as a whole: In 2016, there was a change in the arrangements whereby the ancillary services provided to the occupants became less significant component of the arrangements as a whole. Accordingly, HNB towers is classified as an investment property in the financial statements of Sithma as at 31st December 2016, in accordance with Sri Lanka accounting standard - LKAS 40 on 'Investment property'.

The said building is treated as property, plant and equipment in the consolidated statement of financial position, since a major portion of the building is used by the Bank.

De-recognition

Investment properties are de-recognised when disposed of, or permanently withdrawn from the use since no future economic benefits are expected. Gains or losses arising from de-recognition of an investment property are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in the statement of profit or loss.

Transfers are made to and from investment properties only when there is a change in use.

Investment Property Leased within the Group

Any property leased out to the parent or a subsidiary in full or where the parent or subsidiary occupies a significant portion of such a property is considered as owner-occupied from the perspective of the Group and adjustments are made for consolidation purposes.

	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Cost				
Balance as at 1st January	435,442	435,442	1,140,184	1,135,963
Disposal during the year	-	-	(5,400)	-
Improvements	22,787	-	21,516	4,221
Balance as at 31st December	458,229	435,442	1,156,300	1,140,184
Accumulated depreciation				
Balance as at 1st January	48,799	43,354	98,387	93,577
Disposal during the year	-	-	(1,200)	-
Charge for the year (Note 17)	5,471	5,445	4,813	4,810
Balance as at 31st December	54,270	48,799	102,000	98,387
Net book value as at 31st December	403,959	386,643	1,054,300	1,041,797

Notes to the Financial Statements

37 INVESTMENT PROPERTIES (CONTD.)

37 (a) Valuation of Investment Properties - Bank

	Building sq.ft	Extent Perches	Cost / Carrying Amount As at 31st December 2016			Fair Value As at 31st December 2016			Fair Value as at 31st December 2015
			Building (Net Book Value)			Land	Building	Total	Total
			(Cost) Rs 000	Rs 000	Total Rs 000				
23 & 23 1/1, Independence Avenue, Colombo 7 [Note 37 (b) i]	10,645	105.10	37,081	44,830	81,911	-	-	739,000	739,000
479 T B Jayah Mawatha, Colombo 10 [Note 37 (b) ii]	Land	112.96	126,480	-	126,480	1,412,000	-	1,412,000	903,680
21, 21A, 23 & 25, Janadhipathi Mawatha, Colombo 1 [Note 37 (b) ii]	Land	26.62	34,889	-	34,889	465,850	-	465,850	159,720
10, Sri Uttarananda Mawatha, Colombo 3 [Note 37 (b) iii]	57,197	40.00	72,000	88,679	160,679	600,000	321,733	921,733	588,000
			270,450	133,509	403,959			3,538,583	2,390,400

37 (b) Valuation of Investment Properties - Group

	Building sq.ft	Extent Perches	Cost / Carrying Amount As at 31st December 2016			Fair Value As at 31st December 2016			Fair Value as at 31st December 2015
			Building (Net Book Value)			Land	Building	Total	Total
			(Cost) Rs 000	Rs 000	Total Rs 000				
Through the Bank									
23 & 23 1/1, Independence Avenue, Colombo 7 [Note 37 (b) i]	10,645	105.10	37,081	44,830	81,911	-	-	739,000	739,000
Through the Subsidiary									
- Sithma Development (Pvt) Ltd									
21, 21A, 23 & 25, Janadhipathi Mawatha, Colombo 1 [Note 37 (b) ii]	41,688	-	-	86,089	86,089	-	308,900	308,900	221,280
Through the Subsidiary									
- HNB Grameen Finance Ltd [Note 37 (b) iv]									
249, Stanley Thilekaratne Mawatha, Pagoda, Nugegoda	24,952	39.60	151,063	407,937	559,000	205,134	482,366	687,500	559,000
Vihara Road, Rankewatte, Matale	Land	15.00	9,000	-	9,000	9,000	-	9,000	9,000
44/1, Service Road, Puttalam	Land	25.60	12,800	-	12,800	15,400	-	15,400	12,800
465/1, Old Police Station Road, Kahathuduwa, Polgasowita	20,494	182.59	49,008	71,992	121,000	56,755	72,845	129,600	121,000
67/1, Mahinda Place, Kirulapone, Colombo 5	5,786	8.00	25,267	90,733	116,000	33,786	96,214	130,000	116,000
06, Abaya Place, 7th Lane, Anuradapura	Land	13.52	20,000	-	20,000	25,000	-	25,000	20,000
10/11, Galle Road, Moratuwa	Land	23.00	34,500	-	34,500	36,800	-	36,800	34,500
Adampodaivayal, Adampodaimalaikadu, Trincomalee	Land	724.00	14,000	-	14,000	16,300	-	16,300	14,000
Nallaruwa, Panadura	Land	-	-	-	-	-	-	-	4,200
			352,719	701,581	1,054,300	-	-	2,097,500	1,850,780

The Bank / Group carries investment properties at cost. Market valuations of the above investment properties were carried out as at 31st December 2016. Since the fair values of the investment properties were above the carrying value, the Board of Directors concluded that there was no impairment in investment properties.

37 INVESTMENT PROPERTIES (CONTD.)

37 (b) Valuation of Investment Properties - Group (Contd.)

37 (b) i Valued as a condominium property.

37 (b) ii Land situated at No 479, T B Jayah Mw, Colombo 10 on which HNB Towers is built, and No 21, 21A, 23 and 25, Janadhipathi Mawatha, Colombo 01 are leased to Sithma Development (Pvt) Ltd by the Bank and the Bank receives ground rent. Accordingly, these lands have been classified as investment properties in the statement of financial position of the Bank. However, according to Sri Lanka Accounting Standard - LKAS 40 on "Investment Property", the said lands are treated as property, plant and equipment in the consolidated statement of financial position, since these are leased to a group entity.

37 (b) iii Building situated at No 10, Sri Uttarananda Mw, Colombo 03 is leased out to HNB Assurance PLC and Royal Ceramics Lanka PLC. Accordingly this building is classified as investment property in the statement of financial position of the Bank. However, according to Sri Lanka Accounting Standard - LKAS 40 on "Investment Property", the said building is treated as property, plant and equipment in the consolidated statement of financial position, since Group uses a significant portion of the building for use in the production or supply of goods and services.

37 (b) iv These properties are held by the subsidiary of the Bank, HNB Grameen Finance Ltd. and valuations of the said properties were carried out by Messer's R.S.Wijesuriya, DIV, FIV (Sri Lanka) a professional independent valuer. All these properties other than the property situated in Trincomalee have been mortgaged to Seylan Bank PLC by HNB Grameen Finance Ltd for the financial facilities obtained by the company. The aggregate mortgage value amounts to Rs 665Mn.

37 (c) Valuation details of Investment Properties

In determining fair value, the current condition of the properties, future usability and associated development requirements have been considered. Further, the valuers have made reference to market evidence of transaction prices for similar properties with appropriate adjustments for size and locations.

37 (c) i Bank

Property	Name of professional Valuer	Method of valuation and significant unobservable inputs	Range of estimates for unobservable inputs
23 & 23 1/1, Independence Avenue, Colombo 07	Mr. J.M.J. Fernando	Income approach	
		- Estimated rent per month	Rs 3,284,500
		- Years purchase	25
		- Outgoing expenses as a percentage of gross annual rent	25%
479, T.B. Jayah Mawatha, Colombo 10	Mr. J.M.J. Fernando	Market comparable method - Rate per perch for land	Rs 12,500,000
21, 21A, 23 & 25, Janadhipathi Mawatha, Colombo 01	Mr. J.M.J. Fernando	Market comparable method - Rate per perch for land	Rs 17,500,000
10, Sri Uttarananda Mawatha, Colombo 03	Mr. J.M.J. Fernando	Depreciated replacement cost basis / Market comparable method	
		- Rate per perch for land	Rs 15,000,000
		- Rate per square foot for building	Rs 12,500
		- Depreciation rate	55%

Notes to the Financial Statements

37 INVESTMENT PROPERTIES (CONTD.)

37 (c) Valuation details of Investment Properties (Contd.)

37 (c) ii Group

Property	Name of professional Valuer	Method of valuation and significant unobservable inputs	Range of estimates for unobservable inputs
Through the Bank			
23 & 23 1/1, Independence Avenue, Colombo 07	Mr. J..MJ. Fernando	Income approach - Estimated rent per month - Years purchase - Outgoing expenses as a percentage of gross annual rent	Rs 3,284,500 25 25%
Through the subsidiary - Sithma Development (Pvt) Ltd.			
21, 21A, 23 & 25, Janadhipathi Mawatha, Colombo 01	Mr. J.M.J. Fernando	Depreciated replacement cost basis - Rate per Sq.ft for building	Rs 5,380
Through the subsidiary - HNB Grameen Finance Ltd			
No.249, Stanley Thilekerathna Mawatha, Pagoda, Nugegoda	Mr. R.S. Wijesuriya	Income approach - Estimated rent per month - Discount rate	Rs 1,700,000 20%
Vihara Road, Rakewatta, Matale	Mr. R.S. Wijesuriya	Market comparable method - Rate per perch for land	Rs 600,000
No.44/1, Service Road, Puttalam	Mr. R.S. Wijesuriya	Market comparable method - Rate per perch for land	Rs 600,000
No.465/1, Old police Station Road, Kahathduwa, Polgasowita	Mr. R.S. Wijesuriya	Income approach - Estimated rent per month - Depreciation rate	Rs 450,000 20%
No. 67/1, Mahinda Place, Kirulapone, Colombo 05	Mr. R.S. Wijesuriya	Income approach - Estimated rent per month - Depreciation rate	Rs 450,000 20%
No. 06, Abaya Place, 7th Lane, Anuradapura	Mr. R.S. Wijesuriya	Market comparable method - Rate per perch for land	Rs 1,850,000
No. 10/11, Galle Road, Katubedda, Moratuwa	Mr. R.S. Wijesuriya	Market comparable method - Rate per perch for land	Rs 1,600,000
Adampodaivayal, Adampodaimlaikadu, Trincomalee	Mr. R.S. Wijesuriya	Market comparable method - Rate per perch for land	Rs 22,500

Unobservable inputs used in measuring fair value

- Depreciated replacement cost basis/Market comparable method

Significant increase / (decrease) in estimated price per perch, price per sq.ft and depreciation rate would result in a significantly higher / (lower) fair value.

- Investment method

Significant increase / (decrease) in rent per sq.ft, outgoing expenses and number of years since purchase would result in a significantly higher / (lower) fair value.

38 PROPERTY, PLANT AND EQUIPMENT**Accounting Policy****Basis of Recognition**

Property, plant and equipment are recognised if it is probable that future economic benefits associated with the assets will flow to the Group and cost of the asset can be reliably measured.

Measurement

An item of property, plant and equipment that qualifies for recognition as an asset is initially measured at its cost. Cost includes expenditure that is directly attributable to the acquisition of the asset and cost incurred subsequently to add to, replace part of, or service it. The cost of self-constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the asset to a working condition for its intended use and the costs of dismantling and removing the items and restoring the site on which they are located. Purchased software that is integral to the functionality of the related equipment is capitalised as part of computer equipment.

When parts of an item of property or equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment.

Cost Model

The Group applies cost model to property, plant and equipment except for freehold land and buildings and records at cost of purchase or construction together with any incidental expenses thereon, less accumulated depreciation and any accumulated impairment losses.

Revaluation Model

The Group applies the revaluation model to the entire class of freehold land and buildings. Such properties are carried at a revalued amount, being their fair value at the date of revaluation, less any subsequent accumulated depreciation and subsequent accumulated impairment loss. Freehold land and buildings of the Group are revalued at least once in every three years on a roll over basis, to ensure that the carrying amounts do not differ materially from the fair values at the reporting date. On revaluation of an asset, any increase in the carrying amount is recognised in other comprehensive income and accumulated in equity, under capital reserve, or used to reverse a previous revaluation decrease relating to the same asset, which was charged to the statement of profit or loss. In this circumstance, the increase is recognised as income to the extent of the previous write down. Any decrease in the carrying amount is recognised as an expense in the statement of profit or loss or debited in the other comprehensive income to the extent of any credit balance existing in the capital reserve in respect of that asset. The decrease recognised in other comprehensive income reduces the amount accumulated in equity under capital reserves. Any balance remaining in the revaluation reserve in respect of an asset, is transferred directly to retained earnings on retirement or disposal of the asset.

Reclassification as Investment Property

When the use of property changes from owner-occupied to investment property, the property is re-measured to fair value and reclassified as investment property. Any gain arising on re-measurement, is recognised in the statement of profit or loss to the extent that it reverses a previous impairment loss on the specific property, with any remaining gain recognised in other comprehensive income and presented in revaluation reserve in equity. Any loss is recognised immediately in the statement of profit or loss.

Subsequent Costs

The subsequent cost of replacing a component of an item of property, plant and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within that part will flow to the Group and its cost can be reliably measured.

The costs of day to day servicing of property, plant and equipment are charged to the statement of profit or loss as incurred. Costs incurred in using or redeploying an item, is not included under carrying amount of an item.

Notes to the Financial Statements

38 PROPERTY, PLANT AND EQUIPMENT (CONTD.)

De-recognition

The carrying amount of an item of property, plant and equipment is de-recognised on disposal or when no future economic benefits are expected from its use or disposal. The gain or loss arising from the de-recognition of an item of property, plant and equipment which is calculated as the difference between the carrying amount and the net disposal proceeds, is included in the statement of profit or loss when the item is de-recognised.

When replacement costs are recognised in the carrying amount of an item of property, plant and equipment, the remaining carrying amount of the replaced part is de-recognised. Major inspection costs are capitalised. At each such capitalisation, the remaining carrying amount of the previous cost of inspections is de-recognised.

Depreciation

The Group provides depreciation from the date the assets are available for use up to the date of disposal. The assets are depreciated at the following rates on a straight line basis over the periods appropriate to the estimated useful lives, based on the pattern in which the asset's future economic benefits are expected to be consumed by the Group other than disclosed separately. Depreciation of an asset ceases at the earlier of the date that the asset is classified as held for sale or the date that the asset is de-recognised. Depreciation does not cease when the assets become idle or is retired from active use unless the asset is fully depreciated.

Hatton National Bank PLC and its Subsidiary Companies (except for Sithma Development (Pvt) Ltd)

Class of Asset	% per annum
Freehold buildings	2.5
Motor vehicles	25
Computer equipment	16.67
Office equipment	20
Furniture and fittings	10
Fixtures	10
Improvements to leasehold buildings	over the lease period

Depreciation is not provided for freehold land.

Sithma Development (Pvt) Ltd

Class of Asset	% per annum
Generators, generator panels and associated power cables	2
Chillers, cooling towers and associated equipment	4
Lifts and escalator	4
Building management systems	4
Plant and machinery	20
Equipment	20
Furniture and fittings	10

Depreciation methods, useful lives and residual values are reassessed at each reporting date and adjusted if appropriate.

Capital Work-in-Progress

These are expenses of a capital nature directly incurred in the construction of buildings, major plant and machinery and system development, awaiting capitalisation. Capital work-in-progress would be transferred to the relevant asset when it is available for use i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Capital work-in-progress is stated at cost less any accumulated impairment losses.

Borrowing Costs

Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset have been capitalised as part of the cost of the asset in accordance with Sri Lanka Accounting Standard - LKAS 23 on "Borrowing Costs". A qualifying asset is an asset which takes substantial period of time to get ready for its intended use or sale. Capitalisation of borrowing costs ceases when substantially all the activities necessary to prepare the qualifying asset for its intended use are completed. Other borrowing costs are recognised in the statement of profit or loss in the period in which they incur.

38 PROPERTY, PLANT AND EQUIPMENT (CONTD.)

Bank

	Leasehold Buildings	Freehold Land and Buildings	Computer Equipment	Equipment Furniture and Fixtures	Motor Vehicles	Capital Work-in Progress	2016 Total	2015 Total
	Note 38 (c) Rs 000	Note 38 (a) Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Cost / valuation as at 1st January	1,546,988	9,143,068	3,376,238	4,280,666	127,917	117,152	18,592,029	16,087,612
Accumulated depreciation								
adjustment on revaluation	-	(103,189)	-	-	-	-	(103,189)	(260,002)
Write-off during the year	-	-	-	(9,594)	-	-	(9,594)	-
Revaluation surplus	-	2,273,397	-	-	-	-	2,273,397	2,095,076
Net impairment (charge) / reversal (Note 14)	-	41,219	-	-	-	-	41,219	(39,569)
Additions and improvements	27,953	62,078	235,403	295,561	-	354,203	975,198	882,803
Disposals during the year	(10,058)	(2,584)	(73,767)	(127,810)	-	-	(214,219)	(153,713)
Transferred to non-current assets								
held for sale (Note 30)	-	-	-	-	-	-	-	(20,178)
Transferred from capital work-in-progress	3,849	-	-	148,810	-	(152,659)	-	-
Cost / valuation								
as at 31st December	1,568,732	11,413,989	3,537,874	4,587,633	127,917	318,696	21,554,841	18,592,029
Accumulated depreciation								
as at 1st January	1,237,615	4,523	2,462,018	3,300,280	114,024	-	7,118,460	6,782,947
Accumulated depreciation								
adjustment on revaluation	-	(103,189)	-	-	-	-	(103,189)	(260,002)
Accumulated depreciation on write-off assets	-	-	-	(5,124)	-	-	(5,124)	-
Charge for the year	99,803	98,666	265,409	338,192	8,251	-	810,321	740,538
Transferred to non-current assets								
held for sale (Note 30)	-	-	-	-	-	-	-	(27)
Disposals during the year	(9,682)	-	(73,555)	(127,392)	-	-	(210,629)	(144,996)
Accumulated depreciation								
as at 31st December	1,327,736	-	2,653,872	3,505,956	122,275	-	7,609,839	7,118,460
Net book value								
as at 31st December 2016	240,996	11,413,989	884,002	1,081,677	5,642	318,696	13,945,002	-
Net book value								
as at 31st December 2015	309,373	9,138,545	914,220	980,386	13,893	117,152	-	11,473,569

The Bank / Group revalued its freehold land and buildings during 2016. The details relating to the revaluation of freehold land and buildings are given in Note 38 (b).

Based on the assessment of potential impairment carried out internally by the Board of Directors as at 31st December 2016, Rs 41.22 Mn was recognised as a reversal of impairment losses on property, plant and equipment which is accounted for in "impairment charge / (reversal) for loans and other losses".

Notes to the Financial Statements

38 PROPERTY, PLANT AND EQUIPMENT (CONTD.)

Group

	Leasehold Buildings Note 38 (c) Rs 000	Freehold Land and Buildings Note 38 (a) Rs 000	Computer Equipment Rs 000	Equipment Furniture and Fixtures Rs 000	Motor Vehicles Rs 000	Capital Work in Progress Rs 000	2016 Total Rs 000	2015 Total Rs 000
Cost / valuation as at 1st January	1,546,988	19,820,653	3,655,728	6,747,021	158,273	120,975	32,049,638	26,053,148
Accumulated depreciation								
adjustment on revaluation	-	(137,629)	-	-	-	-	(137,629)	(470,972)
Revaluation surplus	-	5,748,917	-	-	-	-	5,748,917	5,597,137
Write-off during the year	-	-	-	(9,594)	-	-	(9,594)	-
Net Impairment (charge) / reversal								
Note 14	-	41,219	-	-	-	-	41,219	(39,472)
Additions and improvements	27,953	75,343	306,750	449,859	-	425,962	1,285,867	1,091,320
Disposals during the year	(10,058)	(2,583)	(80,204)	(155,678)	-	-	(248,523)	(161,345)
Transferred from intangible assets	-	-	-	3,051	-	-	3,051	-
Transferred to non-current assets								
held for sale (Note 30)	-	-	-	-	-	-	-	(20,178)
Transferred from capital								
work-in-progress	3,849	-	-	148,810	-	(152,659)	-	-
Cost / valuation								
as at 31st December	1,568,732	25,545,920	3,882,274	7,183,469	158,273	394,278	38,732,946	32,049,638
Accumulated depreciation								
as at 1st January	1,237,615	90,930	2,633,558	4,051,438	127,409	-	8,140,950	7,762,783
Accumulated depreciation								
adjustment on revaluation	-	(137,629)	-	-	-	-	(137,629)	(470,972)
Accumulated depreciation on write-off assets	-	-	-	(5,124)	-	-	(5,124)	-
Charge for the year	99,803	218,238	306,778	487,710	16,129	-	1,128,658	1,001,399
Transferred from intangible assets	-	-	-	610	-	-	610	-
Transferred to non-current assets								
held for sale (Note 30)	-	-	-	-	-	-	-	(27)
Disposals during the year	(9,682)	-	(80,133)	(148,932)	(6)	-	(238,753)	(152,233)
Accumulated depreciation								
as at 31st December	1,327,736	171,539	2,860,203	4,385,702	143,532	-	8,888,712	8,140,950
Net book value								
as at 31st December 2016	240,996	25,374,381	1,022,071	2,797,767	14,741	394,278	29,844,234	-
Net book value								
as at 31st December 2015	309,373	19,729,723	1,022,170	2,695,583	30,864	120,975	-	23,908,688

38 PROPERTY, PLANT AND EQUIPMENT (CONTD.)**38 (a) Information on Freehold Land and Buildings of the Bank - Extents and Locations**

	Extent (perches)	Buildings Sq.ft.	Cost / Valuation of Land Rs 000	Cost / Valuation of Buildings Rs 000	Total Value Rs 000	Accumulated Depreciation Rs 000	As at 31st December 2016 Net Book Value Rs 000	As at 31st December 2015 Net Book Value Rs 000
Akkaraipattu Branch 14, Main Street, Akkaraipattu.	19.32	10,080	53,130	48,870	102,000	-	102,000	88,949
Ambalangoda Branch 94/1, New Galle Road, Ambalangoda.	29.90	4,959	90,000	18,000	108,000	-	108,000	91,975
Anuradhapura Branch 30, Maithripala Senanayake Mawatha, Anuradhapura.	58.99	9,510	106,500	31,500	138,000	-	138,000	137,947
Badulla Branch 15, 15 1/1, Udayaraja Mawatha, Badulla.	27.75	5,629	83,250	20,750	104,000	-	104,000	92,970
Bambalapitiya Branch 285, Galle Road, Colombo 04.	20.00	16,170	240,000	69,000	309,000	-	309,000	228,585
Boralesgamuwa Branch 24, Maharagama Road, Boralesgamuwa.	29.55	5,432	88,650	26,350	115,000	-	115,000	98,966
Borella Branch 53/1, D S Senanayake Mawatha, Colombo 08.	28.00	10,102	196,000	95,000	291,000	-	291,000	227,882
Centralised Operations 90, Vinayalankara Mawatha, Colombo 10.	249.00	10,250	2,128,950	56,631	2,185,581	-	2,185,581	1,467,939
City Office 16, Janadhipathi Mawatha, Colombo 1.	84.00	44,807	1,260,000	82,000	1,342,000	-	1,342,000	584,071
Chavakachcheri Branch 170, Kandy Road, Chavakachcheri .	20.40	5,557	35,420	15,580	51,000	-	51,000	-
Dambulla Branch 700B, Anuradhapura Road, Dambulla.	100.00	7,456	120,000	43,474	163,474	-	163,474	163,416
Fruithill Bungalow No 295/6, Dimbula Road, Hatton.	53.08	4,277	12,105	13,895	26,000	-	26,000	22,985
Galle Branch 3, Wakwella Road, Galle.	13.68	7,920	75,000	20,000	95,000	-	95,000	79,981
Gampaha Branch 148, Colombo Road, Gampaha.	25.00	16,682	65,000	170,929	235,929	-	235,929	235,713
Gampola Branch 142, Kandy Road, Gampola.	17.05	12,825	46,888	64,112	111,000	-	111,000	101,936
Grandpass Branch 182, St Joseph Street, Colombo 14.	24.00	11,220	102,000	80,000	182,000	-	182,000	158,896
Gunasinghapura Stores 11, Mohandiram's Road, Colombo 12.	48.30	6,022	127,740	22,391	150,131	-	150,131	149,963
Ja-Ela Branch 73, Old Negombo Road, Kanuwana, Ja-Ela.	19.00	3,766	29,450	13,750	43,200	-	43,200	42,477

Notes to the Financial Statements

38 PROPERTY, PLANT AND EQUIPMENT (CONTD.)

38 (a) Information on Freehold Land and Buildings of the Bank - Extents and Locations (Contd.)

	Extent (perches)	Buildings Sq.ft.	Cost / Valuation of Land Rs 000	Cost / Valuation of Buildings Rs 000	Total Value Rs 000	Accumulated Depreciation Rs 000	As at 31st December 2016 Net Book Value Rs 000	As at 31st December 2015 Net Book Value Rs 000
Jaffna Metro Branch 177 & 179, Ponnampalam Rd, Jaffna.	61.36	30,694	276,000	254,000	530,000	-	530,000	558,078
Kahawatte Branch 772 A, Main Street, Kahawatte.	16.14	3,298	25,000	16,000	41,000	-	41,000	29,993
Kalmunai Branch 30A, Batticaloa Road, Kalmunai.	25.10	6,123	56,475	35,525	92,000	-	92,000	79,968
Kandy Branch 1, Dalada Veediya, Kandy.	58.00	26,821	576,500	138,500	715,000	-	715,000	667,640
Kegalle Branch 451, Kandy Road, Kegalle.	61.70	-	83,400	-	83,400	-	83,400	83,400
Kuliyapitiya Branch 225, Main Street, Kuliyapitiya.	32.08	4,500	24,000	15,800	39,800	-	39,800	39,973
Kurunegala Branch 6, St. Anne's Street, Kurunegala.	36.25	17,970	145,000	105,828	250,828	-	250,828	250,650
Mount Bungalow 16, Mount Road, Hatton.	160.09	5,074	32,018	17,982	50,000	-	50,000	14,989
Mannar Branch 68, Main Street, Mannar.	23.00	5,866	11,500	19,700	31,200	-	31,200	31,475
Marawila Branch 534, Colombo Road, Marawila.	43.80	7,217	32,150	25,400	57,550	-	57,550	57,957
Maskeliya Branch 7/11, New Town, Maskeliya.	20.32	8,277	22,352	39,648	62,000	-	62,000	53,944
Matara Branch 58D, Esplanade Road, Matara.	26.00	7,242	54,000	31,000	85,000	-	85,000	82,948
Minuwangoda Branch 41, Samarakkody Road, Minuwangoda.	20.51	3,452	30,765	15,235	46,000	-	46,000	45,981
Managers' Bungalow 295, Dimbula Road, Hatton.	42.20	1,976	9,495	8,505	18,000	-	18,000	42,975
Mount Lavinia Branch 605, Galle Road, Mount Lavinia.	22.66	11,350	84,975	66,025	151,000	-	151,000	134,298
Negombo Branch 18, Rajapakse Broadway, Negombo.	8.88	5,450	15,984	19,300	35,284	-	35,284	34,967
Negombo Metro 201, Colombo Road, Negombo.	51.98	28,081	103,960	211,040	315,000	-	315,000	314,734
Nittambuwa Branch 22, Kandy Road, Nittambuwa.	55.69	10,411	111,380	149,588	260,968	-	260,968	260,671
Nochchiyagama Branch * 10, Puttalam Road, Nochchiyagama.	-	8,652	-	24,500	24,500	-	24,500	24,659

38 PROPERTY, PLANT AND EQUIPMENT (CONTD.)**38 (a) Information on Freehold Land and Buildings of the Bank - Extents and Locations (Contd.)**

	Extent (perches)	Buildings Sq.ft.	Cost / Valuation of Land Rs 000	Cost / Valuation of Buildings Rs 000	Total Value Rs 000	Accumulated Depreciation Rs 000	As at 31st December 2016 Net Book Value Rs 000	As at 31st December 2015 Net Book Value Rs 000
Nugegoda Branch 181, High Level Road, Nugegoda.	16.50	11,096	99,000	72,124	171,124	-	171,124	140,895
Nugegoda Branch 190,190/1, High Level Road, Nugegoda.	39.65	Under construction	128,863	-	128,863	-	128,863	128,863
Nuwara Eliya Branch / Bungalow 42, Queen Elizabeth Drive, Nuwara Eliya.	149.03	12,929	514,833	55,167	570,000	-	570,000	509,920
Panchikawatte Branch 168, Panchikawatta Road, Colombo 10.	22.55	16,366	135,300	94,700	230,000	-	230,000	198,905
Pettah Branch 149-151, Main Street, Colombo 11.	13.03	11,460	195,450	79,450	274,900	-	274,900	229,277
Pettah Metro ** 88, Main Street, Colombo 11.	-	3,708	-	83,000	83,000	-	83,000	63,919
Polonnaruwa Branch * 467, Main Street, Kaduruwela, Polonnaruwa.	-	9,882	-	56,884	56,884	-	56,884	56,759
Pussellawa Branch 510, Nuwaraeliya Road, Pussellawa.	14.30	4,785	25,025	24,975	50,000	-	50,000	42,974
Ratnapura Branch 21 & 23, Senanayake Mawatha, Ratnapura.	43.40	6,732	86,000	12,000	98,000	-	98,000	92,471
Sea Street Branch 60, Sea Street, Colombo 11.	6.93	9,608	83,160	44,840	128,000	-	128,000	105,927
Trincomalee Branch 59, Ehamparam Road, Trincomalee.	31.75	9,156	69,850	49,623	119,473	-	119,473	119,775
Vavuniya Branch * 43, Inner Circular Road, Vavuniya.	-	9,032	-	25,300	25,300	-	25,300	25,457
Wattala Branch 270, 270/1, Negombo Road, Wattala.	53.00	8,579	185,500	52,100	237,600	-	237,600	195,925
Welimada Branch 35, Nuwara Eliya Road, Welimada.	14.37	9,909	39,518	55,482	95,000	-	95,000	82,941
Wellawaya Branch 70, Kumaradasa Mawatha, Wellawaya.	26.60	5,873	7,000	14,000	21,000	-	21,000	12,750
Wellawatte Branch 100 & 102, Galle Road, Colombo 06.	36.05	16,082	360,500	123,500	484,000	-	484,000	347,836
Total freehold land and buildings			8,485,036	2,928,953	11,413,989	-	11,413,989	9,138,545

*Buildings constructed on state land given on lease

** Condominium property

Notes to the Financial Statements

38 PROPERTY, PLANT AND EQUIPMENT (CONTD.)

38 (b) Information on Valuations of Freehold Land and Buildings of the Bank

The below table summarises the result of the revaluation carried out in 2016

	Name of Professional Valuer	Method of Valuation and Significant Unobservable Inputs
Akkaraipattu Branch 14, Main Street, Akkaraipattu.	Mr. M.H.G.Heenbanda	Depreciated replacement cost basis/ Market comparable method - Price per perch for land - Price per square foot for building - Depreciation rate
Ambalangoda Branch 94/1, New Galle Road, Ambalangoda.	Mr. G.K.D.K. Abeytung	Depreciated replacement cost basis/ Market comparable method - Price per perch for land - Price per square foot for building - Depreciation rate
Anuradhapura Branch 30, Maithripala Senanayake Mawatha, Anuradhapura.	Mr. Tissa Weeratne	Depreciated replacement cost basis/ Market comparable method - Price per perch for land - Price per square foot for building - Depreciation rate
Badulla Branch 15, 15 1/1, Udayaraja Mawatha, Badulla.	Mr. M.H.G.Heenbanda	Depreciated replacement cost basis/ Market comparable method - Price per perch for land - Price per square foot for building - Depreciation rate
Bambalapitiya Branch 285, Galle Road, Colombo 4.	Mr. J.M.J. Fernando	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building - Depreciation rate
Boralesgamuwa Branch 24, Maharagama Road, Boralesgamuwa.	Mr. J.M.J. Fernando	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building - Depreciation rate
Borella Branch 53/1, D S Senanayake Mawatha, Borella.	Mr. J.M.J. Fernando	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building - Depreciation rate
Centralised Operations Building 90, Vinayalankara Mawatha, Colombo 10.	Mr. J.M.J. Fernando	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building - Depreciation rate
Chavakachcheri Branch 170, Kandy Road, Chavakachcheri	Mr. Balenthiran B.	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building - Depreciation rate
City Office 16, Janadhipathi Mawatha, Colombo 1.	Mr. J.M.J. Fernando	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building - Depreciation rate
Dambulla Branch 700B, Anuradhapura Road, Dambulla.	Mr. N.M. Jayatilake	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building - Depreciation rate
Fruithill Bungalow No 295/6, Dimbula Road, Hatton.	Mr. W.M.H.G. Heenbanda	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building - Depreciation rate

Range of Estimates for Unobservable Inputs	Net book value before revaluation of		Revalued amount of		Revaluation Gain/(Loss) Recognised on	
	Land	Building	Land	Building	Land	Building
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
	48,300	39,375	53,130	48,870	4,830	9,495
Rs.2,750,000 p.p Rs.5,000 p. sq.ft 10.00%						
	74,500	16,850	90,000	18,000	15,500	1,150
Rs.3,000,000 p.p Rs.4,500 to Rs.5,000 p. sq.ft 30.00%						
	106,500	30,219	106,500	31,500	-	1,281
Rs.1,000,000 to Rs.2,850,000 p.p Rs.3,500 to Rs.4,500 p. sq.ft 20.00%						
	74,925	17,293	83,250	20,750	8,325	3,457
Rs.3,000,000 p.p Rs.2,000 to Rs.5,000 p. sq.ft 25.00%						
	160,000	65,727	240,000	69,000	80,000	3,273
Rs.12,000,000 p.p Rs.9,000 p. sq.ft 52.00%						
	73,875	24,255	88,650	26,350	14,775	2,095
Rs.3,000,000 p.p Rs.3,750 to Rs.7,500 p. sq.ft 25.00%						
	140,000	84,951	196,000	95,000	56,000	10,049
Rs.7,000,000 p.p Rs.3,850 to Rs.12,750 p. sq.ft 22.00%						
	1,419,300	47,114	2,128,950	56,631	709,650	9,517
Rs.9,000,000 p.p Rs.6,500 p. sq.ft 15.00%						
	36,017	16,069	35,420	15,580	(597)	(489)
Rs.11,000,000 p.p Rs.1,500 to Rs.3,500 p. sq.ft						
	504,000	77,146	1,260,000	82,000	756,000	4,854
Rs.15,000,000 p.p Rs.3,300 to Rs.7,750 p. sq.ft 73.67%						
	120,000	41,978	120,000	43,474	-	1,496
Rs.800,000 to Rs.1,600,000 p.p Rs.7,500 to Rs.8,000 p. sq.ft 25.00%						
	10,760	11,841	12,105	13,895	1,345	2,054
Rs.225,000 p.p Rs.4,000 p. sq.ft 30.00%						

Notes to the Financial Statements

38 PROPERTY, PLANT AND EQUIPMENT (CONTD.)

38 (b) Information on Valuations of Freehold Land and Buildings of the Bank (Contd.)

	Name of Professional Valuer	Method of Valuation and Significant Unobservable Inputs
Galle Branch 3, Wakwella Road, Galle.	Mr. G.K.D.K. Abeytungu	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building - Depreciation rate
Gampaha Branch 148, Colombo Road, Gampaha.	Mr. N.M. Jayatilake	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building - Depreciation rate
Gampola Branch 142, Kandy Road, Gampola.	Mr. W.M.H.G. Heenbanda	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building
Grandpass Branch 182, St Joseph Street, Colombo 14.	Mr. J.M.J. Fernando	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building - Depreciation rate
Gunasinghepura Stores 11, Mohandiram's Road, Colombo 12.	Mr. J.M.J. Fernando	Depreciated replacement cost basis - Price per perch for land - Price per square foot for building - Depreciation rate
Ja-Ela Branch 73, Old Negombo Road, Ja-Ela.	Mr. Tissa Weeratne	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building - Depreciation rate
Jaffna Metro Branch 177 179 Ponnampalam Rd, Jaffna.	Mr. B. Balenthiran	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building
Kahawatte Branch 77 2A, Main Street, Kahawatte.	Mr. G.K.D.K. Abeytungu	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building - Depreciation rate
Kalmunai Branch 30A, Batticaloa Road, Kalmunai.	Mr. W.M.H.G. Heenbanda	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building
Kandy Branch 1, Dalada Veediya, Kandy.	Mr. W.M.H.G. Heenbanda	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building - Depreciation rate
Kegalle Branch 451, Kandy Road, Kegalle.	Mr. N.M. Jayatilake	Depreciated replacement cost basis - Price per perch for land - Price per square foot for building
Kuliyapitiya Branch 225, Main Street, Kuliyapitiya.	Mr. Tissa Weeratne	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building - Depreciation rate
Kurunegala Branch 6, St. Anne's Street, Kurunegala.	Mr. N.M. Jayatilake	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building - Depreciation rate
Mount Bungalow No 295, Mount Road, Hatton.	Mr. W.M.H.G. Heenbanda	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building
Mannar Branch 68, Main Street, Mannar.	Mr. Tissa Weeratne	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building

Range of Estimates for Unobservable Inputs	Net book value		Revalued amount of		Revaluation Gain/(Loss)	
	before revaluation of				Recognised on	
	Land Rs 000	Building Rs 000	Land Rs 000	Building Rs 000	Land Rs 000	Building Rs 000
Rs.5,500,000 p.p Rs.3,500 to Rs.4,000p. sq.ft 30.00%	68,400	11,480	75,000	20,000	6,600	8,520
Rs.2,600,000 p.p Rs.8,000 to Rs.15,000 p. sq.ft 15.00%	65,000	165,364	65,000	170,929	-	5,566
Rs.2,750,000 p.p Rs. 5,000 p. sq.ft	42,625	57,707	46,888	64,112	4,262	6,405
Rs.4,250,000 p.p Rs.9,350 p. sq.ft 23.00%	84,000	72,308	102,000	80,000	18,000	7,692
Rs.3,000,000 p.p Rs.2,000 to Rs.5,000 p. sq.ft 23.66% and 73.67%	127,740	21,297	127,740	22,391	-	1,094
Rs.1,550,000 p.p Rs.2,500 to 4,500 p. sq.ft 18.00%	28,500	13,466	29,450	13,750	950	284
Rs.4,500,000 p.p Rs.9,200 p. sq.ft	276,000	274,453	276,000	254,000	-	(20,453)
Rs.1,550,000 p.p Rs.3,000 to Rs.3,500 p. sq.ft 35.00%	24,210	5,634	25,000	16,000	790	10,366
Rs.2,250,000 p.p Rs.5,500 p. sq.ft	50,200	29,247	56,475	35,525	6,275	6,278
Rs.10,000,000 p.p Rs.4,750 to Rs.6,500 p.sq.ft 40.00%	547,675	114,944	576,500	138,500	28,825	23,556
Rs.1,000,000 to Rs.2,000,000 p.p Rs.4,500 to Rs.5,500 p. sq.ft	83,400	-	83,400	-	-	-
Rs.425,000 to Rs.850,000 p.p Rs.4,300 p. sq.ft 18.00%	24,000	15,791	24,000	15,800	-	9
Rs.4,000,000 p.p Rs.4000 to Rs.8,500 p. sq.ft 20.00%	145,000	101,776	145,000	105,828	-	4,052
Rs.225,000 p.p Rs.3,500 p. sq.ft	8,440	6,485	9,495	8,505	1,055	2,020
Rs.500,000 p.p Rs.2,750 to Rs.3,550 p. sq.ft	11,500	19,505	11,500	19,700	-	195

Notes to the Financial Statements

38 PROPERTY, PLANT AND EQUIPMENT (CONTD.)

38 (b) Information on Valuations of Freehold Land and Buildings of the Bank (Contd.)

	Name of Professional Valuer	Method of Valuation and Significant Unobservable Inputs
Marawila Branch 534, Chilaw Road, Marawila.	Mr. Tissa Weeratne	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building - Depreciation rate
Maskeliya Branch 7/11, New Town, Maskeliya.	Mr. W.M.H.G. Heenbanda	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building - Depreciation rate
Matara Branch 58D, Esplanade Road, Matara.	Mr. G.K.D.K. Abeytungu	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building
Minuwangoda Branch 41, Samarakkody Road, Minuwangoda.	Mr. J.M.J. Fernando	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building - Depreciation rate
Manager Bungalow 295, Dimbula Road, Hatton.	Mr. W.M.H.G. Heenbanda	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building - Depreciation rate
Mount Lavinia Branch 605, Galle Road, Mount Lavinia.	Mr. J.M.J. Fernando	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building - Depreciation rate
Negombo Branch 18, Rajapakse Broadway, Negombo.	Mr. Tissa Weeratne	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building - Depreciation rate
Negombo Metro Building 201, Colombo Road, Negombo.	Mr. Tissa Weeratne	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building
Nittambuwa Branch 22, Kandy Road, Nittambuwa.	Mr. N.M. Jayatilake	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building - Depreciation rate
Nochchiyagama Branch* 10, Puttalam Road, Nochchiyagama.	Mr. Tissa Weeratne	Depreciated replacement cost basis/Market comparable method - Price per square foot for building - Depreciation rate
Nugegoda Branch 181, High Level Road, Nugegoda.	Mr. J.M.J. Fernando	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building - Depreciation rate
Nugegoda Branch (Under construction) 190,190/1, High Level Road, Nugegoda	Mr. J.M.J. Fernando	Market comparable method - Price per perch for land
Nuwara Eliya Branch / Bungalow 42, Queen Elizabeth Drive, Nuwara Eliya.	Mr. W.M.H.G. Heenbanda	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building - Depreciation rate
Panchikawatta Branch 168, Panchikawatta Road, Colombo 10.	Mr. J.M.J. Fernando	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building - Depreciation rate
Pettah Branch 149-151, Main Street, Colombo 11.	Mr. J.M.J. Fernando	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building - Depreciation rate

Range of Estimates for Unobservable Inputs	Net book value		Revalued amount of		Revaluation Gain/(Loss)	
	before revaluation of				Recognised on	
	Land Rs 000	Building Rs 000	Land Rs 000	Building Rs 000	Land Rs 000	Building Rs 000
Rs. 500,000 to Rs. 1,000,000 p.p Rs. 3,300 to Rs. 4,300 p. sq.ft 25.00%	32,150	24,768	32,150	25,400	-	632
Rs. 1,100,000 p.p Rs. 4,500 to Rs. 5,000 p. sq.ft 25.00%	20,320	32,222	22,352	39,648	2,032	7,426
Rs. 2,250,000 p.p Rs. 4,500 to Rs. 5,000 p. sq.ft	52,000	31,900	54,000	31,000	2,000	(900)
Rs. 1,500,000 p.p Rs. 2,500 to Rs. 6,000 p. sq.ft 21.00%	30,765	14,755	30,765	15,235	-	480
Rs. 200,000 p.p Rs. 4,000 p. sq.ft 35.00%	28,016	14,336	32,018	17,982	4,002	3,646
Rs. 3,750,000 p.p Rs. 9,000 p. sq.ft 35.00%	73,645	58,126	84,975	66,025	11,330	7,899
Rs. 1,800,000 p.p Rs. 850 to Rs. 4,850 p. sq.ft 16.50%	15,500	18,729	15,984	19,300	484	571
Rs. 2,000,000 p.p Rs. 8,550 to Rs. 9,500 p. sq.ft	103,960	204,472	103,960	211,040	-	6,568
Rs. 2,000,000 p.p Rs. 12,000 to Rs. 18,000 p. sq.ft 12.00%	108,753	143,114	111,380	149,588	2,627	6,473
Rs. 1,500 to Rs. 4,400 p. sq.ft 23. % and 30.5%	-	23,631	-	24,500	-	869
Rs. 6,000,000 p.p Rs. 10,000 p. sq.ft 35.00%	78,550	59,747	99,000	72,124	20,451	12,377
Rs. 3,250,000 p.p	128,863	-	128,863	-	-	-
Rs. 2,750,000 to Rs. 4,500,000 p.p Rs. 5,000 p. sq.ft 40.00%	462,575	45,641	514,833	55,168	52,258	9,526
Rs. 6,000,000 p.p Rs. 3,000 to Rs. 9,000 p. sq.ft 35.00%	112,750	83,727	135,300	94,700	22,550	10,973
Rs. 15,000,000 p.p Rs. 9,500 p. sq.ft 27.00%	156,360	70,029	195,450	79,450	39,090	9,421

Notes to the Financial Statements

38 PROPERTY, PLANT AND EQUIPMENT (CONTD.)

38 (b) Information on Valuations of Freehold Land and Buildings of the Bank (Contd.)

	Name of Professional Valuer	Method of Valuation and Significant Unobservable Inputs
Pettah Metro ** 88, Main Street, Colombo 11.	Mr. J.M.J. Fernando	Investment basis - Rent per sqft - Out-going expenses - Years purchase
Polonnaruwa Branch * 467, Main Street, Kaduruwela, Polonnaruwa.	Mr. N.M. Jayatilake	Depreciated replacement cost basis/Market comparable method - Price per square foot for building - Depreciation rate
Pussellawa Branch 510, Pussellawa Road, Pussellawa.	Mr. W.M.H.G. Heenbanda	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building - Depreciation rate
Ratnapura Branch 21 & 23, Senanayake Mw, Ratnapura.	Mr. G.K.D.K. Abeytunga	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building
Sea Street Branch 60, Sea Street, Colombo 11.	Mr. J.M.J. Fernando	Depreciated replacement cost basis/ Market comparable method - Price per perch for land - Price per square foot for building - Depreciation rate
Trincomalee Branch 59, Ehampraram Road, Trincomalee.	Mr. N.M. Jayatilake	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building - Depreciation rate
Vavuniya Branch * 43, Inner Circular Road, Vavuniya.	Mr. Tissa Weeratne	Depreciated replacement cost basis/ - Price per square foot for building - Depreciation rate
Wattala Branch 270, 270/1, Negombo Road, Wattala.	Mr. J.M.J. Fernando	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building - Depreciation rate
Wellimada Branch 35, Nuwara Eliya Road, Wellimada.	Mr. W.M.H.G. Heenbanda	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building
Wellawayya Branch 70, Kumaradasa Mawatha Wellawayya.	Mr. G.K.D.K. Abeytunga	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building - Depreciation rate
Wellawatte Branch 100 & 102, Galle Road, Wellawatte.	Mr. J.M.J. Fernando	Depreciated replacement cost basis/Market comparable method - Price per perch for land - Price per square foot for building - Depreciation rate

* Buildings constructed on state land given on lease

** Valued as a condominium property

Unobservable inputs used in measuring fair value

- Depreciated replacement cost basis/Market comparable method

Significant increase / (decrease) in estimated price per perch, price per sq.ft and depreciation rate would result in a significantly higher / (lower) fair value.

- Investment method

Significant increase / (decrease) in rent per sq.ft, outgoing expenses and number of years since purchase would result in a significantly higher / (lower) fair value.

Range of Estimates for Unobservable Inputs	Net book value before revaluation of		Revalued amount of		Revaluation Gain/(Loss) Recognised on	
	Land	Building	Land	Building	Land	Building
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Rs 180.00 35% of the gross annual rent 16	-	63,833	-	83,000	-	19,167
Rs.6,500 to Rs.7,500 p. sq.ft 20.00%	-	55,049	-	56,884	-	1,835
Rs.1,750,000 p.p Rs.5,000 p. sq.ft 5.00%	21,450	20,891	25,025	24,975	3,575	4,084
Rs.1,750,000 to Rs.2,250,000 p.p Rs.3,000 p. sq.ft	75,000	16,755	86,000	12,000	11,000	(4,755)
Rs.12,000,000 p.p Rs.9,000p. sq.ft 48.00%	62,370	41,742	83,160	44,840	20,790	3,098
Rs.2,200,000 p.p Rs.6,500 to Rs.8,000 p. sq.ft 25.00%	69,850	49,022	69,850	49,623	-	601
Rs.1,500 to Rs.4,250 p. sq.ft 28.50%	-	24,520	-	25,300	-	780
Rs.3,500,000 p.p Rs.3,750 p.sq.ft to Rs.9000 p. sq.ft 27.00%	145,750	48,388	185,500	52,100	39,750	3,712
Rs.2,750,000 p.p Rs.5,250 p. sq.ft	35,925	45,671	39,518	55,483	3,593	9,811
Rs.250,000 p.p Rs.3,500 to Rs.4,000 p. sq.ft 25.00%	2,809	9,810	7,000	14,000	4,191	4,190
Rs.10,000,000 p.p Rs10,000 p. sq.ft 23.00%	234,325	109,668	360,500	123,500	126,175	13,832
	6,406,553	2,692,821	8,485,036	2,928,955	2,078,483	236,132

Notes to the Financial Statements

38 PROPERTY, PLANT AND EQUIPMENT (CONTD.)

38 (c) Leasehold Buildings

As at 31st December	Bank				Group			
	2016		2015		2016		2015	
	Cost of Buildings	Accumulated Depreciation	Net Book Value	Net Book Value	Cost of Buildings	Accumulated Depreciation	Net Book Value	Net Book Value
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
01 - 05 years	1,349,517	1,170,999	178,518	27,421	1,349,519	1,170,999	178,520	27,421
06 - 10 years	148,305	89,477	58,828	268,071	148,303	89,477	58,826	268,071
11 - 15 years	70,910	67,260	3,650	12,942	70,910	67,260	3,650	12,942
16 - 20 years	-	-	-	939	-	-	-	939
Total	1,568,732	1,327,736	240,996	309,373	1,568,732	1,327,736	240,996	309,373

38 (d) Temporarily Idle Property, Plant and Equipment - Bank

There was no temporarily idle property, plant and equipment as at 31st December 2016.

38 (e) Compensation from Third Parties for Property, Plant and Equipment - Bank

Rs. 2.01 Mn was received as compensation from third parties for items of property, plant and equipment that were impaired, lost or given up.

39 INTANGIBLE ASSETS AND GOODWILL

Accounting Policy

Basis of Recognition

An intangible asset is recognised if it is probable that the future economic benefits that are attributable to the asset will flow to the Group and the cost of the asset can be measured reliably. An intangible asset is initially measured at cost. The cost of intangible assets acquired in a business combination is the fair value as at the date of acquisition.

(a) Goodwill

Goodwill that arises upon the acquisition of subsidiaries is included in intangible assets. Goodwill is measured at initial recognition in accordance with Note 3.1.1.

Subsequent measurement

Goodwill is measured at cost less accumulated impairment losses. In respect of equity accounted investees, the carrying amount of goodwill is included in the carrying amount of the investment, and an impairment loss in such an investment is not allocated to any asset, including goodwill, that forms part of the carrying amount of the equity accounted investee.

Any gain on bargain purchase is recognised immediately in the statement of profit or loss.

(b) Software

All computer software costs incurred, licensed for use by the Group, which are not integrally related to associated hardware, which can be clearly identified, reliably measured and it's probable that those will lead to future economic benefits, are included in the statement of financial position under the category 'intangible assets' and are carried at cost less accumulated amortisation and any accumulated impairment losses.

39 INTANGIBLE ASSETS AND GOODWILL (CONTD.)

License

The amount that would be required to obtain a license to operate a registered finance business is recognised as license in the financial statements.

Subsequent expenditure

Expenditure incurred on software is capitalised, only when it is probable that this expenditure will enable the asset to generate future economic benefits in excess of its originally assessed standard of performance and this expenditure can be measured and attributed to the asset reliably. All other expenditure is expensed as incurred.

Amortisation

The useful lives of intangible assets are assessed as either finite or infinite. Intangible assets, with finite lives, are amortised on a straight line basis in the statement of profit or loss from the date when the asset is available for use, over the best estimate of the useful economic life based on a pattern in which the asset's economic benefits are consumed by the Group, at 16.67% per annum.

Those assets are assessed for impairment whenever there is an indication that the intangible asset may be impaired.

Expenditure on an intangible item that was initially recognised as an expense by the Group in previous annual financial statements or interim financial statements are not recognised as part of the cost of an intangible asset at a later date. Amortisation methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

Goodwill and intangible assets with infinite useful lives such as license are not amortised, but are assessed for impairment annually. The assessment of infinite life is reviewed annually to determine whether the infinite life continues to be supportable.

De-recognition

An intangible asset is de-recognised on disposal or when no future economic benefits are expected from its use and subsequent disposal. Gains or losses arising from de-recognition of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in the statement of profit or loss.

As at 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Cost				
Balance as at 1st January	2,650,728	2,573,534	3,135,428	2,979,122
Additions and improvements during the year	350,477	77,194	441,837	156,306
Transferred to property, plant and equipment	-	-	(3,051)	-
Balance as at 31st December	3,001,205	2,650,728	3,574,214	3,135,428
Accumulated amortisation				
Balance as at 1st January	1,991,419	1,770,806	2,134,198	1,889,363
Amortisation for the year (Note 17)	220,138	220,613	260,357	244,835
Transferred to property, plant and equipment	-	-	(610)	-
Balance as at 31st December	2,211,557	1,991,419	2,393,945	2,134,198
Net book value as at 31st December	789,648	659,309	1,180,269	1,001,230

Notes to the Financial Statements

39 INTANGIBLE ASSETS AND GOODWILL (CONTD.)

39 (a) Analysis of Intangible Assets

As at 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Computer Software	789,648	659,309	957,328	778,289
Goodwill *	-	-	122,941	122,941
License	-	-	100,000	100,000
	789,648	659,309	1,180,269	1,001,230

*Goodwill amounting to Rs 122.94 Mn has been recognised in respect of acquisition of HNB Grameen Finance Ltd.

The Bank carried out an impairment assessment as at 31st December 2016 on the goodwill recognised on acquisition of HNB Grameen Finance Ltd.

39 (a) i Assessment of Goodwill Impairment

The recoverable value of the goodwill has been determined based on the residual income method.

Key assumptions used in residual income calculation

Profit Growth

Profit growth for the next five years was projected at Compound Annual Growth Rate (CAGR). This was based on a reasonable value growth, taking into account the anticipated growth in micro finance industry and the existing interest margin of the company. Beyond five years terminal growth was assumed to be 0%.

Discount factor

The discount rate used is the risk free rate, adjusted by the addition of an appropriate risk premium.

Inflation

The basis used to determine the value assigned to the budgeted cost inflation is the inflation rate based on projected economic conditions.

40 OTHER ASSETS

As at 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Deposits and prepayments	1,184,065	1,149,211	986,290	841,268
Items held for use	74,442	31,778	74,442	31,778
Items in transit	24,891	12,557	24,891	12,557
Receivable from pension fund	1,955,967	1,093,303	1,955,967	1,093,303
Un-amortised cost on staff loans	3,442,399	2,633,289	3,553,722	2,707,835
VAT recoverable	26,543	162,528	26,543	162,528
Other debtors	2,485,572	1,520,256	4,098,651	2,478,784
	9,193,879	6,602,922	10,720,506	7,328,053

41 DUE TO BANKS

Accounting Policy

Due to banks represents refinance borrowings, call and time deposits and borrowings from banks. Subsequent to initial recognition, these are measured at their amortised cost using the Effective Interest Rate (EIR) method. Amortised cost is calculated by taking into account any discount or premium on the issue and costs that are an integral part of the EIR. The EIR amortisation is included in "interest expenses" in the statement of profit or loss. Gains and losses are recognised in the statement of profit or loss when the liabilities are de-recognised.

As at 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Call and time deposits	-	6,495,946	-	6,495,946
Foreign bank borrowings	52,215,707	31,794,480	52,215,707	31,794,480
Local bank borrowings	13,688,878	15,876,680	13,724,469	15,928,484
Refinance borrowings	4,024,204	4,064,928	4,024,204	4,064,928
	69,928,789	58,232,034	69,964,380	58,283,838

42 SECURITIES SOLD UNDER REPURCHASE AGREEMENTS

Accounting Policy

Securities sold under agreements to repurchase at a specified future date are not de-recognised from the statement of financial position, as the Group retains substantially all of the risks and rewards of ownership. The corresponding cash received is recognised in the statement of financial position as an asset and a corresponding obligation to return it with accrued interest, as 'securities sold under repurchase agreements', reflecting the transaction's economic substance as a loan to the Group. The difference between the sale and repurchase prices is treated as interest expense and is accrued over the life of agreement using the Effective Interest Rate (EIR).

As at 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Securities sold under repurchase agreements				
With banks	800,372	3,303,720	800,372	3,303,720
With customers	12,657,755	13,326,481	12,657,755	13,326,481
	13,458,127	16,630,201	13,458,127	16,630,201

Notes to the Financial Statements

43 DUE TO CUSTOMERS

Accounting Policy

Due to customers include non-interest bearing deposits, savings deposits, term deposits, deposits payable at call, certificate of deposits and margin deposits. Subsequent to initial recognition, deposits are measured at their amortised cost using the Effective Interest Rate (EIR) method, except where the Group designates liabilities at fair value through profit or loss. Amortised cost is calculated by taking into account any discount or premium on the issue and costs that are an integral part of the EIR. The EIR amortisation is included in "interest expenses" in the statement of profit or loss. Gains and losses are recognised in the statement of profit or loss when the liabilities are de-recognised.

As at 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Local currency deposits	522,168,609	438,253,261	534,044,737	447,347,346
Foreign currency deposits	101,326,360	88,872,920	101,326,360	88,785,443
	623,494,969	527,126,181	635,371,097	536,132,789
43 (a) Analysis of Due to Customers				
43 (a) i By Product				
Current account deposits	36,675,800	33,958,697	36,392,699	33,676,332
Savings deposits	188,845,184	184,204,894	190,211,901	185,608,355
Time deposits	395,482,519	305,945,326	406,275,031	313,830,838
Certificates of deposit	957,804	1,092,264	957,804	1,092,264
Margin deposits	1,533,662	1,925,000	1,533,662	1,925,000
	623,494,969	527,126,181	635,371,097	536,132,789
43 (a) ii By Currency				
Sri Lankan Rupees	522,168,609	438,253,261	534,102,873	447,347,346
United States Dollars	78,507,427	67,911,332	78,449,617	67,823,855
Great Britain Pounds	7,226,325	6,361,377	7,226,325	6,361,377
Euros	10,730,892	9,795,940	10,730,566	9,795,940
Australian Dollars	3,997,421	4,047,365	3,997,421	4,047,365
Other currencies	864,295	756,906	864,295	756,906
	623,494,969	527,126,181	635,371,097	536,132,789

44 DIVIDENDS PAYABLE

Accounting Policy

Provision for final dividends is recognised at the time the dividend recommended and declared by the Board of Directors, is approved by the shareholders. Interim dividends payable is recognised, when the Board of Directors approves such dividends in accordance with the Companies Act No. 7 of 2007.

Details of dividends declared for the year after the reporting date are given in Note 64 (a) to the financial statements as an event after the reporting period in accordance with the Sri Lanka Accounting Standard - LKAS 10 on "Events after the reporting period".

	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Balance as at 1st January	764,771	587,078	764,771	587,078
Final cash dividends declared in the prior year	1,421,200	2,827,776	1,578,995	2,902,776
Interim cash dividends declared during the year	620,387	608,548	620,387	608,548
Dividends paid during the year	(1,799,283)	(3,258,631)	(1,948,690)	(3,333,631)
Balance as at 31st December	1,007,075	764,771	1,015,463	764,771

45 OTHER BORROWINGS

Accounting Policy

Other borrowings represent refinance borrowings and borrowings from other financial institutions. Subsequent to initial recognition these borrowings are measured at their amortised cost using the Effective Interest Rate (EIR) method. Amortised cost is calculated by taking into account any discount or premium on the issue and costs that are an integral part of the EIR. The EIR amortisation is included in "interest expenses" in the statement of profit or loss. Gains and losses are recognised in the statement of profit or loss when the liabilities are de-recognised.

As at 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Refinance borrowings	115,778	162,362	115,778	162,362
Foreign borrowings	27,014,580	26,670,747	27,014,580	26,670,747
	27,130,358	26,833,109	27,130,358	26,833,109

46 DEBT SECURITIES ISSUED

Accounting Policy

Debt securities issued represent funds borrowed for long term funding purposes. Subsequent to initial recognition debt securities are measured at their amortised cost using the Effective Interest Rate (EIR) method. Amortised cost is calculated by taking into account any discount or premium on the issue and costs that are an integral part of the EIR. The EIR amortisation is included in "interest expenses" in the statement of profit or loss. Gains and losses are recognised in the statement of profit or loss when the liabilities are de-recognised.

	Colombo Stock Exchange Listing	Interest Payment Frequency	Face Value Rs 000	Interest Rate	Repayment Terms	Issue Date	Maturity Date	Bank		Group	
								As at 31.12.2016 Rs 000	As at 31.12.2015 Rs 000	As at 31.12.2016 Rs 000	As at 31.12.2015 Rs 000
(i) Year of issuance 2013*	Listed	Annually	2,000,000	8.00%	10 Years	30th Aug 2013	29th Aug 2023	1,536,302	1,490,742	1,515,060	1,470,125
(ii) Year of issuance 2014*	Listed	Semi	158,720	6.88%	3 Years	15th Dec 2014	15th Dec 2017	164,225	158,720	164,225	158,720
		Annually									
		Semi	2,757,240	7.75%	5 Years	15th Dec 2014	15th Dec 2019	2,864,961	2,757,240	2,832,750	2,725,029
		Annually									
		Semi	84,040	8.33%	10 Years	15th Dec 2014	15th Dec 2024	87,569	84,040	66,729	63,200
		Annually									
(iii) Year of issuance 2011**	Not Listed	Monthly	665,000	1 Yr Avg TB rate	20 Years	30th Jun 2014	30th Jun 2034	-	-	537,037	496,677
Total debt securities issued								4,653,057	4,490,742	5,115,801	4,913,751
Due within one year								329,831	54,207	329,831	54,208
Due after one year								4,323,226	4,436,535	4,785,970	4,859,543
Total debt securities issued								4,653,057	4,490,742	5,115,801	4,913,751

* HNB Assurance PLC, subsidiary of the Bank has invested Rs 74.29 Mn in debt securities issued by the Bank.

** Debt securities issued by HNB Grameen Finance Ltd. Capital repayment will commence from 2024.

Notes to the Financial Statements

47 SUBORDINATED TERM DEBTS

Accounting Policy

Subordinated term debts represent funds borrowed for long term funding purposes which are subordinated to the other claims. Subsequent to initial recognition, subordinated term debts are measured at their amortised cost using the Effective Interest Rate (EIR) method. Amortised cost is calculated by taking into account any discount or premium on the issue and costs that are an integral part of the EIR. The EIR amortisation is included in "interest expenses" in the statement of profit or loss. Gains and losses are recognised in the statement of profit or loss when the liabilities are de-recognised.

As at 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Subordinated debentures [Note 47 (a)]	22,409,926	8,471,740	22,157,560	8,492,968
Subordinated loan [Note 47 (b)]	3,743,550	3,592,630	3,743,550	3,592,630
	26,153,476	12,064,370	25,901,110	12,085,598

47 (a) Subordinated Debentures

	Colombo Stock Exchange Listing	Interest Payment Frequency	Face Value Rs 000	Interest Rate	Repayment Terms	Issue Date	Maturity Date	Bank		Group	
								As at 31.12.2016 Rs 000	As at 31.12.2015 Rs 000	As at 31.12.2016 Rs 000	As at 31.12.2015 Rs 000
(i) Year of issuance 2006*	Listed	At maturity	514,345	11.00%	15 Year	1st Apr 2006	31st Mar 2021	330,287	297,488	307,217	276,709
		At maturity	1,362,800	11.25%	18 Year	1st Apr 2006	31st Mar 2024	629,495	565,709	629,495	565,709
(ii) Year of issuance 2007	Listed	Annually	500,000	16.00%	10 Year	1st Aug 2007	31st Jul 2017	540,000	540,000	540,000	540,000
		Annually	700,000	16.75%	15 Year	1st Aug 2007	31st Jul 2022	758,625	758,625	758,625	758,625
(iii) Year of issuance 2011	Listed	Semi Annually	2,000,000	11.50%	10 Year	5th Sep 2011	4th Sep 2021	2,115,628	2,000,000	2,115,628	2,000,000
(iv) Year of issuance 2013*	Listed	Annually	4,000,000	14.00%	5 Year	13th Jun 2013	12th Jun 2018	4,309,918	4,309,918	4,251,905	4,251,925
(v) Year of issuance 2016	Listed	Annually	7,000,000	11.25%	5 Year	28th Mar 2016	28th Mar 2021	7,599,795	-	7,328,512	-
	Listed	Annually	2,000,000	11.75%	5 Year	1st Nov 2016	1st Nov 2021	2,039,274	-	2,039,274	-
	Listed	Annually	4,000,000	13.00%	7 Year	1st Nov 2016	1st Nov 2023	4,086,904	-	4,086,904	-
(v) Year of issuance 2013	Not Listed	Monthly	100,000	17.50%	5 Year	17th Jun 2013	16th Jun 2018	-	-	100,000	100,000
Total subordinated debentures								22,409,926	8,471,740	22,157,560	8,492,968
Due within one year								1,250,144	-	1,250,144	-
Due after one year								21,159,782	8,471,740	20,907,416	8,492,968
Total subordinated debentures								22,409,926	8,471,740	22,157,560	8,492,968

* HNB Assurance PLC, subsidiary of the Bank has invested Rs 352.36 Mn in subordinated debentures issued by the Bank

47 (b) Subordinated Loan

Subordinated loan represents eight year subordinated loan of USD 25 Mn from German Development Financial Institution (DEG).

48 CURRENT TAX LIABILITIES

As at 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Tax payable	6,223,943	4,542,977	6,425,379	4,762,707
	6,223,943	4,542,977	6,425,379	4,762,707

49 DEFERRED TAX

As at 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Deferred tax liabilities [Note 49 (a)]	2,397,140	2,573,495	3,086,438	2,981,800
Deferred tax assets [Note 49 (b)]	(2,165,776)	(2,194,675)	(2,261,660)	(2,402,698)
	231,364	378,820	824,778	579,102

49 (a) Deferred Tax Liabilities

49 (a) i Deferred Tax Liabilities on Other Temporary Differences

	Bank				Group			
	2016		2015		2016		2015	
	Temporary Difference Rs 000	Tax Effect Rs 000	Temporary Difference Rs 000	Tax Effect Rs 000	Temporary Difference Rs 000	Tax Effect Rs 000	Temporary Difference Rs 000	Tax Effect Rs 000
Balance as at 1st January	9,191,052	2,573,495	6,982,518	1,955,105	9,736,224	2,726,143	7,611,839	2,131,315
Originating during the year								
Recognised in the statement of profit or loss	623,921	174,698	2,375,857	665,240	775,746	217,209	2,296,300	642,964
Recognised in OCI								
Revaluation surplus charged to equity	194,604	54,489	371,571	104,040	550,612	154,171	371,571	104,040
Realisation of revaluation surplus	(4,336)	(1,214)	-	-	(4,336)	(1,214)	-	-
Others	(1,444,029)	(404,328)	(538,894)	(150,890)	(1,450,546)	(406,153)	(543,486)	(152,176)
Balance as at 31st December	8,561,212	2,397,140	9,191,052	2,573,495	9,607,700	2,690,156	9,736,224	2,726,143

49 (a) ii Deferred Tax Liabilities on Undistributed Profits of Subsidiaries

	Bank				Group			
	2016		2015		2016		2015	
	Temporary Difference Rs 000	Tax Effect Rs 000	Temporary Difference Rs 000	Tax Effect Rs 000	Temporary Difference Rs 000	Tax Effect Rs 000	Temporary Difference Rs 000	Tax Effect Rs 000
Balance as at 1st January	-	-	-	-	2,556,570	255,657	1,005,290	100,529
Originating during the year								
Recognised in the statement of profit or loss	-	-	-	-	502,232	140,625	1,551,280	155,128
Balance as at 31st December	-	-	-	-	3,058,802	396,282	2,556,570	255,657
Total deferred tax liabilities (Note 49)	8,561,212	2,397,140	9,191,052	2,573,495	12,666,502	3,086,438	12,292,794	2,981,800

Notes to the Financial Statements

49 DEFERRED TAX (CONTD.)

49 (b) Deferred Tax Assets

	Bank				Group			
	2016		2015		2016		2015	
	Temporary Difference Rs 000	Tax Effect Rs 000	Temporary Difference Rs 000	Tax Effect Rs 000	Temporary Difference Rs 000	Tax Effect Rs 000	Temporary Difference Rs 000	Tax Effect Rs 000
Balance as at 1st January	7,838,125	2,194,675	8,008,889	2,242,489	8,581,063	2,402,698	8,682,709	2,431,159
Originating during the year								
Recognised in the statement of profit or loss	(103,211)	(28,899)	(170,764)	(47,814)	(490,786)	(137,420)	(101,646)	(28,461)
Recognised in OCI	-	-	-	-	(12,921)	(3,618)	-	-
Balance as at 31st December (Note 49)	7,734,914	2,165,776	7,838,125	2,194,675	8,077,356	2,261,660	8,581,063	2,402,698

49 (c) Recognised Deferred Tax Assets and Liabilities

49 (c) i Recognised Deferred Tax Assets and Liabilities - Bank

Deferred tax assets and liabilities are attributable to the following.

	Statement of Financial Position As at 31st December		Income Statement For the year ended 31st December		Other Comprehensive Income For the year ended 31st December	
	2016	2015	2016	2015	2016	2015
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Accelerated depreciation for tax purposes						
- Property, plant and equipment	(514,626)	(486,975)	(27,652)	16,937	-	-
- Intangible assets	(137,760)	(106,585)	(31,175)	(10,792)	-	-
- Assets on leasing business	(1,910,626)	(1,794,754)	(115,871)	(671,385)	-	-
Revaluation of government securities	514,494	110,166	-	-	404,328	150,890
Revaluation of freehold buildings	(348,622)	(295,347)	-	-	(53,275)	(104,040)
Temporary difference on provisions	2,165,776	2,194,675	(28,899)	(47,814)	-	-
	(231,364)	(378,820)	(203,597)	(713,054)	351,053	46,850

49 (c) ii Recognised Deferred Tax Assets and Liabilities - Group

Deferred tax assets and liabilities are attributable to the following.

	Statement of Financial Position As at 31st December		Income Statement For the year ended 31st December		Other Comprehensive Income For the year ended 31st December	
	2016	2015	2016	2015	2016	2015
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Accelerated depreciation for tax purposes						
- Property, plant and equipment	(618,637)	(616,806)	(1,830)	63,603	-	-
- Intangible assets	(137,760)	(106,585)	(31,175)	(10,792)	-	-
- Assets on leasing business	(1,978,959)	(1,794,754)	(184,204)	(671,385)	-	-
Revaluation of government securities	517,605	111,452	-	-	406,153	152,176
Revaluation of freehold buildings	(472,406)	(319,449)	-	(24,390)	(152,957)	(104,040)
Undistributed profits of subsidiaries	(396,282)	(255,657)	(140,625)	(155,128)	-	-
Unutilised tax losses	43,997	164,289	-	16,799	-	-
Temporary difference on provisions	2,217,664	2,238,408	(137,420)	(45,260)	(3,618)	-
	(824,778)	(579,102)	(495,254)	(826,553)	249,578	48,136

50 INSURANCE PROVISION - LIFE**Accounting Policy****Insurance Provision - Life Insurance**

The insurance provision - life balance represents the life fund of the subsidiary HNB Assurance PLC, which is carrying out life insurance business.

Life insurance liabilities are recognised when contracts are entered into and premiums are charged. These liabilities are measured by using a prospective actuarial valuation method. The liability is determined as the sum of the present value of future benefits, the expected future management and distribution expenses, less the present value of future gross premiums arising from the policy discounted at the appropriate risk discount rate. The liability is based on best estimate assumptions and with due regard to significant recent experience. An appropriate allowance for provision of risk margin for adverse deviation from expected experience is included in the valuation.

Liability Adequacy Test (LAT)

As required by Sri Lanka Accounting Standard - SLFRS 4 on "Insurance Contracts", the entity performed a Liability Adequacy Test (LAT) in respect of Life Insurance contract liabilities with the assistance of an external actuary. In performing the LAT, current best estimates of future contractual cash flows, including related cash flows such as claims handling and policy administration expenses, policyholder options and guarantees, as well as investment income from assets backing such liabilities, are used. Number of valuation techniques are applied including discounting cashflows, interest rate applied is based on the managements expectation of current market interest rates. The liability value is adjusted to the extent that it is insufficient to meet future benefits and expenses.

Insurance provision - life balance represents the amounts attributable to life policy holders included in the Group's net assets. The valuation of the Life Insurance business as at 31st December 2016 was made by Mr. Hassan Scott Odierno, of M/S Actuarial Partners Consulting Sdn Bhd.

The life fund stands at Rs 8,747.86 Mn as at 31st December 2016 (2015 : Rs 7,007.08 Mn) and in the opinion of the actuary this amount is adequate to cover the liabilities pertaining to the long term insurance business of HNB Assurance PLC, as per the actuary's report dated 9th February 2017.

51 INSURANCE PROVISION - GENERAL**Accounting Policy****Insurance Provision – General Insurance**

General insurance contract liabilities are recognized when contracts are entered into and premiums are charged. These liabilities comprise claims liabilities and premium liabilities.

Claims liabilities

Claims liabilities are recognized in respect of both with reinsurance and without reinsurance. Claims liabilities refer to the obligation by the insurance company, whether contractual or otherwise to make future payments in relation to all claims that have been incurred as at valuation date. These include provision for claims reported, claims incurred but not reported ("IBNR") together with related claims handling costs. Claims liabilities consist of the best estimate value of the claim liabilities and the Provision of Risk Margin for adverse Deviation ("PRAD") calculated at line of business level.

Premium liabilities

Premium liabilities is the higher of the aggregate of the UPR and the best estimate value of the insurer's unexpired risk reserves ("URR") at the valuation date and the PRAD calculated at line of business level.

The provision for unearned premiums represents premiums received for risks that have not yet expired. Generally the reserve is released over the term of the contract and is recognized as premium income.

Liability Adequacy Test (LAT)

As required by Sri Lanka Accounting Standard - SLFRS 4 on "Insurance Contracts", the entity performed a Liability Adequacy Test (LAT) in respect of general insurance contract liabilities with the assistance of an external actuary.

Title Insurance Reserve

Title insurance reserve is maintained by the Group to pay potential claims arising from the title insurance policies. Title insurance policies are normally issued for a long period such as 5 years or more. Thus, no profit is recognised in the first year of the policy given the higher probability of claims occurring in the first two years. From the 2nd year onwards, profit is recognised by amortising the premium received over a five year period using the straight line method. Profit in the first year will be recognised in the 2nd year and thereafter it is periodically recognised.

If the corresponding loan of the Title Insurance Policy issued is settled before the maturity, full premium of such policies remaining as at the date of settlement of such loan is recognised in profits upon confirmation of the same by the respective Bank.

Notes to the Financial Statements

51 INSURANCE PROVISION - GENERAL (CONTD.)

As at 31st December	Group			
	2016		2015	
	Rs 000	Rs 000	Rs 000	Rs 000
Unearned premium				
Gross		1,596,757		1,301,243
Reinsurance		(317,896)		(203,026)
Net		1,278,861		1,098,217
Deferred acquisition expenses				-
Reserve for title insurance		19,611		19,154
Unexpired risk reserve				-
				1,117,371
Claims outstanding - gross	555,807		359,921	-
Claims incurred but not reported - gross	67,288	623,095	68,974	428,895
Total		1,921,567		1,546,266

52 OTHER LIABILITIES

As at 31st December	Bank		Group	
	2016	2015	2016	2015
	Rs 000	Rs 000	Rs 000	Rs 000
Cheques sent on clearing	32,549	27,290	32,549	27,290
Bills payable	1,770,925	2,970,847	1,770,925	2,970,847
Items in transit	19,887	52,772	19,887	52,772
Refundable deposits and advances	-	-	88,822	60,186
Balance held o/a of pension fund	336,418	240,599	336,418	240,599
Balance held o/a of Widows', Widowers' and Orphans' Pension Fund (WW&OP)	62,530	33,526	62,530	33,526
Balance held o/a of Employees' Provident Fund (EPF)	4,902	4,460	4,902	4,460
Liability for EPF interest rate guarantee [Note 53 (b)]	57,434	54,237	57,434	54,237
Liability for leave accrual plan [Note 53 (c)]	114,885	110,855	114,885	110,855
Provision for gratuity benefits	-	-	253,381	228,176
Payable to vendors for lease equipments	697,620	582,087	697,620	582,087
Other creditors	2,653,957	2,174,183	3,750,675	2,885,858
	5,751,107	6,250,856	7,190,028	7,250,893

53 EMPLOYEE RETIREMENT BENEFITS

Accounting Policy

Defined Benefit Plan

A defined benefit plan is a post-employment benefit plan other than a defined contribution plan.

Pension Fund

The Bank operates an approved pension fund to facilitate the following payments for permanent staff of the Bank:

Pensions to Retiring Staff

Pensionable staff members who are in the permanent cadre are eligible to draw pension from the pension fund as per the trust deed dated 24th September 1981.

Benefits to Staff who Opted for the Optional Scheme for Pension introduced in 2005

Staff members who opted for the optional scheme for pension introduced in 2005 are eligible for the payment in accordance with the terms and conditions agreed upon.

53 EMPLOYEE RETIREMENT BENEFITS (CONTD.)**Gratuity**

Gratuity would be the payments to staff who satisfy the criteria as per the Gratuity Act No 12 of 1983 at the time of leaving the services of the Bank without pension rights. Payment of gratuities to employees who have completed more than five years of service under the said act is covered through the Bank's own non-contributory pension scheme which is in force.

The Bank's obligation in respect of defined benefit pension plan is calculated by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods, and discounting that benefit to determine its present value, then deducting the fair value of any plan assets to determine the net amount to be shown in the statement of financial position. The value of any defined benefit asset is restricted to the present value of any economic benefits available in the form of refunds from the plan or reductions in the future contributions to the plan. In order to calculate the present value of economic benefits, consideration is given to any minimum funding requirements that apply to any plan in the Bank. An economic benefit is available to the Bank if it is realisable during the life of the plan, or on settlement of the plan liabilities.

The Bank determines the net interest expense / (income) on the net defined benefit liability / (asset) by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the net defined benefit liability / (asset) at the beginning of the annual period.

The discount rate is the yield at the reporting date on government bonds that have maturity dates approximating to the terms of the Bank's obligations. The calculation is performed by a qualified actuary using the projected unit credit method.

The Bank recognises the total actuarial gains and losses that arise in calculating the Bank's obligation in respect of a plan in other comprehensive income during the period in which it occurs.

The demographic assumptions underlying the valuation are retirement age (55 yrs), early withdrawals from service and retirement on medical grounds, death before and after retirement etc. The assets of the fund are held separately from those of the Bank's assets and are administered independently by the trustees of the fund.

Details of pension fund are given in Note 53 (a) to the financial statements.

Gratuity Obligation

The subsidiaries of the Bank do not operate pension funds and make a provision for gratuity obligation. These liabilities are assessed either by actuarial valuations or by the use of gratuity formula.

Other Long-term Employee Benefits

The Bank's net obligation in respect of long-term employee benefits other than pension fund, is the amount of future benefit that employees have earned in return for their service in the current and prior periods. That benefit is discounted to determine its present value. The discount rate is the yield at the reporting date on government bonds that have maturity dates approximating to the terms of the Bank's obligation. The calculation is performed using the projected unit credit method. Any actuarial gains and losses are recognised in the statement of profit or loss in the period in which they arise. The Bank's liability towards the portion of the accumulated leave which is expected to be utilised beyond one year from the end of the reporting period is treated as other long term employee benefits.

Widows', Widowers' and Orphans' Pension Fund

The Bank operates a separate Widows', Widowers' and Orphans' Pension Scheme (WW & OP) which was established with effect from 1st September 1995. The contributions are from employees only and the Bank does not have any legal or constructive obligation towards the above scheme.

Details of Widows', Widowers' and Orphans' Pension Fund are given in Note 53 (d) to the financial statements.

Employees' Provident Fund – Group Companies

The Group entities and their employees contribute at 12% and 8% respectively on the salary of each employee to Employees' Provident Fund except for the Bank as explained below.

Notes to the Financial Statements

53 EMPLOYEE RETIREMENT BENEFITS (CONTD.)

Employees' Provident Fund - Bank

Employees' Provident Fund is an approved private provident fund which has been set up to meet the provident fund liabilities of the Bank to which the Bank and employees contribute at 12% and 8% respectively on the salary of each employee. Staff members who are members of the fund are entitled to receive a minimum interest rate which is the higher of one year fixed deposit rate of HNB or National Savings Bank on their balance on a semi-annual basis. Accordingly this obligation was treated as a defined benefit liability and an actuarial valuation was conducted to value the Bank's obligation of the same.

Defined Contribution Plans

A defined contribution plan is a post-employment plan under which an entity pays fixed contributions into a separate entity (a fund) and will have no legal or constructive obligation to pay a further contribution if the fund does not hold sufficient assets to pay all employee benefits relating to employee services in the current and prior periods. Obligations for contributions to defined contribution plans are recognised as an expense in the statement of profit or loss as and when they are due.

Employees' Trust Fund

The Bank and the Group contribute 3% of the salary of each employee to the Employees' Trust Fund.

53 (a) Pension Fund - Bank

An actuarial valuation of the pension fund was carried out as at 31st December 2016 by Mr M Poopalanathan, AIA, M/s Actuarial and Management Consultants (Pvt) Ltd, a firm of professional actuaries. The valuation method used by the actuaries to value the fund is the projected unit credit method, the method recommended by the Sri Lanka Accounting Standard - LKAS 19 on "Employee Benefits".

The Bank contributes 20% of the basic salary to the pension fund in respect of all employees. (2015: 20%)

The assets of the fund, which are independently administered by the trustees as per the provision of the Trust Deed are held separately from those of the Bank.

No additional provision has been made in the financial statements of the Bank for gratuities to employees who have completed five or more years of service, payable under the Payment of Gratuity Act No 12 of 1983 as the Bank contributes for all permanent employees to its own non-contributory pension scheme, which is in force.

53 (a) i Net Asset / (Liability) Recognised in the Statement of Financial Position

As at 31st December	2016 Rs 000	2015 Rs 000
Present value of funded obligation [Note 53 (a) iii]	12,543,413	12,425,853
Total present value of obligations	12,543,413	12,425,853
Fair value of plan assets [Note 53 (a) ii]	(14,499,380)	(13,519,157)
Present value of net surplus [Note 53 (a) iv]	(1,955,967)	(1,093,304)
Recognised asset for defined benefit obligations	(1,955,967)	(1,093,304)

The Bank is expecting to recover the above surplus by way of reduced future contributions to the pension fund and accordingly the Bank recognised a net receivable of Rs 1,955.9 Mn from the pension fund as the present value of the reduction in future contributions.

53 (a) ii Fair Value of Plan Assets consist of the following

	2016 Rs 000	2015 Rs 000
Equity securities and debentures	2,579,854	2,332,155
Government securities	5,155,437	5,185,470
Balance with Hatton National Bank PLC	335,487	231,810
Fixed deposits	6,456,570	5,649,561
Others	(27,968)	120,161
	14,499,380	13,519,157

53 EMPLOYEE RETIREMENT BENEFITS (CONTD.)**53 (a) Pension Fund - Bank (Contd.)****53 (a) iii Movement in the Present Value of Defined Benefit Obligations**

	2016 Rs 000	2015 Rs 000
Liability for defined benefit obligations as at 1st January	12,425,853	11,486,841
Current service cost	527,676	546,842
Interest on obligation	1,230,159	1,062,533
Actuarial (gains) / losses	(874,585)	192,323
Benefits paid by the plan	(765,690)	(862,686)
Liability for defined benefit obligations as at 31st December	12,543,413	12,425,853

53 (a) iv Movement in Fair Value of Plan Assets

	2016 Rs 000	2015 Rs 000
Fair value of plan assets as at 1st January	13,519,157	13,020,795
Expected return on plan assets	1,338,395	1,204,424
Contributions paid into plan	920,383	862,270
Benefits paid by the plan	(765,690)	(862,686)
Actuarial gains / (losses)	(512,865)	(705,646)
Fair value of plan assets as at 31st December	14,499,380	13,519,157

53 (a) v Net Interest on Defined Benefit Asset

For the year ended 31st December	2016 Rs 000	2015 Rs 000
Interest on obligation	1,230,159	1,062,533
Expected return of plan assets	(1,338,395)	(1,204,424)
Net interest on defined benefit asset	(108,236)	(141,891)

53 (a) vi Actuarial Gains and Losses Recognised in Other Comprehensive Income

For the year ended 31st December	2016 Rs 000	2015 Rs 000
Actuarial gains / (losses) on present value of defined benefit obligations	874,585	(192,323)
Actuarial gains / (losses) on fair value of plan assets	(512,865)	(705,646)
Actuarial gains / (losses) recognised during the year	361,720	(897,969)

53 (a) vii Actuarial Assumptions

As at 31st December	2016	2015
Discount rate	12.37%	9.90%
Expected return on plan assets as at 1st January	9.90%	9.25%
Future salary increment rate	11.25%	9.00%
Future pension increments	Nil	Nil
Increase in cost of living allowance	11.25%	9.00%
Normal retirement age	55 years	55 years
Mortality	1967-70	1967-70
	Mortality Table issued by the Institute of Actuaries	Mortality Table issued by the Institute of Actuaries

The average duration of the pension fund obligation is 28 years as at 31st December 2016 (2015 - 26 years).

Notes to the Financial Statements

53 EMPLOYEE RETIREMENT BENEFITS (CONTD.)

53 (a) Pension Fund - Bank (Contd.)

53 (a) viii Sensitivity of Assumptions Employed on Actuarial Valuation

Assumptions regarding discount rate and salary increment rate have a significant effect on the amounts recognised in the statement of comprehensive income and statement of financial position.

The following table demonstrates the sensitivity of a reasonably possible change in such assumptions with all other variables held constant, in the actuarial valuation of the pension fund as at 31st December 2016.

Increase / (decrease) in Discount Rate	Increase / (decrease) in Salary Increment Rate	Sensitivity Effect on Statement of Comprehensive Income Increase / (decrease) in results for the year Rs 000	Sensitivity Effect on Pension Fund Surplus Increase / (decrease) Rs 000
1%		1,020,492	1,020,492
-1%		(1,220,693)	(1,220,693)
	1%	(780,650)	(780,650)
	-1%	695,278	695,278

53 (b) Provision for EPF Interest Rate Guarantee Plan - Bank

EPF is an approved provident fund which has been set up to meet the provident fund liabilities of the Bank. Staff members who are members of the fund are entitled to receive a minimum interest rate which is the higher of one year fixed deposit rate of HNB or National Savings Bank on their balance on a semi-annual basis. Accordingly, this obligation was treated as a defined benefit liability and an actuarial valuation was conducted to value the Bank's obligation on same with the following actuarial assumptions.

As at 31st December	2016	Bank 2015
Discount rate	9.95%	6.95%
Long term interest rate to credit the fund	10.00%	7.00%

	2016 Rs 000	Bank 2015 Rs 000
Present value of obligation as at 1st January	54,237	38,360
Provision made during the year	3,197	15,877
Present value of obligation as at 31st December (Note 52)	57,434	54,237

53 (c) Provision for Leave Accrual Plan - Bank

Employees are entitled to accumulate annual leave up to a maximum of ninety days and such accumulated leave to be utilised prior to their retirement. This has been treated as other long term benefit in terms of Sri Lanka Accounting Standards - LKAS 19 on "Employee benefits" and an actuarial valuation has been conducted on same with the following assumptions.

As at 31st December	2016	2015
Discount rate	12.37%	9.90%
Future salary increase	11.25%	9.00%

	2016 Rs 000	Bank 2015 Rs 000
Present value of obligation as at 1st January	110,855	114,099
Charge / (reversal) of provision during the year	4,030	(3,244)
Present value of obligation as at 31st December (Note 52)	114,885	110,855

53 EMPLOYEE RETIREMENT BENEFITS (CONTD.)

53 (d) Widows', Widowers' and Orphans' Pension Fund

The results of the actuarial valuation of the Widows', Widowers' and Orphans' Pension Fund indicate that the actuarial present value of the promised benefit is Rs 483 Mn and that the fair value of the fund assets is Rs 1,340 Mn resulting in a past service surplus of Rs 857.57 Mn (2015 : Rs 600.63 Mn) in the Widows', Widowers' and Orphans' Pension Scheme as at 31st December 2016.

No contribution is made by the Bank and the members' contribution during the period amounted to Rs 85 Mn.

54 STATED CAPITAL

In accordance with Section 58 of Companies Act No 7 of 2007, which became effective from 3rd May 2007, share capital and share premium have been classified as stated capital.

54 (a) Stated Capital - Bank / Group

	2016 Rs 000	2015 Rs 000
Voting ordinary shares		
Balance as at 1st January	11,110,689	10,640,391
Issue of shares under ESOP	157,128	368,785
Transfer from ESOP reserve *	48,444	101,513
Issue of shares through scrip dividend	1,022,473	-
Balance as at 31st December	12,338,734	11,110,689
Non-voting ordinary shares		
Balance as at 1st January	2,716,184	2,649,601
Issue of shares under ESOP	21,813	52,113
Transfer from ESOP reserve *	6,820	14,470
Issue of shares through scrip dividend	256,607	-
Balance as at 31st December	3,001,424	2,716,184
Stated capital as at 31st December	15,340,158	13,826,873

54 (b) Reconciliation of Number of Shares

	2016	2015
Voting ordinary shares		
Balance as at 1st January	324,405,445	321,736,509
Issue of shares under ESOP	1,088,993	2,668,936
Issue of shares through scrip dividend	5,262,344	-
Balance as at 31st December	330,756,782	324,405,445
Non-voting ordinary shares		
Balance as at 1st January	81,415,925	80,861,147
Issue of shares under ESOP	225,050	554,778
Issue of shares through scrip dividend	1,417,717	-
Balance as at 31st December	83,058,692	81,415,925
Total number of shares as at 31st December	413,815,474	405,821,370

* Fair value of options on the grant date relating to options exercised during the year has been transferred from the ESOP reserve to stated capital.

The non-voting shares rank pari passu in respect of all rights with the ordinary shares of the Bank except voting rights on resolutions passed at general meetings. If the Bank fails to pay dividends for three consecutive years, these shares will automatically be converted into voting ordinary shares.

Notes to the Financial Statements

54 STATED CAPITAL (CONTD.)

54 (c) Share-Based Payment Transactions

Accounting Policy

Equity Settled Share Based Payment Transactions

Fair value of equity settled share based payment awards granted to employees on the grant date is recognised as an employee expense, with a corresponding increase in equity, over the period in which the employees unconditionally became entitled to the awards. The amount recognised as an expense is adjusted to reflect the number of share awards for which the related service and non-market performance vesting conditions are expected to be met such that, the amount ultimately recognised as an expense is based on the number of share awards that do meet the related service and non-market performance conditions at the vesting date. For share based payment awards with non-vesting conditions, the grant date fair value of the share based payment is measured to reflect such conditions and there is no true-up for difference between expected and actual outcomes.

On 28th March 2008 the Bank established an employee share option scheme that entitled employees in the rank of management and above to purchase shares in the Bank. Holders of vested options are entitled to purchase shares at the given exercise prices. The total number of share options available to the eligible employees per year was 1.25% of shares issued by the Bank up to a maximum limit of 5% of the shares issued (both voting and non-voting) by the Bank in 4 years. The benefits under ESOP are accrued to eligible employees of the Bank in any particular year only if the conditions set out in the ESOP are met.

An eligible employee qualified to receive share options in a particular year by achieving a positive performance rating in the annual performance assessment. The amount of share options granted to each qualified eligible employee depended on his/her seniority in the Bank. This employee share option plan has potential dilutive effect on the earnings per share of the Bank.

The recognition and measurement principles in Sri Lanka Accounting Standard - SLFRS 2 on "Share based payment" have not been applied to the grants made in 2008 and 2010 based on the transitional provisions available in SLFRS 2. The standard is applied for share options granted after 1st January 2012 and have not been vested on the effective date of SLFRS 2.

The Bank made two further grants under the employee share option scheme on 30th March 2012 and 05th June 2013, which are recognised and measured in terms of SLFRS 2.

All options are to be settled by physical delivery of shares.

54 (c) i Employee Share Option Plan (Equity-Settled Share Based Payment Scheme)

The number and the weighted average exercise price of share options are as follows:

	2016		2015	
	Weighted Average Exercise Price Rs	Number of Options	Weighted Average Exercise Price Rs	Number of Options
Outstanding as at 1st January	136.13	3,266,569	132.99	6,715,057
Exercised during the year	136.18	(1,314,043)	130.56	(3,223,714)
Expired during the year	136.51	(98,951)	122.29	(224,774)
Outstanding as at 31st December	136.07	1,853,575	136.13	3,266,569
Exercisable as at 31st December	136.07	1,853,575	136.13	3,266,569

The options outstanding as at 31st December 2016 have exercise prices in the range of Rs 81.43 to Rs 145.79 (2015: Rs 81.43 to Rs 145.79) and a weighted average contractual life of 1.10 years (2015 : 1.95 years)

The weighted average share price at the date of exercise, for share options exercised during the year ended 31st December 2016 was Rs 217.20 for voting shares and Rs 184.55 for non-voting shares (2015: Rs 226.01 voting and Rs 178.68 non-voting).

55 STATUTORY RESERVES

Statutory Reserve Fund

	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Balance as at 1st January	3,760,000	3,160,000	3,760,000	3,160,000
Transfers during the year	800,000	600,000	800,000	600,000
Balance as at 31st December	4,560,000	3,760,000	4,560,000	3,760,000

Statutory reserve fund is maintained as per the statutory requirements in terms of Section 20 (1) and (2) of the Banking Act No 30 of 1988. This fund is built up by transferring a sum equivalent to not less than 5% of the profit after tax before any dividend is declared or any profits are transferred until the fund equals 50% of the Bank's stated capital. Thereafter a further sum equal to 2% of profit after tax is transferred until the fund equals to the stated capital of the Bank.

56 RETAINED EARNINGS

	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Balance as at 1st January	5,270,848	7,808,059	7,949,848	10,396,517
Profit for the year	14,143,406	10,448,786	14,755,634	10,553,568
Other comprehensive income for the year	362,934	(897,969)	368,586	(903,213)
Transfer to other reserves	(6,790,165)	(6,577,456)	(6,790,165)	(6,577,456)
Dividends	(3,462,787)	(3,436,324)	(3,462,787)	(3,436,324)
Deemed disposal gain through joint venture	-	-	-	9,830
Super gains tax paid	-	(2,074,248)	-	(2,093,074)
Balance as at 31st December	9,524,236	5,270,848	12,821,116	7,949,848

56 (a) Super Gains Tax

A Super Gains Tax (SGT) was imposed by the Finance Bill passed in Parliament on 20th October 2015, whereby SGT was payable by every company or individual whose profit before income tax as per the audited financial statements for the year of assessment 2013/2014 exceeded Rs 2 Bn, at the rate of 25% on its taxable profits for the said year of assessment. SGT payments were made in three equal instalments on 30th October 2015, 30th November 2015 and 31st December 2015. The impact for the Bank/Group from SGT amounted to Rs 2,074 Mn / Rs 2,105 Mn respectively.

57 OTHER RESERVES**57 (a) 2016**

	Bank			Group		
	Opening Balance As at 1st January 2016 Rs 000	Movement/ Transfers Rs 000	Closing Balance As at 31st December 2016 Rs 000	Opening Balance As at 1st January 2016 Rs 000	Movement/ Transfers Rs 000	Closing Balance As at 31st December 2016 Rs 000
Capital reserve [Note 57 (c)]	6,435,410	2,209,073	8,644,483	14,263,234	5,508,671	19,771,905
Available for sale reserve [Note 57 (d)]	4,455,566	(2,754,309)	1,701,257	4,518,441	(2,776,906)	1,741,535
General reserve [Note 57 (e)]	31,100,000	6,000,000	37,100,000	31,100,000	6,000,000	37,100,000
ESOP reserve [Note 57 (f)]	202,356	(55,264)	147,092	202,356	(55,264)	147,092
Life policy holder reserve fund [Note 57 (g)]	-	-	-	(56,350)	(134,781)	(191,131)
	42,193,332	5,399,500	47,592,832	50,027,681	8,541,720	58,569,401

Notes to the Financial Statements

57 OTHER RESERVES (CONTD.)

57 (b) 2015

	Bank			Group		
	Opening Balance As at 1st January 2015 Rs 000	Movement/ Transfers Rs 000	Closing Balance As at 31st December 2015 Rs 000	Opening Balance As at 1st January 2015 Rs 000	Movement/ Transfers Rs 000	Closing Balance As at 31st December 2015 Rs 000
Capital reserve [Note 57 (c)]	4,466,918	1,968,492	6,435,410	8,792,778	5,470,456	14,263,234
Available for sale reserve [Note 57 (d)]	6,755,355	(2,299,789)	4,455,566	6,806,191	(2,287,750)	4,518,441
General reserve [Note 57 (e)]	25,100,000	6,000,000	31,100,000	25,100,000	6,000,000	31,100,000
ESOP reserve [Note 57 (f)]	318,339	(115,983)	202,356	318,339	(115,983)	202,356
Life policy holder reserve fund [Note 57 (g)]	-	-	-	40,748	(97,098)	(56,350)
	36,640,612	5,552,720	42,193,332	41,058,056	8,969,625	50,027,681

57 (c) Capital Reserve

	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Balance as at 1st January	6,435,410	4,466,918	14,263,234	8,792,778
Revaluation during the year	2,273,397	2,095,076	5,656,382	5,597,040
Deferred tax effect on				
Revaluation of freehold land and buildings	(54,489)	(104,040)	(137,876)	(104,040)
Amount transferred to retained earnings				
on disposal of property, plant and equipment	(9,835)	(22,544)	(9,835)	(22,544)
Balance as at 31st December	8,644,483	6,435,410	19,771,905	14,263,234

Capital reserve relates to revaluation surplus that resulted from the revaluation of freehold land and buildings carried out in 1989, 1993, 2007, 2012, 2015 and 2016.

57 (d) Available-for-sale Reserve

	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Balance as at 1st January	4,455,566	6,755,355	4,518,441	6,806,191
Net change in fair value during the year	(3,158,637)	(2,450,679)	(3,191,009)	(2,428,191)
Net amount transferred to profit or loss on disposal of				
available for sale financial assets	-	-	8,680	(11,545)
Deferred tax effect	404,328	150,890	405,423	151,986
Balance as at 31st December	1,701,257	4,455,566	1,741,535	4,518,441

The available for sale reserve comprises of the cumulative net change in fair value of available-for-sale financial investments until the assets are de-recognised or impaired.

57 OTHER RESERVES (CONTD.)**57 (e) General Reserve**

	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Balance as at 1st January	31,100,000	25,100,000	31,100,000	25,100,000
Transfer during the year	6,000,000	6,000,000	6,000,000	6,000,000
Balance as at 31st December	37,100,000	31,100,000	37,100,000	31,100,000

General reserve comprises of the amounts appropriated by the Board of Directors as a general banking reserve.

57 (f) ESOP Reserve

	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Balance as at 1st January	202,356	318,339	202,356	318,339
Transfer to stated capital	(55,264)	(115,983)	(55,264)	(115,983)
Balance as at 31st December	147,092	202,356	147,092	202,356

ESOP reserve consists of the liability recognised on account of the ESOP allocations granted in 2012 and 2013.

57 (g) Life Policy Holder Reserve Fund

	Group	
	2016 Rs 000	2015 Rs 000
Balance as at 1st January	(56,350)	40,748
Transfer to life policy holder reserve fund	(134,781)	(97,098)
Balance as at 31st December	(191,131)	(56,350)

58 NON-CONTROLLING INTERESTS

As at 31st December	Group	
	2016 Rs 000	2015 Rs 000
Subsidiaries		
HNB Assurance PLC	1,086,409	889,142
HNB Grameen Finance Ltd	1,934,614	1,290,146
Total	3,021,023	2,179,288

Notes to the Financial Statements

59 CONTINGENT LIABILITIES AND COMMITMENTS

Commitments and Contingencies

Contingent liabilities are possible obligations whose existence will be confirmed only by uncertain future events or present obligations where the transfer of economic benefit is not probable or cannot be reliably measured as defined in the Sri Lanka Accounting Standard - LKAS 37 on "Provisions, contingent liabilities and contingent assets".

To meet the financial needs of customers, the Bank enters into various irrevocable commitments and contingent liabilities. These consist of financial guarantees, letters of credit and other undrawn commitments to lend. Letters of credit and guarantees (including standby letters of credit) commit the Bank to make payments on behalf of customers in the event of a specific act, generally related to the import or export of goods. Guarantees and standby letters of credit carry a similar credit risk to loans. Operating lease commitments of the Bank (as a lessor and as a lessee) and pending legal claims against the Bank also form part of commitments of the Bank. Contingent liabilities are not recognised in the statement of financial position but are disclosed unless they are remote. But these contingent liabilities do contain credit risk and therefore form part of the overall risk of the Bank.

All discernible risks are accounted for in determining the amount of all known liabilities. The Bank's share of any contingencies and capital commitments of a subsidiary or joint venture for which the Bank is also liable severally or otherwise are also included with appropriate disclosures.

Financial Guarantees

Financial guarantees are initially recognised in the financial statements within 'other liabilities' at fair value, being the premium received. Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the amount initially recognised less cumulative amortisation recognised in the statement of profit or loss, and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

Any increase in the liability relating to financial guarantees is recorded in the statement of profit or loss. The premium received is recognised in the statement of profit or loss in 'net fee and commission income' on a straight line basis over the life of the guarantee.

No material losses are anticipated as a result of these commitments and contingencies.

59 (a) Commitments and Contingent Liabilities - Bank / Group

As at 31st December	2016 Rs 000	2015 Rs 000
Documentary credit	24,629,974	21,730,162
Guarantees	108,900,608	79,246,945
Acceptances	15,827,724	10,865,852
Bills for collection	11,321,870	9,532,904
Forward exchange contracts		
Forward exchange sales	25,559,988	11,328,378
Forward exchange purchases	95,863,030	62,352,069
Cheques sent on clearing	5,122,910	4,566,674
Commitments for unutilised facilities - direct	114,244,896	101,817,028
Commitments for unutilised facilities - indirect	100,901,909	41,946,000
Total - Bank	502,372,909	343,386,012

59 CONTINGENT LIABILITIES AND COMMITMENTS (CONTD.)

59 (b) Capital Commitments

Capital expenditure approved by the Board of Directors for which provision has not been made in the accounts amounts to approximately Rs 592 Mn.

As at 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Approved and contracted but not provided for	592,401	524,137	592,401	524,137
Approved and not contracted for	-	-	-	-
	592,401	524,137	592,401	524,137

59 (c) Operating leases

Operating leases are those leasing arrangements that do not transfer to the Bank, substantially all the risks and rewards incidental to ownership of the leased items.

When the Bank is the lessee, leased assets are not recognised in the statement of financial position. Rentals payable under operating leases are accounted for on a straight line basis over the periods of the leases and are included in the statement of profit or loss.

59 (c) i Future Monthly Commitments on Operating Leases

As at 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Less than 1 year	1,130,976	725,566	1,310,875	745,944
1-5 years	2,033,164	946,785	2,509,080	975,779
6-10 years	256,040	205,817	277,123	205,817
11-15 years	27,570	660	35,625	660
	3,447,750	1,878,828	4,132,703	1,928,200

59 (d) Litigation against the Bank

Litigation is a common occurrence in the banking industry due to the nature of the business undertaken.

The Bank has formal controls and policies in place for managing legal claims. Once professional advice has been obtained and the amount of loss is reasonably estimated, the Bank makes adjustments to accounts for any adverse effects of such claims on its financial standing.

The Bank confirms that there is no case (including the LT cases) filed against the Bank, which is not disclosed that would have a material impact on the financial position of the Bank.

59 (e) Tax Assessments

59 (e) i Tax assessments against the Bank

Assessments to the value of Rs 376.1 Mn on Financial Services VAT (relating to 2003, 2004, 2012 and 2013), assessments to the value of Rs 2,021.3 Mn on Income tax (relating to Y/A 2012/13 and 2013/14) and an assessment to the value Rs 47.6 Mn on PAYE tax (relating to Y/A 2012/13) received by the Bank are outstanding and have been duly appealed.

The Bank is of the view that the above assessments will not have any material impact on the financial statements.

59 (e) ii Tax assessments against group entity - HNB Assurance PLC (Company)

Assessments to the value of Rs 13.3 Mn on VAT on Reinsurance Claims and Commissions (relating to Y/A 2010/11) and assessments to the value of Rs 132 Mn on Income tax (relating to Y/A 2011/12, 2012/13, and 2013/14) received by the Company are outstanding and have been duly appealed.

The Group is of the view that the above assessments will not have any material impact on the financial statements.

Notes to the Financial Statements

60 RELATED PARTY DISCLOSURES

The Bank carries out transactions with parties who are defined as related parties in the Sri Lanka Accounting Standard - LKAS 24 on "Related party disclosures", in the ordinary course of its business. The details of such transactions are reported below. The pricing applicable to such transactions is based on the assessment of risk and pricing model of the Bank and is comparable with what is applied to transactions between the Bank and its unrelated customers.

60 (a) Parent and ultimate controlling party

The Bank does not have an identifiable parent of its own.

60 (b) Transactions with Key Management Personnel (KMP)

According to Sri Lanka Accounting Standard - LKAS 24 on "Related party disclosures", Key Management Personnel (KMP) are those having authority and responsibility for planning, directing and controlling the activities of the entity.

Accordingly, the Bank's KMP include the Board of Directors (including executive and non-executive directors) and selected key employees who meet the above criteria.

Key Management Personnel (KMP) of the Group

Bank is the ultimate parent of its subsidiaries listed out in Note 36 to the financial statements. Thus the KMPs of the Bank have the authority and responsibility for planning, directing and controlling the activities of the Group and have been identified as KMPs of the Group as well.

Close Family Members (CFMs) of KMPs are those family members who may be expected to influence, or be influenced by that KMP in their dealings with the entity. CFMs may include the domestic partner and children of KMP, the children of KMP's domestic partner and dependents of KMP and the KMP's domestic partner.

60 (b) i Compensation to KMP

For the year ended 31st December	Bank		Group	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Short term employment benefits				
Board of Directors and other KMP's	122,903	110,377	127,673	111,933

60 (b) ii Transactions, Arrangements and Agreements involving Key Management Personnel (KMPs) and their Close Family Members (CFMs)

Statement of Financial Position-Bank

	Closing Balance		Average Balance	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Assets				
Loans and receivables to customers	90,259	77,601	76,193	66,744
	90,259	77,601	76,193	66,744
Liabilities				
Securities sold under repurchase agreements	-	7,500	7,580	7,500
Due to customers	248,200	171,803	198,462	170,234
	248,200	179,303	206,042	177,734

	Closing Balance	
	2016 Rs 000	2015 Rs 000
Commitments for unutilised facilities		
Direct	42,237	33,847
	42,237	33,847

60 RELATED PARTY DISCLOSURES (CONTD.)**60 (b) Transactions with Key Management Personnel (KMP) (Contd.)****60 (b) ii Transactions, Arrangements and Agreements involving Key Management Personnel (KMPs) and their Close Family (Contd.)****Statement of Profit or Loss - Bank**

For the year ended 31st December	2016 Rs 000	2015 Rs 000
Interest income	6,203	4,291
Interest expenses	13,746	9,631

Details of ESOPs granted to KMP are given below.

	2016	2015
Number of options exercised during the year	99,926	34,342
Number of options remaining as at 31st December	99,926	199,852

60 (b) iii Transactions, Arrangements and Agreements with Entities which are controlled and/or jointly controlled by the KMP's or their Close Family Members (CFMs)**Statement of Financial Position - Bank**

	Closing Balance		Average Balance	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Assets				
Loans and receivables to customers	3,432,032	3,064,384	3,266,297	2,478,731
	3,432,032	3,064,384	3,266,297	2,478,731
Liabilities				
Due to customer	260,641	129,657	173,904	81,774
	260,641	129,657	173,904	81,774

Commitments and contingencies

	Closing Balance	
	2016 Rs 000	2015 Rs 000
Guarantees	35,080	60,290
Documentary credit	730,010	87,360
Commitments for unutilised facilities		
Direct	2,579,150	2,032,160
Indirect	412,860	1,219,700
	3,757,100	3,399,510

Statement of Profit or Loss - Bank

For the year ended 31st December	2016 Rs 000	2015 Rs 000
Interest income	359,380	175,152
Interest expenses	8,306	1,802

Notes to the Financial Statements

60 RELATED PARTY DISCLOSURES (CONTD.)

60 (c) Transactions with Group Entities

The Group entities include subsidiaries and joint venture of the Bank.

60 (c) i Transactions with Subsidiaries

Statement of Financial Position - Bank

	Closing Balance		Average Balance	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Assets				
Loans and receivables to customers	586,729	112,675	102,163	65,603
Other assets	495,256	496,327	497,718	490,300
	1,081,985	609,002	599,881	555,903
Liabilities				
Securities sold under repurchase agreements	-	-	-	117,000
Debt securities issued and subordinated term debt	381,073	146,215	414,785	144,251
Due to customers	1,197,536	948,230	1,300,462	293,078
	1,578,609	1,094,445	1,715,247	554,329

Commitments and contingencies

	Closing Balance	
	2016 Rs 000	2015 Rs 000
Commitments for unutilised facilities		
Direct	50,000	50,000
	50,000	50,000

Statement of Profit or Loss - Bank

For the year ended 31st December	2016	2015
	Rs 000	Rs 000
Interest income	62,608	58,548
Interest expenses	134,589	42,292
Other income	884,609	1,130,645
Other expenses	749,591	719,150
Other transactions		
Expenses reimbursed to the bank	56,294	53,174
Expenses reimbursed by the bank	89,717	103,866
Insurance claims received	8,752	9,839

60 RELATED PARTY DISCLOSURES (CONTD.)

60 (c) Transactions with Group Entities (Contd.)

60 (c) ii Transactions with the Joint Venture

Statement of Financial Position - Bank

	Closing Balance		Average Balance	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Assets				
Loans and receivables to customers	1,547,632	1,701,422	1,563,277	1,589,226
	1,547,632	1,701,422	1,563,277	1,589,226
Liabilities				
Due to customers	50,421	59,369	97,903	58,079
Securities sold under repurchase agreements	28,100	88,910	64,440	66,700
	78,521	148,279	162,343	124,779

Commitments and Contingencies

	Closing Balance	
	2016 Rs 000	2015 Rs 000
Commitments for unutilised facilities		
Direct	3,814,270	1,353,310
	3,814,270	1,353,310

Statement of Profit or Loss - Bank**For the year ended 31st December**

	2016 Rs 000	2015 Rs 000
Interest income	144,824	115,744
Interest expenses	13,299	6,471
Other income	6,462	4,724
Other expenses	9,601	10,855

60 (d) Transactions with Post Employment Benefit Plans of the Bank

Statement of Financial Position - Bank

	Closing Balance		Average Balance	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Liabilities				
Due to customers	13,427,401	12,670,073	12,490,093	10,015,651
Debt securities issued and subordinated term debts	719,806	106,299	623,618	106,298
Securities sold under repurchase agreements	73,100	73,089	565,590	574,090
	14,220,307	12,849,461	13,679,301	10,696,039
Equity				
Stated capital	139,379	130,288	125,534	130,288
	139,379	130,288	125,534	130,288

Statement of profit or loss - Bank**For the year ended 31st December**

	2016 Rs 000	2015 Rs 000
Interest expenses	1,278,546	658,054
Other Transactions		
Dividends paid	4,693	5,452
Contributions made	1,853,213	1,382,189

Notes to the Financial Statements

60 RELATED PARTY DISCLOSURES (CONTD.)

60 (e) Transactions with Government of Sri Lanka/ Entities Controlled, Jointly Controlled, Significantly Influenced by the Government of Sri Lanka

The Government of Sri Lanka indirectly holds more than 25% of the voting rights of the Bank as at 31st December 2016 through Sri Lanka Insurance Corporation Ltd , Employees Provident Fund , National Savings Bank and Employees Trust Fund. Accordingly, the Bank has considered Government of Sri Lanka and other entities which are controlled, jointly controlled or significantly influenced by the Government of Sri Lanka (government related entities) as related parties according to Sri Lanka Accounting Standard - LKAS 24 on "Related party disclosures".

During the year ended 31st December 2016, the Bank has carried out transactions with the Government of Sri Lanka and other government related entities in the ordinary course of its business, the details of which are given below. The pricing applicable to such transactions was based on the assessment of risk and pricing model of the Bank and was comparable with what was applied to transactions between the Bank and its unrelated customers.

Statement of Financial Position - Bank

	Closing Balance		Average balance	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000
Assets				
Balances with Central Bank of Sri Lanka	33,777,614	20,096,090	29,157,412	18,929,352
Reverse repurchase agreements	-	-	3,062,220	1,000,000
Financial investments - held for trading and available for sale	166,402,528	140,754,595	166,685,751	123,759,536
Loans and receivables to customers	56,652,176	38,471,591	42,010,311	32,560,861
Placements with banks	118,000	3,809,000	3,243,336	3,024,771
Financial investments - loans and receivables	4,208,320	2,351,454	2,514,510	702,870
	261,158,638	205,482,730	246,673,540	179,977,390
Liabilities				
Due to customers	15,444,918	9,381,758	13,482,528	6,564,571
Due to banks	2,144,842	8,764,315	4,421,991	9,753,324
Debt securities issued and subordinated term debts	9,329,233	6,133,797	6,893,026	6,089,522
Securities sold under repurchase agreements	1,864,270	6,333,060	3,267,960	2,774,030
Other borrowings	-	-	-	2,083,333
Taxation	6,223,943	4,542,977	5,657,816	3,861,085
	35,007,206	35,155,907	33,723,321	31,125,865

Commitments and Contingencies

Balance as at 31st December	Closing Balance	
	2016	2015
Forward foreign exchange contracts		
Sales - Rs 000	35,467,025	14,065,140
Commitments for unutilised facilities		
Direct - Rs 000	25,391,470	12,352,870
Indirect - Rs 000	1,376,312	1,312,842

Statement of Profit or Loss - Bank

For the year ended 31st December	2016 Rs 000	2015 Rs 000
Interest income	16,620,371	9,846,720
Interest expenses	1,801,506	1,557,096
Other income	7,960	4,800
Tax expenses (income tax, financial services VAT, NBT)	10,151,582	6,702,511

Transactions which are not individually significant

Apart from the transactions listed above the Bank has carried out transactions with the Government of Sri Lanka and other government related entities in the form of utility bills, telephone charges, deposit insurance payments, crib charges etc. The total of such payments made during the year ended 31st December 2016 was Rs. 473.80 Mn (2015 - Rs. 613.44 Mn).

61 MATURITY ANALYSIS

61 (a) As at 31st December 2016

	Bank			Group		
	Within	More than	Total	Within	More than	Total
	12 months	12 months		12 months	12 months	
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Assets						
Cash and cash equivalents	17,511,446	-	17,511,446	18,668,703	-	18,668,703
Balances with Central Bank of Sri Lanka	-	33,777,614	33,777,614	-	33,777,614	33,777,614
Placements with banks	753,050	-	753,050	1,391,274	807,172	2,198,446
Reverse repurchase agreements	4,303,460	-	4,303,460	5,756,794	-	5,756,794
Derivative financial instruments	289,989	-	289,989	289,989	-	289,989
Financial investments - fair value through profit or loss	544,915	-	544,915	716,009	-	716,009
Loans and receivables to customers	322,385,348	262,027,379	584,412,727	334,291,542	263,175,918	597,467,460
Financial investments -						
Loans and receivables	42,366,749	56,893,949	99,260,698	42,714,722	59,348,507	102,063,229
Financial investments - available-for-sale	37,062,483	52,852,670	89,915,153	38,726,384	57,070,758	95,797,142
Financial investments - held-to-maturity	-	-	-	291,056	174,025	465,081
Investment in joint venture	-	755,000	755,000	-	1,450,806	1,450,806
Investments in subsidiaries	-	3,017,285	3,017,285	-	-	-
Investment properties	-	403,959	403,959	-	1,054,300	1,054,300
Property, plant and equipment	-	13,945,002	13,945,002	-	29,844,234	29,844,234
Intangible assets and goodwill	-	789,648	789,648	-	1,180,269	1,180,269
Other assets	3,145,664	6,048,215	9,193,879	4,737,377	5,983,130	10,720,506
Total assets	428,363,104	430,510,721	858,873,825	447,583,850	453,866,734	901,450,582
Liabilities						
Due to banks	41,680,338	28,248,451	69,928,789	41,702,893	28,261,487	69,964,380
Derivative financial instruments	665,890	-	665,890	665,890	-	665,890
Securities sold under repurchase agreements	13,458,127	-	13,458,127	13,458,127	-	13,458,127
Due to customers	606,310,053	17,184,916	623,494,969	613,320,466	22,050,631	635,371,097
Dividends payable	1,007,075	-	1,007,075	1,015,463	-	1,015,463
Other borrowings	3,045,640	24,084,718	27,130,358	2,900,657	24,229,701	27,130,358
Debt securities issued	329,831	4,323,226	4,653,057	318,862	4,796,939	5,115,801
Current tax liabilities	6,223,943	-	6,223,943	6,425,379	-	6,425,379
Deferred tax liabilities	-	231,364	231,364	-	824,778	824,778
Insurance provision - life	-	-	-	902,525	7,845,331	8,747,856
Insurance provision - general	-	-	-	1,921,567	-	1,921,567
Other provisions	3,158,444	-	3,158,444	3,407,050	-	3,407,050
Other liabilities	5,338,092	413,015	5,751,107	6,648,756	541,272	7,190,028
Subordinated term debts	1,255,750	24,897,726	26,153,476	1,214,726	24,686,384	25,901,110
Shareholders' funds	-	77,017,226	77,017,226	-	94,311,698	94,311,698
Total liabilities	682,473,183	176,400,642	858,873,825	693,902,362	207,548,221	901,450,582
Maturity gap	(254,110,079)	254,110,079		(246,318,512)	246,318,512	
Cumulative gap	(254,110,079)	-		(246,318,512)	-	

Notes to the Financial Statements

61 MATURITY ANALYSIS (CONTD.)

61 (b) As at 31st December 2015

	Within 12 months Rs 000	Bank More than 12 months Rs 000	Total Rs 000	Within 12 months Rs 000	Group More than 12 months Rs 000	Total Rs 000
Assets						
Cash and cash equivalents	14,909,598	-	14,909,598	15,419,654	-	15,419,654
Balances with Central Bank of Sri Lanka	-	20,096,090	20,096,090	-	20,096,090	20,096,090
Placements with banks	26,827	-	26,827	388,230	786,096	1,174,326
Reverse repurchase agreements	4,869,219	-	4,869,219	7,782,374	-	7,782,374
Derivative financial instruments	1,302,872	-	1,302,872	1,302,872	-	1,302,872
Financial investments - fair value through profit or loss	593,390	-	593,390	773,053	1,175,719	1,948,772
Non-current assets held for sale	20,151	-	20,151	20,151	-	20,151
Loans and receivables to customers	234,104,217	264,237,411	498,341,628	242,405,760	264,838,569	507,244,329
Financial investments -						
Loans and receivables	24,275,024	59,931,678	84,206,702	24,626,349	62,460,856	87,087,205
Financial investments - available-for-sale	34,520,815	43,525,690	78,046,505	34,773,197	44,945,034	79,718,231
Financial investments - held-to-maturity	-	-	-	1,089,146	168,287	1,257,433
Investment in joint venture	-	655,000	655,000	-	1,253,370	1,253,370
Investments in subsidiaries	-	3,017,285	3,017,285	-	-	-
Investment properties	-	386,643	386,643	-	1,041,797	1,041,797
Property, plant and equipment	-	11,473,569	11,473,569	-	23,908,688	23,908,688
Intangible assets and goodwill	-	659,309	659,309	-	1,001,230	1,001,230
Other assets	2,257,750	4,345,172	6,602,922	3,142,472	4,185,581	7,328,053
Total assets	316,879,863	408,327,847	725,207,710	331,723,258	425,861,317	757,584,575
Liabilities						
Due to banks	33,795,056	24,436,978	58,232,034	33,842,840	24,440,998	58,283,838
Derivative financial instruments	304,485	-	304,485	304,485	-	304,485
Securities sold under repurchase agreements	16,630,201	-	16,630,201	16,630,201	-	16,630,201
Due to customers	513,964,760	13,161,421	527,126,181	519,558,971	16,573,818	536,132,789
Dividends payable	764,771	-	764,771	764,771	-	764,771
Other borrowings	312,142	26,520,967	26,833,109	312,141	26,520,968	26,833,109
Debt securities issued	-	4,490,742	4,490,742	-	4,913,751	4,913,751
Current tax liabilities	4,542,977	-	4,542,977	4,762,707	-	4,762,707
Deferred tax liabilities	-	378,820	378,820	-	579,102	579,102
Insurance provision - life	-	-	-	284,280	6,722,801	7,007,081
Insurance provision - general	-	-	-	1,546,266	-	1,546,266
Other provisions	2,538,111	-	2,538,111	2,746,294	-	2,746,294
Other liabilities	5,833,151	417,705	6,250,856	6,529,273	721,620	7,250,893
Subordinated term debts	-	12,064,370	12,064,370	-	12,085,598	12,085,598
Shareholders' funds	-	65,051,053	65,051,053	-	77,743,690	77,743,690
Total liabilities	578,685,654	146,522,056	725,207,710	587,282,229	170,302,346	757,584,575
Maturity gap	(261,805,791)	261,805,791		(255,558,971)	255,558,971	
Cumulative gap	(261,805,791)	-		(255,558,971)	-	

62 SEGMENT REPORTING

Accounting Policy

An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Group's other components, whose operating results are reviewed regularly by the chief operating decision maker to make decisions about resources allocated to each segment and assess its performance, and for which discrete financial information is available.

Group's activities have been segregated into five different segments (banking, leasing / hire purchase, property, insurance and others) based on the business activities that each unit is engaged for the purpose of reviewing the operating results of the Group as well as to make decisions about resource allocation. The operating results of the Bank is split between banking and leasing / hire purchase activities. Property and insurance represent the operating results and financial position of the subsidiaries, Sithma Development (Pvt) Ltd and HNB Assurance PLC respectively. Operating results and financial position of HNB Grameen Finance Ltd is presented as others.

Management monitors the operating results of its business units separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance is evaluated based on operating profits or losses which, in certain respects, are measured differently from operating profits or losses in the consolidated financial statements.

Inter segment transactions are accounted for at fair market prices, charged to inter-bank counterparts for similar services on an arm's length basis. Such transfers are eliminated on consolidation.

Income taxes are not allocated to operating segments. Other expenses which cannot be directly identified against a particular business segment have been treated as consolidation adjustments.

No revenue from transactions with a single external customer or counter party amounted to 10% or more of the Bank's total revenue in 2016 or in 2015.

Segment information is presented in respect of the Group's business segments. The Group's primary format for segment reporting is based on business segments. The business segments are determined based on the Group's management and internal reporting structure.

Business segments - Group

	Banking		Leasing/Hire purchase		Property		Insurance		Others*		Eliminations / Unallocated		Consolidated	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000	2016 Rs 000	
Net interest income	32,246,731	24,335,892	2,185,546	1,994,644	-	-	1,130,726	814,610	3,559,806	2,582,316	(33,950)	(33,742)	39,088,859	29,693,720
Net fee and commission income	7,046,721	5,775,910	-	-	-	-	139,815	100,439	538,812	367,638	-	-	7,725,348	6,243,987
Net gain/(loss) from trading	(1,795,691)	196,993	-	-	-	-	(17,761)	30,263	(11,000)	(14,892)	-	-	(1,824,452)	212,364
Net gain/(loss) from financial investments	111,713	253,858	-	-	-	-	(8,548)	31,870	-	12,250	-	-	103,165	297,978
Net insurance premium income	3,251,305	2,182,111	-	-	193,836	194,444	19,063	44,076	238,122	60,650	(920,361)	(964,858)	2,781,965	1,516,423
Other operating income	40,860,779	32,744,764	2,185,546	1,994,644	193,836	194,444	6,754,007	5,701,155	4,325,740	3,007,962	(954,311)	(998,600)	53,365,597	42,644,369
Inter-segment revenue	(22,701)	35,502	-	-	746,739	676,104	142,809	74,476	63,050	(396)	(929,897)	(785,686)	-	-
Total operating income	40,838,078	32,780,266	2,185,546	1,994,644	940,575	870,548	6,896,816	5,775,631	4,388,790	3,007,566	(1,884,208)	(1,784,286)	53,365,597	42,644,369
Impairment charge for loans and other losses	278,785	385,300	(41,625)	546,625	-	-	4,434	350	266,565	89,836	-	-	508,159	1,022,111
Net operating income	40,559,293	32,394,966	2,227,171	1,448,019	940,575	870,548	6,892,382	5,775,281	4,122,225	2,917,730	(1,884,208)	(1,784,286)	52,857,438	41,622,258
Segment result	19,004,565	14,639,538	2,177,194	1,377,075	726,669	702,352	770,509	237,361	2,031,957	1,406,945	(967,209)	(1,012,044)	23,743,685	17,351,227

Notes to the Financial Statements

62 SEGMENT REPORTING (CONTD.)

	Banking		Leasing/Hire purchase		Property		Insurance		Others*		Eliminations / Unallocated		Consolidated	
	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000	2016 Rs 000	2015 Rs 000	2016 Rs 000	
Unallocated operating expenses													(1,393,828)	(1,251,044)
Operating profit													22,349,857	16,100,183
Share of profit of associates and joint venture													148,790	60,085
Income tax expense													(6,833,685)	(5,064,424)
Profit for the year													15,664,962	11,095,844
Non-controlling interests													(909,328)	(542,276)
Profit attributable to the Equity Holders of the Bank													14,755,634	10,553,568
Profit for the year													15,664,962	11,095,844
Other comprehensive income ,net of tax	(172,467)	(1,206,722)	-	-	-	2,893,381	479	(10,608)	141,117	(9,207)	3,222,871	625,624	3,192,000	2,292,468
Total Comprehensive Income													18,856,962	13,388,312
Non-controlling interests													(991,142)	(532,707)
Total comprehensive income attributable to the Equity Holders of the Bank													17,865,820	12,855,605
Segment assets	789,151,149	663,129,144	41,617,904	39,263,687	10,203,235	10,231,547	14,528,854	11,640,828	18,614,934	13,490,777	2,247,019	30,996	876,363,095	737,786,979
Investment in associates													1,450,806	1,257,433
Unallocated assets													23,636,681	18,540,163
Total Assets													901,450,582	757,584,575
Segment liabilities	723,866,762	606,417,435	41,617,904	39,263,687	625,296	609,327	11,831,797	9,356,883	15,292,385	11,400,854	(2,467,193)	(1,682,838)	790,766,951	665,365,348
Unallocated liabilities													16,371,933	14,475,537
Total liabilities													807,138,884	679,840,885
Cash flows from operating activities	11,575,535	42,749,948	(2,891,643)	(18,547,698)	717,134	712,160	1,292,190	1,169,770	(248,916)	792,988	2,744,825	177,995	13,189,125	27,055,163
Cash flows from investing activities	(28,753,613)	(60,939,596)	-	-	(84,534)	(3,638)	(953,592)	(767,836)	992,446	(665,479)	(3,107,221)	(1,246,715)	(31,906,514)	(63,623,264)
Cash flows from financing activities	23,397,792	34,742,938	-	-	(600,000)	(832,600)	(100,000)	(188,250)	382,056	(46,751)	(89,290)	968,439	22,990,558	34,643,776
Capital Expenditure	1,344,022	952,512	4,440	7,485	12,775	3,638	111,362	64,384	204,865	223,826	71,756	-	1,749,220	1,251,845
Depreciation	815,620	745,573	172	410	165,445	135,207	44,882	51,115	104,156	70,687	3,196	3,217	1,133,471	1,006,209
Amortization	200,413	202,452	19,725	18,161	67	67	20,106	17,225	20,046	10,024	-	(3,094)	260,357	244,835

* Business of HNB Grameen Finance Limited

63 NET ASSETS VALUE PER ORDINARY SHARE

As at 31st December	Bank		Group	
	2016	2015	2016	2015
Amount used as the numerator:				
Equity holders funds (Rs 000)	77,017,226	65,051,053	91,290,675	75,564,402
Number of ordinary shares used as the denominator:				
Total number of shares	413,815,474	405,821,370	413,815,474	405,821,370
Net assets value per share (Rs)	186.11	160.29	220.60	186.20

64 EVENTS OCCURRING AFTER THE REPORTING PERIOD

Events after the reporting period are those events, favourable and unfavourable, that occur between the reporting date and the date the financial statements are authorised for issue.

There are no events occurring after the reporting date which require adjustments to or disclosure in the financial statements, other than those disclosed below:

64 (a) Proposed Dividends

Refer Note 22 (a).

65 COMPARATIVE INFORMATION

The presentation and classification of the following items in these financial statements are amended to ensure the comparability with the current year.

	Note	Bank			Group		
		As disclosed previously	Current Presentation	Adjustment	As disclosed previously	Current Presentation	Adjustment
		Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Income Statement							
Net gain/(loss) from trading	65 (a) (i)	346,577	196,993	149,584	361,948	212,364	149,584
Other operating income	65 (a) (i)	2,062,640	2,212,224	(149,584)	1,366,839	1,516,423	(149,584)

Foreign exchange gain of Rs 149.584 Mn classified in "gain/(loss) on revaluation of foreign currency derivatives" has been reclassified to "other operating income".

66 DIRECTORS' RESPONSIBILITY STATEMENT

The Board of Directors of the Bank is responsible for the preparation and presentation of these financial statements.

Please refer to page 196 for the statement of the Directors' Responsibility for Financial Reporting.

Compliance with Other Disclosure Requirements

Bank's level of compliance with the other disclosure requirements given in the specified format for the preparation of annual financial statements of licensed commercial banks issued by the Central Bank of Sri Lanka is detailed below.	
1	INFORMATION ABOUT THE SIGNIFICANCE OF FINANCIAL INSTRUMENTS FOR FINANCIAL POSITION AND PERFORMANCE
1.1	Statement of Financial Position
1.1.1	Disclosures on categories of financial assets and financial liabilities Note 23 to the financial statements
1.1.2	Other disclosures
(i)	Special disclosures about financial assets and financial liabilities designated to be measured at fair value through profit or loss, including disclosures about credit risk and market risk, changes in fair values attributable to these risks and the methods of measurement N/A
(ii)	Reclassifications of financial instruments from one category to another N/A
(iii)	Information about financial assets pledged as collateral and about financial or non-financial assets held as collateral Note 33 (k) and 37 (b) to the financial statements
(iv)	Reconciliation of the allowance account for credit losses by class of financial assets Note 31 (b) to the financial statements
(v)	Information about compound financial instruments with multiple embedded derivatives N/A
(vi)	Breaches of terms of loan agreements N/A
1.2	Statement of Comprehensive Income Statement of Comprehensive Income
1.2.1	Disclosures on items of income, expense, gains and losses Note 8,9,10,11, 12,13, 14, 15, 16 and 17 to the financial statements
1.2.2	Other disclosures
(i)	Total interest income and total interest expense for those financial instruments that are not measured at fair value through profit and loss Note 8 to the financial statements
(ii)	Fee income and expense Note 9 to the financial statements
(iii)	Amount of impairment losses by class of financial assets Note 14 to the financial statements
(iv)	Interest income on impaired financial assets Note 8 (a) to the financial statements
1.3	Other disclosures
1.3.1	Accounting policies for financial instruments Note 3.3,29,31,32 and 33 to the financial statements
1.3.2	Information on hedge accounting N/A
1.3.3	Information about the fair values of each class of financial asset and financial liability, along with: Note 5 to the financial statements
(i)	Comparable carrying amounts Note 5 to the financial statements
(ii)	Description of how fair value was determined Note 5 to the financial statements
(iii)	The level of inputs used in determining fair value Note 5 to the financial statements
(iv)	Reconciliations of movements between levels of fair value measurement hierarchy, additional disclosures for financial instruments that fair value is determined using level 3 inputs Note 5 to the financial statements
(v)	Information if fair value cannot be reliably measured N/A
2	INFORMATION ABOUT THE NATURE AND EXTENT OF RISKS ARISING FROM FINANCIAL INSTRUMENTS
2.1	Qualitative disclosures
2.1.1	Risk exposures for each type of financial instrument Note 4 to the financial statements and "Risk Management report"
2.1.2	Management's objectives, policies, and processes for managing those risks Note 4 to the financial statements and "Risk Management report"
2.1.3	Changes from the prior period "Risk Management report"

2.2	Quantitative disclosures	
2.2.1	Summary of quantitative data about exposure to each risk at the reporting date	Note 4 to the financial statements
2.2.2	Disclosures about credit risk, liquidity risk, market risk, operational risk, interest rate risk and how these risks are managed	
	(i) Credit Risk	
	(a) Maximum amount of exposure (before deducting the value of collateral), description of collateral, information about credit quality of financial assets that are neither past due nor impaired and information about credit quality of financial assets	Note 4.3 to the financial statements and "Risk Management report"
	(b) For financial assets that are past due or impaired, disclosures on age, factors considered in determining as impaired and the description of collateral on each class of financial asset	Note 4.3 to the financial statements
	(c) Information about collateral or other credit enhancements obtained or called	Note 4.3 to the financial statements and "Risk Management report"
	(d) For other disclosures, refer Banking Act Direction No. 7 of 2011 on Integrated Risk Management Framework for Licensed Banks (Section H)	Note 4.3 to the financial statements and "Risk Management report"
	(ii) Liquidity Risk	
	(a) A maturity analysis of financial liabilities	Note 61 to the financial statements
	(b) Description of approach to risk management	Note 4.4 to the financial statements and "Risk Management report"
	(c) For other disclosures, refer Banking Act Direction No. 7 of 2011 on Integrated Risk Management Framework for Licensed Banks (Section H)	Note 4.4 to the financial statements and "Risk Management report"
	(iii) Market Risk	
	(a) A sensitivity analysis of each type of market risk to which the entity is exposed	Note 4.5 to the financial statements and "Risk Management report"
	(b) Additional information, if the sensitivity analysis is not representative of the entity's risk exposure	Note 4.5 to the financial statements and "Risk Management report"
	(c) For other disclosures, refer Banking Act Direction No. 7 of 2011 on Integrated Risk Management Framework for Licensed Banks (Section H)	Note 4.5 to the financial statements and "Risk Management report"
	(iv) Operational Risk	
	Refer Banking Act Direction No. 7 of 2011 on Integrated Risk Management Framework for Licensed Banks (Section H)	"Risk Management report"
	(v) Equity risk in the banking book	Note 4.5 to the financial statements and "Risk Management report"
	(a) Qualitative disclosures	
	*Differentiation between holdings on which capital gains are expected and those taken under other objectives including for relationship and strategic reasons.	Note 3.3,29,31,32 and 33 to the financial statements
	*Discussion of important policies covering the valuation and accounting of equity holdings in the banking book.	Note 3.3,29 and 33 to the financial statements
	(b) Quantitative disclosures	
	*Value disclosed in the statement of financial position of investments, as well as the fair value of those investments; for quoted securities, a comparison to publicly quoted share values where the share price is materially different from fair value.	Note 5, 29 and 33 and 34 to the financial statements
	*The types and nature of investments.	Note 29 and 33 to the financial statements
	* The cumulative realised gains/(losses) arising from sales and liquidations in the reporting period.	Note 10, 11 and 14 to the financial statements
	(vi) Interest rate risk in the banking book	Note 4.5.3 to the financial statements and "Risk Management report"
	(a) Qualitative disclosures	
	Nature of interest rate risk in the banking book (IRRBB) and key assumptions	Note 4.5.3 to the financial statements and "Risk Management report"
	(b) Quantitative disclosures	
	The increase/(decline) in earnings or economic value (or relevant measure used by management) for upward and downward rate shocks according to management's method for measuring IRRBB, broken down by currency (as relevant).	"Risk Management report"
2.2.3	Information on concentrations of risk	"Risk Management report"

Compliance with Other Disclosure Requirements

3	OTHER DISCLOSURES	
3.1	Capital	
3.1.1	Capital structure	
(i)	Qualitative disclosures	
	Summary information on the terms and conditions of the main features of all capital instruments, especially in the case of innovative, complex or hybrid capital instruments.	Note 4.6 to the financial statements
(ii)	Quantitative disclosures	"Computation of Capital Adequacy Ratio"
(a)	The amount of Tier 1 capital, with separate disclosure of:	
	*Paid-up share capital / common stock	"Computation of Capital Adequacy Ratio"
	*Reserves	
	*Non-controlling interests in the equity of subsidiaries	
	*Innovative instruments	
	*Other capital instruments	
	*Deductions from Tier 1 capital	
(b)	The total amount of Tier 2 and Tier 3 capital	
(c)	Other deductions from capital	
(d)	Total eligible capital	
3.1.2	Capital adequacy	
(i)	Qualitative disclosures	"Computation of Capital Adequacy Ratio"
	A summary discussion of the bank's approach to assessing the adequacy of its capital to support current and future activities.	
(ii)	Quantitative disclosures	
(a)	Capital requirements for credit risk, market risk and operational risk	
(b)	Total and Tier 1 capital ratio	

Statement of Profit or Loss in US Dollars

For the year ended 31st December	Bank		Group	
	2016 US\$ 000	2015 US\$ 000	2016 US\$ 000	2015 US\$ 000
Gross Income	562,620	424,353	640,259	485,925
Interest income	504,307	365,106	543,829	394,795
Less: Interest expenses	275,048	182,360	283,106	188,746
Net interest income	229,259	182,746	260,723	206,049
Fee and commission income	47,619	40,767	52,732	44,591
Less: Fee and commission expenses	604	684	1,204	1,263
Net fee and commission income	47,015	40,083	51,528	43,328
Net interest, fee and commission income	276,274	222,829	312,251	249,377
Net gain/(loss) from trading	(11,977)	1,367	(12,169)	1,474
Net gain from financial investments	745	1,762	688	2,068
Net insurance premium income	-	-	36,623	32,474
Other operating income	21,926	15,351	18,556	10,523
Total Operating income	286,968	241,309	355,949	295,916
Less: Impairment charges for loans and other losses	1,582	6,467	3,390	7,093
Net operating income	285,386	234,842	352,559	288,823
Less : Operating expenses				
Personnel expenses	58,053	55,011	69,475	63,529
Benefits, claims and underwriting expenditure	-	-	30,491	29,228
Other expenses	63,927	55,867	71,937	63,098
Total Operating expenses	121,980	110,878	171,903	155,855
Operating profit before Value Added Tax (VAT) and Nation Building Tax (NBT) on financial services	163,406	123,964	180,656	132,968
Less: Value added tax (VAT) and Nation Building Tax (NBT) on financial services	29,033	19,529	31,582	21,246
Operating profit after Value Added Tax (VAT) and Nation Building Tax (NBT) on financial services	134,373	104,435	149,074	111,722
Share of profit of joint venture (net of income tax)	-	-	992	417
PROFIT BEFORE INCOME TAX	134,373	104,435	150,066	112,139
Less: Income tax expense	40,036	31,929	45,581	35,143
PROFIT FOR THE YEAR	94,337	72,506	104,485	76,996
Profit attributable to:				
Equity holders of the Bank	94,337	72,506	98,420	73,233
Non-controlling interests	-	-	6,065	3,763
PROFIT FOR THE YEAR	94,337	72,506	104,485	76,996
Earnings per share				
Basic earnings per ordinary share (\$)	0.23	0.18	0.24	0.18
Diluted earnings per ordinary share (\$)	0.23	0.18	0.24	0.18
Dividend per share				
Dividend per share: Gross (\$)	*0.06	0.06	*0.06	0.06

Exchange rate of US\$ 1 was Rs 149.925 as at 31st December 2016 (Rs 144.11 as at 31st December 2015)

The statement of profit or loss given on this page is solely for the convenience of the stakeholders of financial statements and do not form part of the audited financial statements.

*Calculated on interim dividend paid and final dividend proposed, which is to be approved at the Annual General Meeting.

Statement of Comprehensive Income in US Dollars

For the year ended 31st December	Bank		Group	
	2016 US\$ 000	2015 US\$ 000	2016 US\$ 000	2015 US\$ 000
PROFIT FOR THE YEAR	94,337	72,506	104,485	76,996
OTHER COMPREHENSIVE INCOME FOR THE YEAR, NET OF TAX				
Other comprehensive income to be reclassified to profit or loss in subsequent periods				
Available-for-sale financial assets:				
Net change in fair value during the year	(21,068)	(17,006)	(22,092)	(17,613)
Transfer to life policy holder reserve fund	-	-	899	674
Net amount transferred to profit or loss (available-for-sale financial assets)	-	-	97	(133)
Deferred tax effect on above	2,697	1,047	2,709	1,056
Share of other comprehensive income of equity accounted joint venture	-	-	(141)	118
Net other comprehensive income to be reclassified to profit or loss in subsequent periods	(18,371)	(15,959)	(18,528)	(15,898)
Other comprehensive income not to be reclassified to profit or loss in subsequent periods				
Re-measurement gains/(losses) on defined benefit plans	2,413	(6,231)	2,518	(6,311)
Revaluation of freehold land and buildings	15,163	14,538	38,345	38,839
Deferred tax effect on above	(363)	(722)	(1,052)	(722)
Deferred tax effect on realisation of revaluation surplus	8	-	8	-
Net other comprehensive income not to be reclassified to profit or loss in subsequent periods	17,221	7,585	39,819	31,806
OTHER COMPREHENSIVE INCOME FOR THE YEAR, NET OF TAX	(1,150)	(8,374)	21,291	15,908
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	93,187	64,132	125,776	92,904
Total comprehensive income attributable to:				
Equity holders of the Bank	93,187	64,132	119,165	89,207
Non-controlling interests	-	-	6,611	3,697
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	93,187	64,132	125,776	92,904

Exchange rate of US\$ 1 was Rs 149.925 as at 31st December 2016 (Rs 144.11 as at 31st December 2015)

The statement of comprehensive income given on this page is solely for the convenience of the stakeholders of financial statements and do not form part of the audited financial statements.

Statement of Financial Position in US Dollars

As at 31st December	Bank		Group	
	2016 US\$ 000	2015 US\$ 000	2016 US\$ 000	2015 US\$ 000
ASSETS				
Cash and cash equivalents	116,801	103,460	124,520	106,999
Balances with Central Bank of Sri Lanka	225,297	139,450	225,297	139,450
Placements with banks	5,023	186	14,664	8,149
Reverse repurchase agreements	28,704	33,788	38,398	54,003
Derivative financial instruments	1,934	9,041	1,934	9,041
Financial investments - fair value through profit or loss	3,635	4,117	4,776	13,523
Non-current assets held for sale	-	140	-	140
Loans and receivables to customers	3,898,034	3,458,064	3,985,109	3,519,841
Financial investments - loans and receivables	662,069	584,322	680,762	604,311
Financial investments - available-for-sale	599,734	541,576	638,967	553,176
Financial investments - held-to-maturity	-	-	3,102	8,725
Investment in joint venture	5,036	4,545	9,677	8,697
Investment in subsidiaries	20,125	20,937	-	-
Investment properties	2,695	2,683	7,032	7,229
Property, plant and equipment	93,013	79,617	199,061	165,906
Intangible assets and goodwill	5,267	4,576	7,872	6,948
Other assets	61,323	45,819	71,506	50,850
Total assets	5,728,690	5,032,321	6,012,677	5,256,988
LIABILITIES				
Due to banks	466,425	404,080	466,663	404,440
Derivative financial instruments	4,441	2,113	4,441	2,113
Securities sold under repurchase agreements	89,766	115,399	89,766	115,399
Due to customers	4,158,712	3,657,804	4,237,926	3,720,302
Dividends payable	6,717	5,307	6,773	5,307
Other borrowings	180,960	186,199	180,960	186,199
Debt securities issued	31,036	31,162	34,122	34,097
Current tax liabilities	41,514	31,524	42,857	33,049
Deferred tax liabilities	1,543	2,629	5,501	4,019
Insurance provision - life	-	-	58,348	48,623
Insurance provision - general	-	-	12,817	10,730
Other provisions	21,067	17,612	22,725	19,057
Other liabilities	38,360	43,376	47,958	50,315
Subordinated term debts	174,444	83,717	172,761	83,864
Total liabilities	5,214,985	4,580,922	5,383,618	4,717,514
EQUITY				
Stated capital	102,319	95,947	102,319	95,947
Statutory reserve	30,415	26,091	30,415	26,091
Other reserves	317,444	292,786	390,658	347,149
Retained earnings	63,527	36,575	85,517	55,165
Total equity attributable to equity holders of the Bank	513,705	451,399	608,909	524,352
Non-controlling interests	-	-	20,150	15,122
Total equity	513,705	451,399	629,059	539,474
Total liabilities and equity	5,728,690	5,032,321	6,012,677	5,256,988
Contingent liabilities and commitments	3,350,828	2,940,896	3,350,828	2,940,896
Net assets value per share (\$)	1.24	1.11	1.47	1.29

Exchange rate of US\$ 1 was Rs 149.925 as at 31st December 2016 (Rs 144.11 as at 31st December 2015)

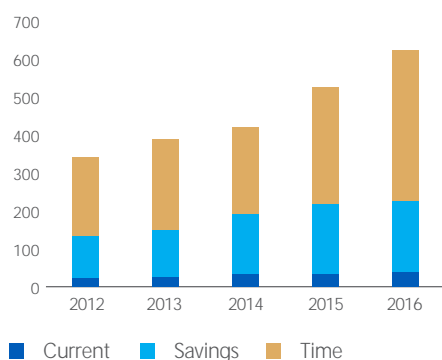
The statement of financial position given on this page is solely for the convenience of the stakeholders of financial statements and do not form part of the audited financial statements.

Analysis of Deposits

	2012	2013	2014	2015	2016
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Analysis of Total Deposits					
Local currency deposits	280,644,471	323,925,015	352,732,715	438,253,261	522,168,609
Foreign currency deposits	60,779,515	63,233,375	66,594,408	88,872,920	101,326,360
	341,423,986	387,158,390	419,327,123	527,126,181	623,494,969
Product wise analysis of Deposits					
Current	23,390,690	23,837,932	32,608,645	33,958,697	36,675,800
Savings	109,176,640	124,510,240	157,946,623	184,204,894	188,845,184
Time	208,856,656	238,810,218	228,771,855	308,962,590	397,973,985
	341,423,986	387,158,390	419,327,123	527,126,181	623,494,969

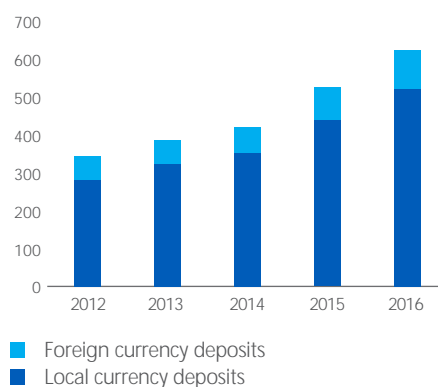
Product wise analysis of Deposits

Rs. Bn



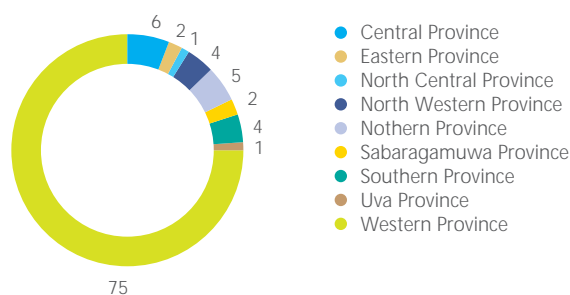
Analysis of Total Deposits

Rs. Bn



Province-wise Deposits

%



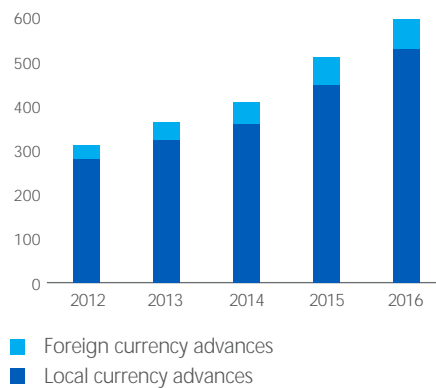
- Central Province
- Eastern Province
- North Central Province
- North Western Province
- North Western Province
- North Western Province
- Sabaragamuwa Province
- Southern Province
- Uva Province
- Western Province

Analysis of Loans and Receivables

	2012	2013	2014	2015	2016
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Analysis of Loans and Receivables to customers (Gross)					
Local currency advances	278,597,183	321,888,416	359,217,435	446,394,387	527,288,700
Foreign currency advances	31,767,370	40,691,142	47,714,009	63,131,080	68,225,219
Total advances (Gross)	310,364,553	362,579,558	406,931,444	509,525,467	595,513,919
Product wise analysis of loans and receivables to customers (Gross)					
Overdrafts	61,160,391	62,458,953	69,118,967	71,566,434	91,093,180
Short term loans	16,756,644	36,200,888	40,664,653	50,881,880	60,562,111
Trust receipts	13,059,931	13,820,841	17,867,491	23,669,721	24,885,713
Term loans	121,856,986	155,626,639	204,143,947	275,817,905	328,374,844
Lease rentals receivables	25,280,078	23,152,822	24,482,873	40,341,596	42,621,900
Housing loans	22,990,253	25,084,496	27,622,481	30,808,329	33,966,019
Pawning advances	49,260,270	46,234,919	23,031,032	16,439,602	14,010,152
	310,364,553	362,579,558	406,931,444	509,525,467	595,513,919

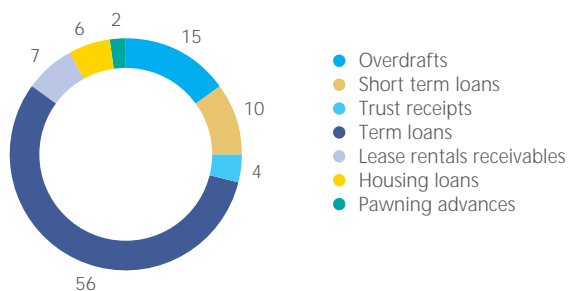
Analysis of Total Advances

Rs. Bn



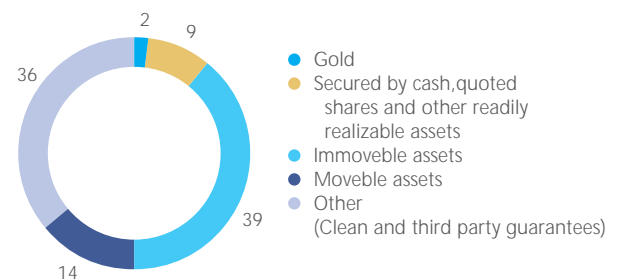
Product wise analysis of loans and receivables (Gross)

%



Analysis of advances by securities

%



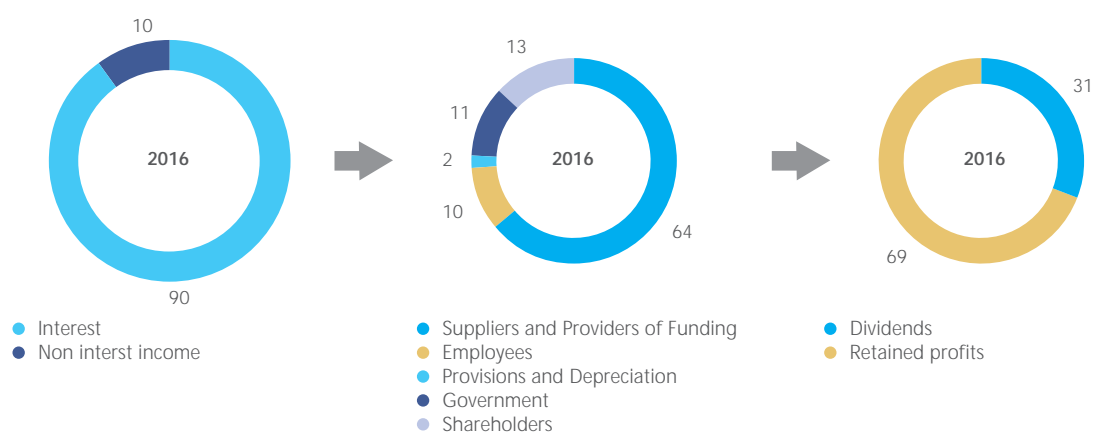
Sources and Utilisation of Income

	2012	2013	2014	2015	2016
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Sources of Income					
Interest	47,326,377	56,770,713	51,868,333	52,615,463	75,608,193
Non interest income	4,212,402	4,235,701	7,632,162	8,538,003	8,742,630
Total	51,538,779	61,006,414	59,500,495	61,153,466	84,350,823
Utilisation of income					
Employees					
Salaries and other payment to Staff	6,689,864	5,453,778	7,407,015	7,927,695	8,703,575
Suppliers and providers of funding					
Interest paid	25,368,432	31,423,945	26,966,826	26,279,934	41,236,605
Other expenses	6,214,551	6,759,719	6,824,411	6,967,804	8,501,199
	31,582,983	38,183,664	33,791,237	33,247,738	49,737,804
Provisions and depreciation					
Depreciation and amortisation	975,700	1,084,256	1,126,995	966,596	1,035,930
Impairment for loans and other losses	1,150,887	4,513,900	2,502,835	1,013,322	237,160
	2,126,587	5,598,156	3,629,830	1,979,918	1,273,090
Net Income before Government Taxes and Levies	11,139,345	11,770,816	14,672,414	17,998,115	24,636,354
Government					
Income Tax, VAT, SGT, NBT, Crop Insurance (Incl. Deferred Tax)	3,605,190	4,760,710	5,667,139	*9,623,577	10,492,948
Shareholders					
Dividends	3,378,684	3,400,244	3,430,715	3,450,948	3,517,095
Retained income	4,155,471	3,609,862	5,574,559	4,923,590	10,626,311
Total	51,538,779	61,006,414	59,500,495	61,153,466	84,350,823

*Including Super Gain Tax (SGT) payment

Sources and Utilisation of Income

%

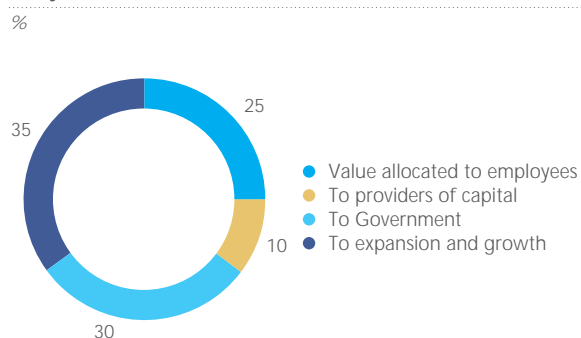


Value Added Statement

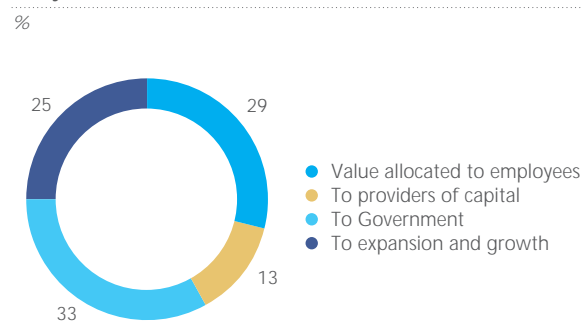
	2016	%	2015	%
	Rs 000		Rs 000	
Value added				
Income earned by providing banking services	85,143,172		59,619,355	
Cost of services	49,737,804		33,329,135	
Value added by banking services	35,405,368		26,290,220	
Non-banking income	891,629		1,083,260	
Net gain / (loss) from trading and financial investments	(1,683,978)		450,851	
Impairment for loans and other losses	(237,160)		(931,925)	
	34,375,859		26,892,406	
Value allocated to employees				
Salaries,wages and other benefits	8,703,575	25.32	7,927,695	29.48
To providers of capital				
Dividends to shareholders	3,517,095	10.23	3,450,948	12.84
To Government				
Income Tax	5,798,826		3,888,177	
Value Added Tax on financial services	3,787,448		2,381,359	
Super Gain Tax (SGT)	-		2,074,248	
Nation Building Tax on financial services	565,308		432,975	
Crop Insurance Levy	113,473		108,379	
Local taxes	13,296		13,047	
Stamp Duty	11,000	29.93	12,338	33.13
To expansion and growth				
Retained income*	10,626,311	30.92	4,923,590	18.31
Depreciation and amortization	1,035,930	3.01	966,596	3.59
Deferred Taxation	203,597	0.59	713,054	2.65
	34,375,859	100.00	26,892,406	100.00

*After adjusting for the payment of Super Gain Tax (SGT) which was imposed by the Finance Bill passed in Parliament on 20th October 2015.

Analysis of Value Addition 2016



Analysis of Value Addition 2015



Ten Year Statistical Summary

Year ended 31st December (Rs Mn)	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
OPERATING RESULTS										
Income	29,565	36,615	38,811	34,870	37,066	51,539	61,006	59,500	61,153	84,351
Interest income	26,250	32,431	34,620	30,249	33,176	47,326	56,771	51,868	52,615	75,608
Interest expense	15,190	19,752	20,040	14,703	16,530	25,368	31,424	26,967	26,280	41,237
Non interest income	3,315	4,184	4,191	4,621	3,890	4,213	4,236	7,633	8,538	8,743
Operating expenses (Incl. financial VAT & NBT)	10,040	12,078	12,853	13,436	12,148	16,294	19,575	20,470	19,824	22,969
Profit before income tax	4,335	4,785	5,918	6,731	8,388	9,876	10,008	12,064	15,050	20,145
Income tax on profit	1,313	1,566	1,566	2,267	2,123	2,342	2,998	3,059	4,601	6,002
Profit after taxation	3,021	3,219	4,352	4,464	6,265	7,534	7,010	9,005	10,449	14,143
LIABILITIES AND SHAREHOLDERS' FUNDS										
Customer deposits	175,660	186,770	210,507	239,034	291,357	341,424	387,158	419,327	527,126	623,495
Refinance borrowings	5,750	6,424	6,169	6,435	7,045	6,429	5,615	4,889	4,227	4,140
Other liabilities	32,472	42,064	38,774	42,572	42,923	50,495	66,083	87,736	128,803	154,222
Deferred tax liabilities	606	872	939	891	1,175	1,111	-	-	-	-
Shareholders' funds	18,419	20,581	23,900	30,775	37,984	46,899	51,454	60,899	65,051	77,016
Total	232,907	256,711	280,289	319,708	380,484	446,358	510,310	572,851	725,208	858,874
ASSETS										
Loans and receivables to customers (Net)	160,343	174,808	169,639	202,253	257,198	302,761	351,965	396,277	498,342	584,413
Cash, short term funds and statutory deposits with the Central Bank of Sri Lanka	32,565	35,149	38,216	30,600	33,446	39,024	29,238	33,838	35,033	52,042
Property, plant and equipment	6,083	6,866	7,180	7,428	7,835	9,418	9,521	9,305	11,474	13,945
Deferred tax assets				506	315	-	768	287	-	-
Other assets	33,916	39,888	65,254	78,921	81,690	95,155	118,818	133,144	180,360	208,474
Total	232,907	256,711	280,289	319,708	380,484	446,358	510,310	572,851	725,208	858,874
RATIOS										
Return on average shareholders funds (%)	19	17	20	16	18	18	14	16	17	20
Income growth (%)	40	24	6	(10)	6	39	18	(2)	3	38
Return on average assets (%)	1.4	1.3	1.6	1.5	1.8	1.8	1.5	1.7	1.6	1.8
Dividend cover (Times)	3.7	3.4	2.8	2.7	2.1	2.2	2.1	2.6	3.0	4.0
Property, plant and equipment to shareholders' funds (%)	33	33	30	24	21	20	19	15	18	18
Total assets to shareholders' funds (Times)	13	12	12	10	10	10	10	9	11	11
Liquid assets to liabilities (%)	22	22	29	24	22	22	23	23	24	24
SHARE INFORMATION										
Market value per share (Rs)										
- Voting	122.50	69.75	170.25	399.90	151.30	148.00	147.00	194.90	210.60	225.00
- Non Voting	53.25	32.00	104.75	214.60	83.20	112.50	119.00	152.90	177.90	190.00
Earnings per share (Rs)	12.83	13.67	18.47	18.84	16.60	18.94	17.59	22.47	25.41	34.25
Earnings per share (Adjusted) (Rs) *	7.35	7.83	10.58	10.86	15.17	18.24	16.97	21.81	25.30	34.25
Price earnings ratio	9.55	5.10	9.22	21.23	9.11	7.81	8.36	8.67	8.29	6.57
Net assets per share (Adjusted) (Rs) **	45.39	50.71	58.89	75.83	91.79	113.33	124.34	147.16	157.20	186.11
Dividend per share (Rs)	3.50	4.00	6.50	7.00	7.50	8.50	8.50	8.50	8.50	8.50
Gross dividends (Rs Mn)	824	942	1,533	1,650	2,915	3,379	3,400	3,431	3,451	3,517
OTHER INFORMATION										
No of employees	4,334	4,395	4,302	4,352	4,584	4,679	4,604	4,451	4,285	4,190
No of customer centres	167	177	186	205	240	247	250	249	249	251
No of student banking centres	152	152	153	159	164	166	168	168	168	150

* Earnings per share has been adjusted for weighted Average number of shares outstanding during the current year.

** Net Assets per share has been computed for the current number of shares issued as at 31st December 2016

Highlighted Information is based on LKASs/SLFRSs.

Quarterly Statistics

For the three months ended	* 2016				* 2015			
	December 31st	September 30th	June 30th	March 31st	December 31st	September 30th	June 30th	March 31st
Statement of financial position (Rs. Million)								
Total assets	858,874	818,557	793,124	760,059	725,208	673,078	630,843	596,566
Loans and receivables to banks and other customers	584,413	544,008	525,586	513,508	498,342	462,030	427,354	408,171
Due to other customers	623,495	580,487	556,949	530,506	527,126	496,808	461,202	435,898
Shareholders' funds	77,017	72,047	67,235	63,275	65,051	63,638	62,506	59,525
Average assets	791,164	774,237	759,463	742,633	639,709	618,335	600,087	584,709
Statement of profit or loss data (Rs 000)								
Net interest income	9,431,217	9,080,937	8,479,771	7,379,663	6,966,545	6,525,810	6,653,823	6,189,351
Net fee and commission income	1,954,498	1,734,634	1,647,120	1,712,407	1,624,927	1,482,898	1,336,539	1,331,942
Net gain/(loss) from trading	(544,869)	(727,494)	(2,594,611)	2,071,283	(498,371)	1,226,645	(602,657)	71,376
Net gain/(loss) from financial investments	4,600	342	3,990	102,781	36,831	16,791	177,940	22,296
Other operating income	1,142,180	1,000,378	2,663,660	(1,518,863)	1,257,758	(620,571)	1,298,919	276,118
Total operating income	11,987,626	11,088,797	10,199,930	9,747,271	9,387,690	8,631,573	8,864,564	7,891,083
Less :Impairment charge / (reversal) for loans and other losses	90,322	9,680	31,264	105,894	(784,871)	296,941	844,746	575,109
Net operating income	11,897,304	11,079,117	10,168,666	9,641,377	10,172,561	8,334,632	8,019,818	7,315,974
Less : Operating expenses	4,744,598	4,523,345	4,577,119	4,442,817	3,677,293	4,243,749	4,073,527	3,984,065
VAT & NBT on financial services	1,497,985	1,176,298	866,235	812,238	948,819	664,885	642,331	558,299
Provision for income tax	1,608,625	1,690,953	1,408,320	1,294,525	1,927,144	908,439	830,082	935,566
Profit for the quarter ended	4,046,096	3,688,521	3,316,992	3,091,797	3,619,305	2,517,559	2,473,878	1,838,044
Other comprehensive income for the quarter ended	1,480,842	1,072,866	610,134	(3,336,309)	435,157	(1,444,373)	356,658	(554,164)
Total comprehensive income for the quarter ended	5,526,938	4,761,387	3,927,126	(244,512)	4,054,462	1,073,186	2,830,536	1,283,880
Ordinary share information								
Market price per share (Rs)	V	NV	V	NV	V	NV	V	NV
High	235.00	202.00	228.00	194.00	216.60	180.00	207.00	176.50
Low	185.00	165.50	206.00	170.00	197.00	169.00	185.00	165.50
Closing	225.00	190.00	224.80	190.50	212.00	172.50	199.30	171.00
V- Voting NV - Non Voting								
Book value per ordinary share	186.11	174.30	162.81	153.31	160.29	156.93	154.30	147.35
Financial measures								
Profitability								
Return on average shareholders' equity (annualised) (%) **	20.24	20.12	19.66	19.27	16.77	14.77	14.14	12.21
Productivity								
Non interest expenses to total operating income (%)	39.58	40.79	44.87	45.58	39.17	49.17	45.95	50.49
Capital								
Risk weighted capital ratios								
Tier I (%)	11.22	10.40	9.77	10.05	10.53	10.60	10.45	10.87
Total (Tier II) (%)	15.27	13.44	12.97	13.48	12.70	13.04	13.01	13.70
Asset quality								
Gross NPA ratio (%) **	1.80	2.18	2.25	2.41	2.43	2.98	3.24	3.62
Net NPA ratio (%) **	0.46	0.76	0.80	0.86	0.84	1.29	1.49	1.89

Note

* Quarterly information has been amended based on classification changes made in 2016.

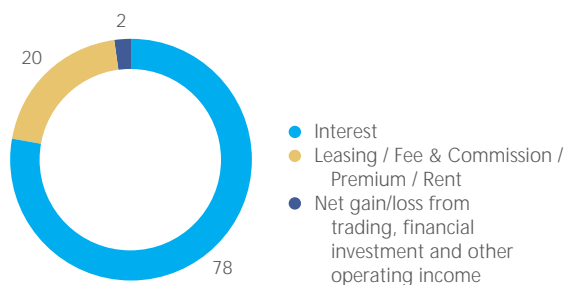
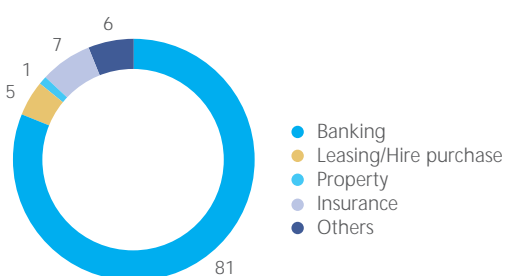
** This information has been compiled in accordance with the instructions issued by the Central Bank of Sri Lanka for interim publication which may differ from information in other disclosures.

Segmental Analysis

Business Segments	Banking		Leasing/Hirepurchase		Property		Insurance		Others		Total	
	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Interest	70,800,583	48,630,385	-	-	19,418	17,645	1,166,368	843,580	4,921,053	3,515,491	76,907,422	53,007,101
Leasing /Fee & Commission / Premium / Rent	7,243,917	5,968,744	4,807,610	3,985,078	919,957	903,694	5,737,694	4,825,842	681,994	493,638	19,391,172	16,176,996
Net Gain/(loss) from Trading & financial investment	(1,683,978)	450,851	-	-	-	-	(26,309)	62,133	(11,000)	(2,642)	(1,721,287)	510,342
Other operating income	3,182,691	2,118,408	-	-	1,200	817	19,063	44,076	192,304	18,121	3,395,258	2,181,422
Total Revenue	79,543,213	57,168,388	4,807,610	3,985,078	940,575	922,156	6,896,816	5,775,631	5,784,350	4,024,608	97,972,564	71,875,861

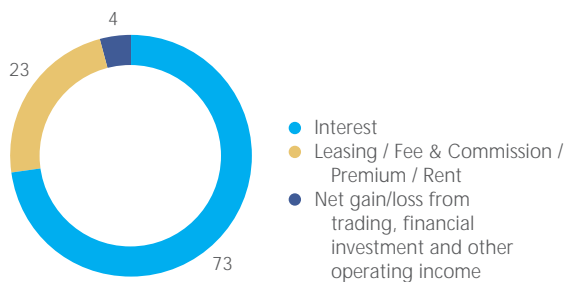
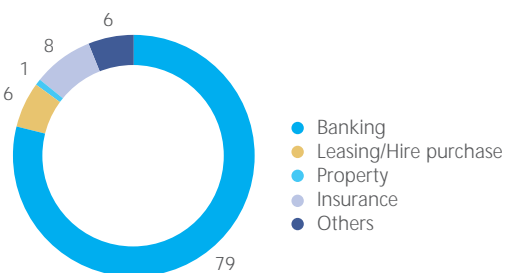
Segmental Analysis 2016

%



Segmental Analysis 2015

%



Investor Relations

1 STOCK EXCHANGE LISTING

The issued ordinary shares of Hatton National Bank PLC are listed with the Colombo Stock Exchange. The audited Income Statement for the year ended 31st December 2016 and the audited Balance Sheet of the Bank as at date have been submitted to the Colombo Stock Exchange within three months of the Balance Sheet date.

Stock Exchange code for Hatton National Bank PLC shares is "HNB". Reuter code of Hatton National Bank PLC is "HNBL"

2 ORDINARY SHAREHOLDERS

SHARE INFORMATION - VOTING

There were 4,593 registered Voting Shareholders as at 31st December 2016 (2015 - 4,619) distributed as follows.

			Resident			Non-Resident			Total		
			No of Share holders	No of Shares	%	No of Share holders	No of Shares	%	No of Share holders	No of Shares	%
1	-	1,000	2,603	661,487	0.30	38	13,147	0.01	2,641	674,634	0.22
1,001	-	10,000	1,256	3,978,891	1.80	48	183,451	0.20	1,304	4,162,342	1.34
10,001	-	100,000	493	14,762,156	6.66	27	903,038	1.00	520	15,665,194	5.02
100,001	-	1,000,000	62	16,047,292	7.24	27	9,394,394	10.42	89	25,441,686	8.16
Over		1,000,000	14	186,125,718	84.00	25	79,700,137	88.37	39	265,825,855	85.26
			4,428	221,575,544	100.00	165	90,194,167	100.00	4,593	311,769,711	100.00

ANALYSIS OF SHAREHOLDERS

Resident / Non-Resident

	31st December 2016			31st December 2015		
	No of Share holders	No of Shares	%	No of Share holders	No of Shares	%
Resident	4,428	221,575,544	71.07	4,440	217,246,155	71.06
Non-Resident	165	90,194,167	28.93	179	88,475,126	28.94
Total	4,593	311,769,711	100.00	4,619	305,721,281	100.00

Individuals / Institutions

	31st December 2016			31st December 2015		
	No Share holders	No of Shares	%	No of Share holders	No of Shares	%
Individuals	4,255	56,257,435	18.04	4,287	55,579,308	18.18
Institutions	338	255,512,276	81.96	332	250,141,973	81.82
Total	4,593	311,769,711	100.00	4,619	305,721,281	100.00

As at 31/12/2016 the average size of holding of ordinary shareholding was 67,879 voting shares. (31/12/2015 - 66,188 voting shares).

As per Rule No. 7.6 (iv) of the Listing Rules of the Colombo Stock Exchange, percentage of public holding of voting shares as at 31st December 2016 was 61% (61% as at 31st December 2015).

As per Rule No. 7.13.1 of the Listing Rules of the Colombo Stock Exchange, No. of shareholders representing public holding as at 31st December 2016 - 4,571 (4,595 as at 31st December 2015).

*18,987,071 shares remain unregistered arising from a direction given by the CBSL dated 26th August 2010 in terms of Sec. 12(IC)(c) of the Banking Act, and these unregistered shares are not included herein.

Investor Relations

SHARE INFORMATION - NON VOTING

There were 10,329 registered Non Voting Shareholders as at 31st December 2016 (2015 - 10,660) distributed as follows.

			Resident			Non-Resident			Total		
			No of Share holders	No of Shares	%	No of Share holders	No of Shares	%	No of Share holders	No of Shares	%
1	-	1,000	6,245	2,077,727	4.35	46	15,417	0.04	6,291	2,093,144	2.52
1,001	-	10,000	3,333	10,042,105	21.04	47	159,309	0.45	3,380	10,201,414	12.28
10,001	-	100,000	568	14,567,848	30.51	14	491,310	1.39	582	15,059,158	18.13
100,001	-	1,000,000	55	13,784,176	28.88	8	3,270,213	9.26	63	17,054,389	20.53
Over		1,000,000	5	7,263,978	15.22	8	31,386,609	88.86	13	38,650,587	46.54
			10,206	47,735,834	100.00	123	35,322,858	100.00	10,329	83,058,692	100.00

ANALYSIS OF SHAREHOLDERS

Resident / Non-Resident

	31st December 2016			31st December 2015		
	No of Share holders	No of Shares	%	No of Share holders	No of Shares	%
Resident	10,206	47,735,834	57.47	10,515	50,323,998	61.81
Non-Resident	123	35,322,858	42.53	145	31,091,927	38.19
Total	10,329	83,058,692	100.00	10,660	81,415,925	100.00

Individuals / Institutions

	31st December 2016			31st December 2015		
	No Share holders	No of Shares	%	No of Share holders	No of Shares	%
Individuals	10,061	32,439,339	39.06	10,376	34,743,795	42.67
Institutions	268	50,619,353	60.94	284	46,672,130	57.33
Total	10,329	83,058,692	100.00	10,660	81,415,925	100.00

As at 31/12/2016 the average size of holding of ordinary shareholding was 8,041 non-voting shares. (31/12/2015 - 7,638 non-voting shares)

As per Rule No. 7.6 (iv) of the Listing Rules of the Colombo Stock Exchange, percentage of public holding of non-voting shares as at 31st December 2016 was 99% (99% as at 31st December 2015).

As per Rule No. 7.13.1 of the Listing Rules of the Colombo Stock Exchange, No. of shareholders representing public holding as at 31st December 2016 - 10,317 (10,647 as at 31st December 2015).

3 SHARE TRADING

VOTING	2016	2015
Number of transactions	4,573	8,287
Number of shares traded (Mn)	20	35
Value of shares traded (Rs Mn)	4,230	7,701

NON VOTING	2016	2015
Number of transactions	3,654	6,051
Number of shares traded (Mn)	12	15
Value of shares traded (Rs Mn)	2,187	2,611

4 DIVIDENDS

	2016	2015
Interim (Rs)	1.50 Paid in December 2016	1.50 Paid in December 2015
Final (Rs) - Cash Dividend	3.50 Propose to be paid in April 2017	3.50 Paid in April 2016
Final (Rs) - Scrip Dividend	3.50 Propose to be paid in April 2017	3.50 Paid in April 2016
Dividend payout ratio (%)	24.87	33.03

5 EARNINGS

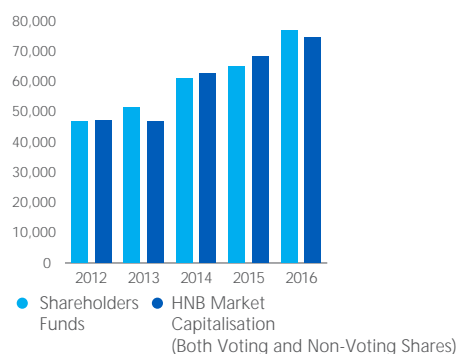
Earnings per share (Rs)	34.25	25.41
Price earnings ratio(Times)-Voting Shares	6.57	8.29

6 MARKET VALUE

	Highest Rs.	Lowest Rs.	Year End Rs.
2012 - Voting	170.00	130.00	148.00
- Non Voting	121.70	77.50	112.50
2013 - Voting	176.00	140.00	147.00
- Non Voting	132.50	108.20	119.00
2014 - Voting	205.00	145.10	194.90
- Non Voting	153.20	116.60	152.90
2015 - Voting	242.00	192.00	210.60
- Non Voting	187.00	150.00	177.90
2016 - Voting	235.00	185.00	225.00
- Non Voting	202.00	165.50	190.00

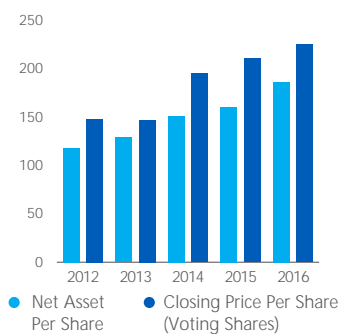
Shareholders' Funds and Market Capitalisation

(Rs.Mn)



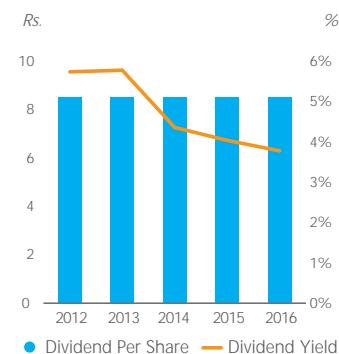
Net Asset Per Share and Closing Price Per Share

(Rs.)



Dividend per Share and Dividend Yield

(Rs.)



7 MARKET CAPITALIZATION (AS AT 31ST DECEMBER)

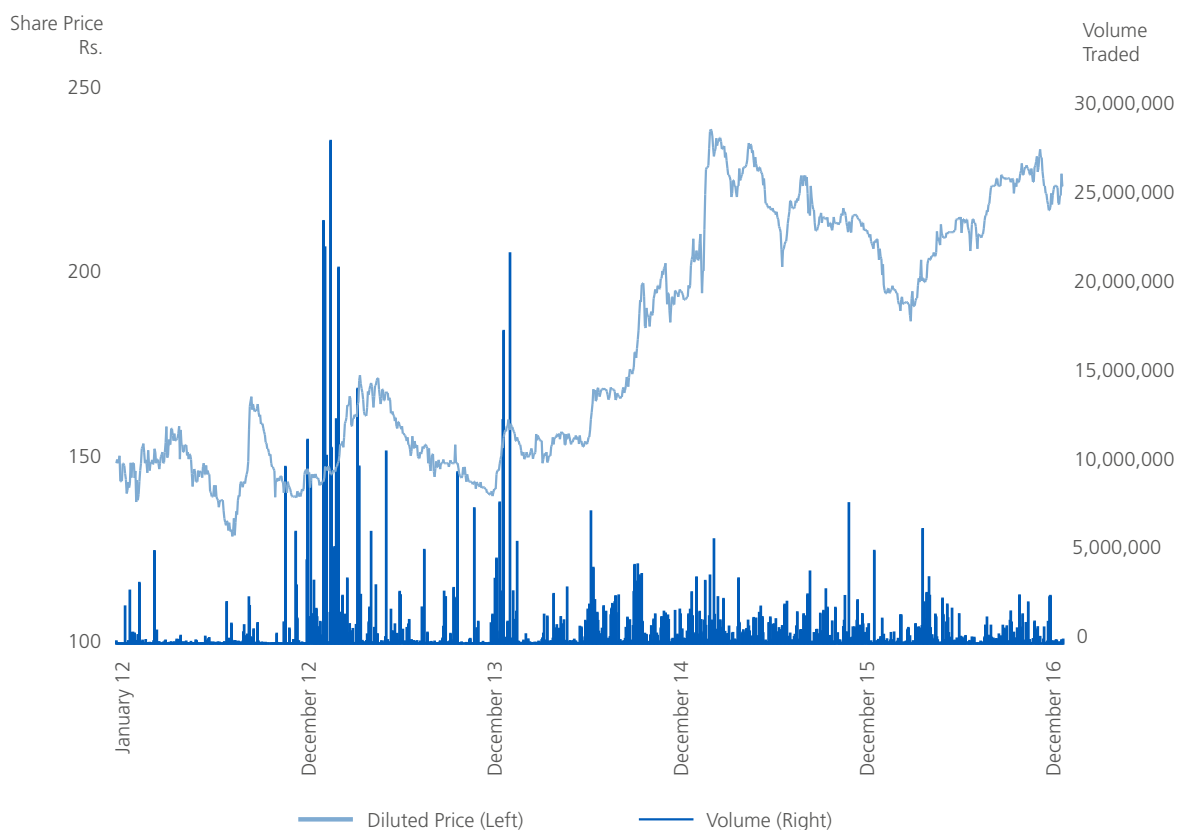
	Capital & Reserves Rs Mn	HNB Market Capitalization Rs Mn	CSE Market Capitalization Rs Mn	HNB Market Capitalization as a % of CSE Market Capitalization	Market Capitalization Ranking
2012	46,899	47,012	2,167,134	2.17	11
2013	51,454	46,945	2,459,897	1.91	11
2014	60,899	62,706	3,104,863	2.02	11
2015	65,051	68,320	2,937,998	2.33	9
2016	77,017	74,420	2,745,410	2.71	7

* HNB Market Capitalization includes only Voting shares

Investor Relations

8 INFORMATION ON MOVEMENT IN SHARE CAPITAL

Year	Issue	Basis	No of Shares
	Prior to public issue		50,000
1971	Public issue		220,000
1977	Rights issue (@ Rs 10/-)	42:50	230,000
1980	Rights issue (@ Rs 10/-)	1:1	500,000
1982	Bonus	1:1	1,000,000
1988	Bonus	1:1	2,000,000
1990	Bonus	1:2	2,000,000
1993	Bonus	1:1	6,000,000
1996	Bonus	2:3	8,000,000
1998	Bonus	1:2	10,000,000
1999	Bonus	2:3	20,000,000
1999	Rights (non voting @ Rs 70/-)	3:10	15,000,000
2002	Bonus	1:10	6,500,000
2004	Rights (voting @ Rs 55.00 and non voting @ Rs 33.00)	2:5	28,600,000
2005	Issue of underlying shares for GDR	-	17,664,700
2007	Bonus	1:1	117,764,700
2009	Shares issued under ESOP		240,747
2010	Shares issued under ESOP		2,198,875
2011	Sub division of shares	1:2	119,179,782
2011	Rights (voting @ Rs 219.50 and non voting @ Rs 119.50)	1:10	21,858,851
2011	Private placement of unsubscribed rights		8,975,700
2011	Shares issued under ESOP		613,488
2012	Scrip Dividend		7,890,528
2012	Shares issued under ESOP		759,078
2013	Shares issued under ESOP		2,308,752
2014	Shares issued under ESOP		3,042,455
2015	Shares issued under ESOP		3,223,714
2016	Shares issued under ESOP		1,314,043
2016	Scrip Dividend		6,680,061
	Total		413,815,474



20 MAJOR SHAREHOLDERS (VOTING) OF THE BANK AS AT 31ST DECEMBER 2016

	Name	% on total capital	% on total voting capital	No. of Shares 2016	No. of Shares 2015
1.	Employees Provident Fund	7.82	9.78	32,352,748	31,836,612
2.	Sri Lanka Insurance Corporation - Life Fund	7.74	9.68	32,014,697	31,503,954
3.	Milford Exports (Ceylon) Limited	6.34	**7.94	26,247,009	25,828,280
4.	Mr.Sohli Edelji Captain	5.82	7.28	24,089,530	23,705,220
5.	Stassen Exports Ltd	5.50	**6.88	22,750,036	22,387,096
6.	Sri Lanka Insurance Corporation - General Fund	3.96	4.96	16,393,058	16,131,533
7.	Sonetto Holdings Limited	3.61	4.52	14,936,204	14,697,921
8.	HSBC Int'l Nominees Ltd-JPMLU-Franklin Templeton Investment	2.68	3.35	11,084,554	12,012,761
9.	Distilleries Company of Sri Lanka PLC	2.46	**3.08	10,178,656	10,016,272
10.	National Savings Bank	2.30	2.88	9,523,878	9,371,940
11.	Standard Chartered Bank Singapore S/A HL Bank Singapore	1.52	1.90	6,270,219	6,420,188
12.	The Bank of New York Mellon SA/NV-CF Ruffer Total return Fund	1.26	1.58	5,221,591	5,138,289
13.	CitiBank Newyork S/A Norges Bank Account 2	0.86	1.08	3,558,424	2,711,926
14.	The Bank of New York Mellon SA/NV-CF Ruffer Absolute return	0.85	1.06	3,504,886	3,448,972
15.	RBC Investor Services Bank - COELI SICAV I - Frontier Market	0.74	0.93	3,068,364	1,330,799
16.	Ms.Leesha Anne Captain	0.70	0.88	2,916,548	2,870,020
17.	HSBC Int'l Nom Ltd-JPMCB-Templeton Global Investment Trust	0.68	0.85	2,818,429	1,520,932
18.	Mrs. Cheryl Susan De Fonseka	0.67	0.84	2,763,993	2,719,898
19.	Citi Group Global Markets Ltd Agency Trading Prop. Sec.	0.66	0.80	2,731,986	3,949,446
20.	BNYM SA/NV-CF Ruffer Investment Funds: CF Ruffer Pacific	0.64	0.81	2,671,131	2,628,518
	Sub total	56.81	71.08	235,095,941	230,230,577
	* Unregistered Shares	4.59	5.74	18,987,071	18,684,164
	Balance held by 4,573 voting shareholders	18.53	23.18	76,673,770	75,490,704
	(Total voting shareholders- 4,593)				
	Total voting shares	79.93	100.00	330,756,782	324,405,445
	Shares held by 10,329 Non-voting shareholders	20.07		83,058,692	81,415,925
	Total No. of Ordinary shares	100.00		413,815,474	405,821,370

*18,987,071 shares remain unregistered arising from a direction given by the CBSL dated 26th August 2010 in terms of Sec. 12(IC)(c) of the Banking Act.

**Pursuant to the provisions of the Banking Act Directions No. 1 of 2007, the total collective voting rights in the Bank, of Milford Exports (Ceylon) Limited, Stassen Exports Limited and Distilleries Company of Sri Lanka (who collectively hold 17.90% of the voting shares of the Bank) are limited to 10% of the total voting rights of the Bank with effect from 15th March 2012 as the voting rights in excess of such percentage is deemed invalid from that date.

Investor Relations

20 MAJOR SHAREHOLDERS (NON-VOTING) OF THE BANK AS AT 31ST DECEMBER 2016

	Name	% on total capital	% on total non-voting capital	No. of Shares 2016	No. of Shares 2015
1.	HSBC Int'l Nom Ltd-UBS AG Zurich	1.74	8.67	7,203,090	7,083,734
2.	CITI Bank Newyork S/A Norges Bank Account 2	1.48	7.37	6,125,146	893,383
3.	HSBC Intl nominees Ltd-JPMLU-Franklin Templeton Invest	1.40	6.96	5,778,350	7,625,980
4.	BNYM SA/NV-Frontaura Global Frontier Fund LLC	1.05	5.23	4,339,801	4,547,707
5.	The Bank of New York Mellon SA/NV-CF Ruffer Total Return Fund	0.63	3.13	2,601,605	2,557,103
6.	BNYM SA/NV-Neon Liberty Lorikeet Master Fund LP	0.62	3.10	2,576,898	745,545
7.	Akbar Brothers Pvt Ltd A/c No. 01	0.60	2.98	2,478,154	2,030,748
8.	The Bank of New York Mellon SA/NV-CF Ruffer Absolute Return	0.42	2.09	1,733,008	1,703,364
9.	Mr. Sohli Edelji Captain	0.35	1.77	1,467,949	1,442,839
10.	Rubber Investment Trust Limited A/c # 01	0.29	1.43	1,184,341	1,164,083
11.	Union Assurance PLC No. 1 A/c	0.27	1.36	1,131,457	1,047,778
12.	BNY-CF Ruffer Investment Funds:CF Ruffer Pacific Fund	0.25	1.24	1,028,711	1,011,115
13.	Mr. Jayampathi Divale Bandaranayake	0.24	1.21	1,002,077	980,022
14.	Northern Trust Company S/A Polar Capital Funds PLC	0.24	1.18	977,006	1,220,030
15.	Employees Trust Fund Board	0.22	1.10	909,800	894,238
16.	CITI Bank NY S/A Forward International Dividend Fund	0.19	0.96	801,235	1,142,944
17.	The Ceylon Guardian Investment Trust PLC A/c #02	0.18	0.90	750,857	580,751
18.	Deutsche Bank AG as Trustee for JB Vantage Value Equity Fund	0.18	0.90	749,353	667,731
19.	The Ceylon Investment PLC A/c No. 2	0.15	0.74	614,227	603,721
20.	Hatton National Bank PLC A/c No. 2	0.14	0.70	584,735	574,733
	Sub total	10.64	53.02	44,037,800	38,517,549
	Balance held by 10,309 Non-voting shareholders	9.43	46.98	39,020,892	42,898,376
	(Total Non-voting shareholders-10,329)				
	Total Non-voting shares	20.07	100.00	83,058,692	81,415,925
	Shares held by 4,593 voting shareholders	75.34		311,769,711	305,721,281
	* Unregistered voting Shares	4.59		18,987,071	18,684,164
	Total voting shares	79.93		330,756,782	324,405,445
	Total No. of Ordinary shares	100.00		413,815,474	405,821,370

*18,987,071 shares remain unregistered arising from a direction given by the CBSL dated 26th August 2010 in terms of Sec. 12(IC)(c) of the Banking Act.

12. DEBENTURE INFORMATION**HNB SUBORDINATED DEBENTURES 2006****i) Market Value**

12 months ended 31st December 2016

These debentures have not traded during the year ended 31st December 2016

ii) Interest Rate

12 months ended 31st December	2016				2015			
	Amount Rs 000	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt.Security %	Amount Rs 000	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt.Security %
15 year Fixed Rate (11.00% p.a.) (Zero Coupon)	330,287	-	11.00	13.37	297,488	-	11.00	10.72
18 year Fixed Rate (11.25% p.a.) (Zero Coupon)	629,495	-	11.25	13.76	565,709	-	11.25	11.18

HNB SUBORDINATED DEBENTURES 2007**i) Market Value**

12 months ended 31st December 2016

These debentures have not traded during the year ended 31st December 2016

ii) Interest Rate

12 months ended 31st December	2016				2015			
	Amount Rs 000	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt.Security %	Amount Rs 000	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt.Security %
10 year Fixed Rate (16.00% p.a.)	540,000	16.00	16.00	11.27	540,000	16.00	16.00	8.73
15 year Fixed Rate (16.75% p.a.)	758,625	16.75	16.75	13.64	758,625	16.75	16.75	10.80

HNB SUBORDINATED DEBENTURES 2011**i) Market Value**

12 months ended 31st December 2016

These debentures have not traded during the year ended 31st December 2016

ii) Interest Rate

12 months ended 31st December	2016				2015			
	Amount Rs 000	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt.Security %	Amount Rs 000	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt.Security %
10 year Fixed Rate (11.50% p.a.)	2,115,628	11.50	11.83	13.46	2,000,000	11.50	11.83	10.68

Investor Relations

HNB SUBORDINATED DEBENTURES 2013

i) Market Value

12 months ended 31st December 2016

These debentures have not traded during the year ended 31st December 2016

ii) Interest Rate

12 months ended 31st December	2016				2015			
	Amount Rs 000	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt.Security %	Amount Rs 000	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt.Security %
5 year Fixed Rate (14.00% p.a.)	4,309,918	14.00	14.00	11.17	4,309,918	14.00	14.00	8.47

HNB SENIOR DEBENTURES 2013

i) Market Value

12 months ended 31st December 2016

These debentures have not traded during the year ended 31st December 2016

ii) Interest Rate

12 months ended 31st December	2016				2015			
	Amount Rs 000	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt.Security %	Amount Rs 000	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt.Security %
10 year Fixed Rate (14.25% p.a.)	1,536,302	8.00	14.25	12.35	1,490,742	8.00	14.25	9.98

HNB SENIOR DEBENTURES 2014

i) Market Value

12 months ended 31st December 2016

	Market Value			Traded Yield		
	Highest Rs	Lowest Rs	Last Traded Rs	Highest %	Lowest %	Last Traded %
3 year Fixed Rate (6.88% p.a.)	94.50	94.00	94.50	11.59	10.58	11.59
5 year Fixed Rate (7.75% p.a.)	89.00	89.00	89.00	11.38	11.38	11.38

ii) Interest Rate

12 months ended 31st December	2016				2015			
	Amount Rs 000	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt.Security %	Amount Rs 000	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt.Security %
03 year Fixed Rate (6.88% p.a.)	164,225	6.88	7.00	10.15	158,720	6.88	7.00	8.21
05 year Fixed Rate (7.75% p.a.)	2,864,961	7.75	7.90	11.85	2,757,240	7.75	7.90	9.25
10 year Fixed Rate (8.33% p.a.)	87,569	8.33	8.50	12.49	84,040	8.33	8.50	9.97

HNB SUBORDINATED DEBENTURES 2016 - March

i) Market Value

12 months ended 31st December 2016

	Market Value			Traded Yield		
	Highest Rs	Lowest Rs	Last Traded Rs	Highest %	Lowest %	Last Traded %
5 year Fixed Rate (11.25% p.a.)	93.40	91.00	91.50	14.05	13.23	13.98

ii) Interest Rate

12 months ended 31st December	2016				2015			
	Amount Rs 000	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt.Security %	Amount Rs 000	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt.Security %
5 year Fixed Rate (11.25% p.a.)	7,599,795	11.25	11.25	12.04	-	-	-	-

Number of Debentures	Class	Consideration received (Rs)	Reason for the issue	Any material change in the use of funds
70,000,000	Subordinated, Unsecured, Redeemable, Rated Debentures	7,000,000,000	I. To increase the Tier II capital base of the Bank. II. To minimize mismatch of durations between assets and liabilities in the Bank's balance sheet III. To strengthen the Bank's liquidity position and to increase the loan portfolio	No

HNB SUBORDINATED DEBENTURES 2016 - November

i) Market Value

12 months ended 31st December 2016

	Market Value			Traded Yield		
	Highest Rs	Lowest Rs	Last Traded Rs	Highest %	Lowest %	Last Traded %
7 year Fixed Rate (13.00% p.a.)	100.00	99.80	100.00	13.04	12.98	12.98

ii) Interest Rate

12 months ended 31st December	2016				2015			
	Amount Rs 000	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt.Security %	Amount Rs 000	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt.Security %
5 year Fixed Rate (11.75% p.a.)	2,039,274	11.75	11.75	12.15	-	-	-	-
7 year Fixed Rate (13.00% p.a.)	4,086,904	13.00	13.00	12.51	-	-	-	-

Investor Relations

Number of Debentures	Class	Consideration received (Rs)	Reason for the issue	Any material change in the use of funds
20,000,000	Subordinated, Unsecured, Redeemable, Rated Debentures	2,000,000,000	I. To increase the Tier II capital base of the Bank II. To strengthen the Bank's liquidity position and thereby to increase the loan portfolio	No
40,000,000		4,000,000,000		

Note: HNB Senior Debenture information is listed under Debt Securities issued, Note 46 of the Financial Position.

Note: HNB Subordinated Debenture information is listed under Note 47 of the Financial Position.

Ratios	2016	2015
Debt to Equity Ratio (%)*	166	146
Interest Cover (Times)**	4.8	5.3
Liquidity Asset Ratio (LAR) (%)	24.23	23.89

*Debt includes Borrowings and Debentures

**Includes interest paid on Borrowings and Debentures

Sustainability Reporting Supplement

MEMBERSHIP IN ASSOCIATIONS

HNB is a member and/or represented at the following membership forums with the objective of having access to new insights, trends and research on various business related topics pertaining to the management of economic, social and environmental impacts, continuous learning and development and to influence sustainable business practices.

Corporate Memberships	Corporate Training Partners	Significant Involvement by our Key Management Personnel
<ul style="list-style-type: none"> • American Chamber of Commerce (Amcham) • Asian Bankers Association • Association of Professional Bankers, Sri Lanka • Banking with the Poor Network, Singapore • Biodiversity Sri Lanka • CSR Sri Lanka • Employers Federation of Ceylon • International Chamber of Commerce Sri Lanka • Lanka SWIFT User Group • Sri Lanka Banks Association • Sri Lanka Forex Association • The Ceylon Chamber of Commerce • The Clearing Association of Bankers • The Institute of Bankers of Sri Lanka • The National Chamber of Commerce Sri Lanka 	<ul style="list-style-type: none"> • The Chartered Institute of Management Accountants (UK) - Sri Lanka Division • Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) 	<ul style="list-style-type: none"> • Sri Lanka Banks Association - Chairman 2015/16 • Bio Diversity Sri Lanka - Advisory Committee Member • Financial Ombudsman Sri Lanka - Chairman 2015/16 • Lanka Financial Services Bureau Ltd - Chairman • Association of HR Professionals, Sri Lanka - Immediate Past President • Association of Banking Sector Risk Professionals (CRO Forum) 2015/16 - President • FinCSIRT - Steering Committee Member • Technical Evaluation Committee for procurement of a new IT System for CRIB - Chairman • Chief Internal Auditors of Banks Forum - representing CIAs of all the banks in Sri Lanka - President • Practicing Accountants in Business Committee - Institute of Chartered Accountants of Sri Lanka - Committee Member • Institute of Internal Auditors - IIA Sri Lanka Chapter - Committee Member • Institute of Chartered Accountants of Sri Lanka - Brand Development & Corporate Communications Committee - Committee Member • Institute of Chartered Accountants of Sri Lanka - Sub Committee on Strengthening Reporting & Practicing in Small & Medium Size Enterprises - Committee Member • Asian Bankers Association - Member, Policy Advocacy Committee • Association of Professional Bankers - Council Member • Central Bank of Sri Lanka - Banks' Technical Advisory Committee Member • Sri Lanka Banks Association - Technical Advisory Committee Member • CFA Sri Lanka Society - Director 2015/16

Sustainability Reporting Supplement

OUR COMMITMENT TO SUSTAINABLE BUSINESS PRACTICES

Measurement	Achievement
Grievances about environmental and human rights impacts and discriminations filed, addressed, and resolved through formal grievance mechanisms	No significant incidents recorded during the year under review
Legal actions for anti-competitive behaviour, anti-trust, and monopoly practices and their outcomes	
Significant fines and total number of non-monetary sanctions for non-compliance with environmental and social laws and regulations	
Negative impact on local communities due to business operations and grievances about impacts on society filed, addressed, and resolved through formal grievance mechanisms	
Incidents of non-compliance with regulations and voluntary codes concerning product and service information and labelling	
Incidents of non-compliance with regulations and voluntary codes concerning marketing communications, including advertising, promotion, and sponsorship	
Substantiated complaints regarding breaches of customer privacy and losses of customer data	
Significant fines for non-compliance with laws and regulations concerning the provision and use of products and services	
Sale of banned or disputed products	

2016 - DIRECT ECONOMIC VALUE GENERATED AND DISTRIBUTED

For the year ended 31st December	2016 Rs 000	2015 Rs 000
Direct Economic value generated		
Interest Income	75,608,193	52,615,463
Fee Commission Income	7,139,253	5,874,928
Net Gain/(loss) from trading & Financial investment	(1,683,978)	450,851
Other operating income	3,287,355	2,212,224
Total Direct Economic value generated	84,350,823	61,153,466
Economic value distributed		
To Depositors/Debenture Holders as Interest	41,236,605	26,279,934
To Employees as Emoluments	8,703,575	7,927,695
Depreciation/ Amortisation Set Aside	1,035,930	966,596
Impairment charge for loans and other losses	237,160	931,925
To providers of Supplies and services	7,824,165	6,587,879
To Government as Taxation	10,289,351	8,910,523
- Income tax	5,798,826	3,888,177
- VAT and NBT on Financial Services	4,352,756	2,814,334
- Super Gains Tax (SGT)	-	2,074,248
- Crop Insurance Levy	113,473	108,379
- Stamp duty and Other Local taxes	24,296	25,385
To Central Bank of Sri Lanka as Deposit insurance premium	664,611	448,503
To Shareholders as Dividends	3,517,095	3,450,948
To Community as Donation/CSR	20,451	12,819
Total Economic value distributed	73,528,943	55,516,822
Economic Value Retained	10,821,880	5,636,644

Independent Assurance Report



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Independent Assurance Report to Hatton National Bank PLC on the Sustainability Reporting Criteria Presented in the Integrated Annual Report- 2016

Introduction and scope of the engagement

The management of Hatton National Bank PLC ("the Bank") engaged us to provide an independent assurance on the following elements of the sustainability reporting indicators in the annual report- 2016 ("the Report").

- Reasonable assurance on the information on financial performance as specified on page 352 of the Report.
- Limited assurance on other information presented in the Report, prepared in accordance with the requirements of the Global Reporting Initiative G4 'In accordance' - Core guidelines.

Basis of our work and level of assurance

We performed our procedures to provide limited assurance in accordance with International Standard on Assurance Engagements (ISAE 3000): 'Assurance Engagements Other than Audits or Reviews of Historical Financial Information', issued by the Institute of Chartered Accountants of Sri Lanka ("CASL").

The evaluation criteria used for this limited assurance engagement are based on the Sustainability Reporting Guidelines ("GRI Guidelines") and related information in particular, the requirements to achieve GRI G4 'In accordance' - Core guideline publication, publicly available at GRI's global website at "www.globalreporting.org".

Our engagement provides limited assurance as well as reasonable assurance. A limited assurance engagement is substantially less in scope than a reasonable assurance engagement conducted in accordance with ISAE-3000 and consequently does not enable to obtain assurance that we would become

aware of all significant matters that might be identified in a reasonable assurance engagement. Accordingly, we do not express an opinion providing reasonable assurance.

Management of the Bank's responsibility for the Report

The management of the bank is responsible for the preparation of the self-declaration, the information and statements contained within the Report, and for maintaining adequate records and internal controls that are designed to support the sustaining reporting process in line with the GRI Sustainability Reporting Guidelines.

Ernst & Young's responsibility

Our responsibility is to express a conclusion as to whether we have become aware of any matter that causes us to believe that the Report is not prepared in accordance with the requirements of the Global Reporting Initiative G4 'In accordance' - Core guidelines. This report is made solely to the Bank in accordance with our engagement letter dated 4th January 2017. We disclaim any assumption of responsibility for any reliance on this report to any person other than the bank or for any purpose other than that for which it was prepared. In conducting our engagement, we have complied with the independence requirements of the Code for Ethics for Professional Accountants issued by the CASL.

Key assurance procedures

We planned and performed our procedures to obtain the information and explanations considered necessary to provide sufficient evidence to support our limited assurance conclusions. Key assurance procedures included:

- Interviewing relevant the bank's personnel to understand the process for collection, analysis, aggregation and presentation of data.
- Reviewing and validation of the information contained in the Report.

- Checking the calculations performed by the bank on a sample basis through recalculation.
- Reconciling and agreeing the data on financial performance are properly derived from the bank's audited financial statements for the year ended 31 December 2016.
- Comparison of the content of the Report against the criteria for a Global Reporting Initiative G4 'In accordance' - Core guidelines.

Our procedures did not include testing electronic systems used to collect and aggregate the information.

Limitations and considerations

Environmental and social performance data are subject to inherent limitations given their nature and the methods used for determining, calculating and estimating such data.

Conclusion

Based on the procedures performed, as described above, we conclude that:

- The information on financial performance as specified on page 352 of the Report are properly derived from the audited financial statements of the Bank for the year ended 31 December 2016.
- Nothing has come to our attention that causes us to believe that other information presented in the Report are not fairly presented, in all material respects, in accordance with the Bank's sustainability practices and policies some of which are derived from GRI-G4-'In accordance' Core Sustainability Reporting Guidelines.

Chartered Accountants

23rd February 2017
Colombo

Partners: W R H Fernando FCA FCMA M P D Cooray FCA FCMA R N de Saram ACA FCMA Ms. N A De Silva FCA Ms. Y A De Silva FCA W K B S P Fernando FCA FCMA
Ms. K R M Fernando FCA ACMA Ms. L K H L Fonseka FCA A P A Gunasekera FCA FCMA A Herath FCA D K Hulangamuwa FCA FCMA LLB (Lond) H M A Jayasinghe FCA FCMA
Ms. A A Ludowyke FCA FCMA Ms. G G S Manatunga FCA N M Suleiman ACA ACMA B E Wijesuriya FCA FCMA

Principal T P M Ruberu FCMA FCCA

A member firm of Ernst & Young Global Limited

Independent Assurance Statement



Independent Assurance Statement

Scope and Approach

DNV GL represented by DNV GL Business Assurance Lanka (Private) Limited has been commissioned by the management of Hatton National Bank PLC ('HNB' or 'the Bank') to carry out an independent assurance engagement (Type 2, Moderate level) for the non-financial - qualitative and quantitative information (sustainability performance) reported in HNB PLC Annual Report 2016 ('the Report') in its printed format for the financial year ending 31st December 2016. The sustainability disclosures in this Report is prepared by the Bank, based on the 'in accordance' – Core reporting option of the Global Reporting Initiative (GRI) Sustainability Reporting Guidelines Version 4 (GRI G4) and International <IR> Framework of The International Integrated Reporting Council (IIRC).

We performed our work using AccountAbility's AA1000 Assurance Standard 2008 (AA1000 AS) and DNV GL's assurance methodology VeriSustain^{TM1}, which is based on our professional experience, international assurance best practice including International Standard on Assurance Engagements 3000 (ISAE 3000) and the Global Reporting Initiative (GRI) Sustainability Reporting Guidelines. Our assurance engagement was planned and carried out in February - 2017.

The intended user of this assurance statement is the management of Bank ('the Management'). We disclaim any liability or responsibility to a third party for decisions, whether investment or otherwise, based on this assurance statement.

The reporting aspect boundary of sustainability performance is based on internal and external materiality assessment covering HNB's operations and key internal and external stakeholders, as set out in the Report.

We planned and performed our work to obtain the evidence we considered necessary to provide a basis for our assurance opinion and the process did not involve engagement with external stakeholders.

Responsibilities of the Management of HNB and of the assurance providers

The management of HNB have sole responsibility for the preparation of the Report as well as the processes for collecting, analysing and reporting the information presented in the Report. In performing our assurance work, our responsibility is to the management of HNB; however, our statement represents our independent opinion and is intended to inform the outcome of our assurance to the stakeholders of HNB. DNV GL was not involved in the preparation of any statements or data included in the Report except for this Assurance Statement.

DNV GL did not provide any other services to HNB, which would have constituted a conflict of interest with this assurance engagement.

DNV GL's assurance engagements are based on the assumption that the data and information provided by the client to us as part of our review have been provided in good faith. We were not involved in the preparation of any statements or data included in the Report except for this Assurance Statement. DNV GL expressly disclaims any liability or co-responsibility for any decision a person or an entity may make based on this Assurance Statement.

Basis of our opinion

A multi-disciplinary team of sustainability and assurance specialists performed work at HNB's Corporate/ Head Office, and as part of assurance we visited sample banking operations in Colombo, Sri Lanka. We undertook the following activities:

- Review of HNB's approach to stakeholder engagement and materiality determination process and the outcome as reported in this Report. We did not have any direct engagement with external stakeholders;
- Interviews with selected senior managers responsible for management of sustainability issues and review of selected evidence to support issues discussed. We were free to choose interviewees and interviewed those with overall responsibility to deliver the Company's sustainability objectives;
- Site visits to City Office and five Retail Customer Centres: Bambalapitiya, Pettah, Kirullapone, Kotte and one Islamic banking operations to review processes and systems for preparing site level sustainability data and implementation of sustainability strategy. We were free to choose sites we visited;
- Review of supporting evidence for key claims and data in the Report;
- Review of the processes for gathering and consolidating the specified performance data and, for a sample, checking the data consolidation. The reported data on economic performance and other financial data are based on audited financial statements issued by the Company's statutory auditors;
- An independent assessment of HNB's reporting against the Global Reporting Initiative (GRI) G4 Guidelines and the reporting requirements for its 'in accordance' – Core option.

During the assurance process, we did not come across limitations to the scope of the agreed assurance engagement.

¹The VeriSustain protocol is available on www.dnvgl.com

Opinion

On the basis of the verification undertaken, nothing came to our attention to suggest that the Report does not properly describe HNB's adherence to the GRI G4 reporting requirements including the Principles for Defining Report Content, representation of the material Aspects, related strategies and Disclosures on Management Approach and Performance Indicators as below:

- **General Standard Disclosures:** The reported information on General Standard Disclosure generally meets the disclosure requirements for the 'in accordance' – Core option of reporting and the reasons for omissions and partial disclosure were explained to us and also brought out within the Report.
- **Specific Standard Disclosures:** The Report describes the generic Disclosures on Management Approach (DMA) and Performance Indicators for identified material Aspects presented within the Report as below:
 - o Economic Performance (EC1,2 3,4)
 - o Indirect Economic Impacts (EC7)
 - o Procurement practices (EC9)
 - o Product Portfolio (FS6,7,8)
 - o Product and Service Labelling (PR3,4, 5)
 - o Customer Privacy (PR8)
 - o Marketing Communications (PR6,7)
 - o Anti-Competitive Behaviour (SO7)
 - o Local community SO1, FS13,14
 - o Compliance (EN29, PR 9, SO8)
 - o Grievance Mechanisms (LA16, HR12, SO11)
 - o Diversity and Equal Opportunity (LA12)
 - o Anti-Corruption (SO3,4,5)
 - o Employment (LA1)
 - o Occupational Health and Safety (LA6)
 - o Training and Education (LA9,10,11)
 - o Freedom of Association and Collective Bargaining(HR4)

Observations

Without affecting our assurance opinion we also provide the following observations. We have evaluated the Report's adherence to the following principles on a scale of 'Good', 'Acceptable' and 'Needs Improvement':

Materiality

The process of determining the issues that is most relevant to an organization and its stakeholders.

The report discloses the outcome of the materiality assessment exercise carried by the Bank through an external consultant and validated by the management team; the process also considered inputs from diverse sources such as needs and concerns of external and internal stakeholders, media reports and impacts of material issues on stakeholder. In our opinion, the level at which the Report adheres to this principle is '**Acceptable**'.

Inclusivity

The participation of stakeholders in developing and achieving an accountable and strategic response to Sustainability.

The stakeholder engagement process is an ongoing and continuous process and involves key stakeholders including business partners, to identify and respond to significant sustainability concerns. In our opinion, the level at which the Report adheres to this principle is '**Good**'.

Responsiveness

The extent to which an organization responds to stakeholder issues.

We consider the response to key stakeholder concerns are well disclosed within the Report i.e. disclosures include business model, policies, management systems and governance mechanisms etc.. In our opinion, the level at which the Report adheres to this principle is '**Acceptable**'.

Reliability

The accuracy and comparability of information presented in the report, as well as the quality of underlying data management systems.

The robustness of the data management and aggregation systems was evaluated, and the sample data and information verified as part of assurance was found to be reliable. Nothing has come to our attention to suggest that reported data has not been properly collated from information reported at operational level, nor that the assumptions used were inappropriate. Some of the data inaccuracies identified during the verification process were found to be attributable to transcription, interpretation and aggregation errors and the errors have been communicated for correction. In our opinion, the level at which the Report adheres to this principle is '**Good**'.

Independent Assurance Statement



Specific Evaluation of the Information on Sustainability Performance

We consider the methodology and process for gathering information developed by Bank for its sustainability performance reporting to be appropriate, and the qualitative and quantitative data included in the Report was found to be identifiable and traceable; the personnel responsible were able to demonstrate the origin and interpretation of the data and its reliability. We observed that the Report presents a faithful description of the reported sustainability activities for the reporting period.

Additional principles as per DNV GL VeriSustain

Completeness

How much of all the information that has been identified as material to the organisation and its stakeholders is reported.

The Report has fairly reported the General and Specific Standard Disclosures including the management approach, monitoring systems and sustainability performance indicators against GRI G4 requirements for its 'in accordance' – Core option of reporting within its identified reporting boundary. In our opinion, the level at which the Report adheres to this principle is 'Good'.

Neutrality

The extent to which a report provides a balanced account of an organization's performance, delivered in a neutral tone.

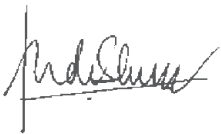
The disclosures related to sustainability issues, challenges and performances are reported in a neutral tone, in terms of content and presentation. In our opinion, the level at which the Report adheres to the principle of Neutrality is 'Good'.

Opportunities for Improvement

The following is an excerpt from the observations and opportunities for improvement reported to the management of the Bank and are not considered for drawing our conclusions on the Report; however, they are generally consistent with the management's objectives:

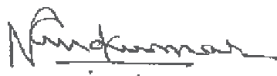
- The Bank may, through a structured risk assessment establish short, medium and long term sustainability goals and targets for identified material Aspects and disclose the same in its future reports;
- A systematic process of internal audit of data management systems may be established to further strengthen the reliability of reported sustainability performance.

For DNV GL



Rathika de Silva

Lead Verifier
Country Head
DNV GL Business Assurance Lanka (Private)
Limited, Colombo, Sri Lanka



Nandkumar Vadakepatth

Regional Sustainability Manager – Region India
and Middle East
DNV GL Business Assurance India Private
Limited, India.



Balasubramoniam Sivasubramaniam

Assurance Reviewer
DNV GL Business Assurance India Private
Limited, India.

23rd February 2017,
Colombo, Sri Lanka.





GRI G4 Content Index

We report against the GRI G4 Sustainability Reporting Guidelines and the GRI Financial Services Sector Disclosures, supported by our internally developed policies and procedures. We continue to improve our application of the G4 guidelines and at this stage our report is prepared - In accordance - Core option of reporting for the identified material aspects.

Disclosures	Disclosure Item	Page Number	External Assurance
STRATEGY AND ANALYSIS			
G4-1	Statement of the MD/CEO	20 - 23	353, 354 - 356
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G4-3	Name of the organisation	Inner Back Cover	353, 354 - 356
G4-4	Primary brands, products, and services	74	353, 354 - 356
G4-5	Location of the organisation's headquarters	Inner Back Cover	353, 354 - 356
G4-6	Countries where organisation operates	69, 93	353, 354 - 356
G4-7	Nature of ownership and legal form	Inner Back Cover	353, 354 - 356
G4-8	Markets served	69, 93	353, 354 - 356
G4-9	Scale of the organisation	15, 64	353, 354 - 356
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G4-12	Organisation's supply chain	75	353, 354 - 356
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G4-15	Externally developed charters, principles, or other initiatives to which the organisation subscribes or which it endorses	12	353, 354 - 356
G4-16	Memberships of associations	351	353, 354 - 356
IDENTIFIED MATERIAL ASPECTS AND BOUNDARIES			
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G4-18	Define the report content and the aspect boundaries	12	353, 354 - 356
G4-19	Material aspects	39 - 40	353, 354 - 356
G4-20	Aspect boundary within the organisation	39	353, 354 - 356
G4-21	Aspect boundary outside the organisation	39	353, 354 - 356
G4-22	Effect of any restatements of information provided in previous reports	12	353, 354 - 356
G4-23	Significant changes from previous reporting periods in the scope and aspect boundaries	41	353, 354 - 356
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G4-24	Stakeholder groups engaged by the organisation	41 - 47	353, 354 - 356
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GRI G4 Content Index

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G4-34	Governance structure of the organisation	103	353, 354 - 356
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G4-56	Organisation's values, principles, standards and norms of behaviour such as codes of conduct and codes of ethics	60, 104, 116, 118, 140	353, 354 - 356
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G4-EC1	Direct economic value generated and distributed	352	353, 354 - 356
G4-EC2	Financial implications and other risks and opportunities for the organisation's activities due to climate change	85	353, 354 - 356
G4-EC3	Coverage of the organisation's defined benefit plan obligations	306 - 311	353, 354 - 356
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G4-EC7	Development and impact of infrastructure investments and services supported	78	353, 354 - 356
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G4-EC9	Proportion of spending on local suppliers at significant locations of operation	75	353, 354 - 356
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G4-EN29	Monetary value of significant fines and total number of non-monetary sanctions for non-compliance with environmental laws and regulations	352	353, 354 - 356
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G4-LA1	Total number and rates of new employee hires and employee turnover by age group, gender and region	60 	353, 354 - 356
ASPECT: OCCUPATIONAL HEALTH AND SAFETY			
G4-LA6	Type of injury and rates of injury, occupational diseases, lost days, and absenteeism, and total number of work-related fatalities, by region and by gender	65	353, 354 - 356
ASPECT: TRAINING AND EDUCATION			
G4-LA9	Average hours of training per year per employee by gender, and by employee category	63	353, 354 - 356
G4-LA10	Programmes for skills management and lifelong learning that support the continued employability of employees and assist them in managing career endings	63	353, 354 - 356
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G4-LA12	Composition of governance bodies and breakdown of employees per employee category according to gender, age group, minority group membership, and other indicators of diversity	60, 64	353, 354 - 356
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G4-HR4	Operations and suppliers identified in which the right to exercise freedom of association and collective bargaining may be violated or at significant risk, and measures taken to support these rights	62 	353, 354 - 356
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G4-HR12	Number of grievances about human rights impacts filed, addressed, and resolved through formal grievance mechanisms	352	353, 354 - 356

Disclosures	Disclosure Item	Page Number	External Assurance
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ASPECT: LOCAL COMMUNITIES			
G4-SO1	Percentage of operations with implemented local community engagement, impact assessments, and development programmes	72 - 78	353, 354 - 356
ASPECT: ANTI-CORRUPTION			
G4-SO3	Total number and percentage of operations assessed for risks related to corruption and the significant risks identified	170 - 173	353, 354 - 356
G4-SO4	Communication and training on anti-corruption policies and procedures	63	353, 354 - 356
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G4-SO7	Total number of legal actions for anti-competitive behaviour, anti-trust, and monopoly practices and their outcomes	352	353, 354 - 356
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G4-SO11	Number of grievances about impacts on society filed, addressed, and resolved through formal grievance mechanisms	352	353, 354 - 356
PRODUCT RESPONSIBILITY			
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G4-PR7	Total number of incidents of non-compliance with regulations and voluntary codes concerning marketing communications, including advertising, promotion, and sponsorship, by type of outcomes	352	353, 354 - 356
ASPECT: CUSTOMER PRIVACY			
G4-PR8	Total number of substantiated complaints regarding breaches of customer privacy and losses of customer data	352	353, 354 - 356
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FS8	Monetary value of products and services designed to deliver a specific environmental benefit for each business line broken down by purpose	82 - 101	354 - 356
FS13	Access points in low populated or economically disadvantaged areas by type	72, 90	354 - 356
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Additional Disclosures

In addition to the 'in-accordance' - Core option of reporting requirements of GRI G4, we have also disclosed additional disclosures with reference to General Standard Disclosures and Specific Standard Disclosures such as governance covering setting of purpose, value and strategy; risk management; sustainability reporting and ethics and integrity etc. to ensure continuity of reported disclosures and for benefit of our stakeholders as detailed below:

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G4-36	Appointment of an executive-level position or positions with responsibility for economic, environmental and social topics, and whether post holders report directly to the highest governance body	38
G4-37	Processes for consultation between stakeholders and the highest governance body on economic, environmental and social topics	38, 40 - 47
G4-38	Report the composition of the highest governance body and its committees	26 - 29
G4-39	Whether the Chair of the highest governance body is also an executive officer	26
G4-40	The nomination and selection processes for the highest governance body and its committees, and the criteria used for nominating and selecting highest governance body members	109
G4-41	Processes for the highest governance body to ensure conflicts of interest are avoided and managed	114, 121
ROLE IN SETTING PURPOSE, VALUES, AND STRATEGY		
G4-42	Highest governance body's and senior executives' roles in the development, approval, and updating of the organisation's purpose, value or mission statements, strategies, policies, and goals related to economic, environmental and social impacts	103, 106
COMPETENCIES AND PERFORMANCE EVALUATION		
G4-43	Measures taken to develop and enhance the highest governance body's collective knowledge of economic, environmental and social topics	106
G4-44	Processes for evaluation of the highest governance body's performance with respect to governance of economic, environmental and social topics. Report whether such evaluation is independent or not, and its frequency and whether such evaluation is a self-assessment	110
ROLE IN RISK MANAGEMENT		
G4-45	The highest governance body's role in the identification and management of economic, environmental and social impacts, risks, and opportunities. Include the highest governance body's role in the implementation of due diligence processes and whether stakeholder consultation is used to support the highest governance body's identification and management of economic, environmental and social impacts, risks, and opportunities	38, 160 - 161
G4-46	The highest governance body's role in reviewing the effectiveness of the organisation's risk management processes for economic, environmental and social topics	160 - 161, 171
G4-47	The frequency of the highest governance body's review of economic, environmental and social impacts, risks, and opportunities	160 - 161, 171
ROLE IN SUSTAINABILITY REPORTING		
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ROLE IN EVALUATING ECONOMIC, ENVIRONMENTAL AND SOCIAL PERFORMANCE		
G4-49	The process for communicating critical concerns to the highest governance body	38
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ASPECT: INDIRECT ECONOMIC IMPACTS		
G4-EC8	Significant indirect economic impacts, including the extent of impacts	72, 90
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ASPECT: SUPPLIER ENVIRONMENTAL ASSESSMENT		
G4-EN32	Percentage of new suppliers that were screened using environmental criteria	80
ASPECT: ENVIRONMENTAL GRIEVANCE MECHANISMS		
G4-EN34	Number of grievances about environmental impacts filed, addressed, and resolved through formal grievance mechanisms	352
SOCIAL		
LABOUR PRACTICES		
ASPECT: OCCUPATIONAL HEALTH AND SAFETY		
G4-LA5	Percentage of total workforce represented in formal joint management-worker health and safety committees that help monitor and advise on occupational health and safety programmes	65
SOCIETY		
ASPECT: LOCAL COMMUNITIES		
G4-SO2	Operations with significant actual and potential negative impacts on local communities	352

Glossary of Financial / Banking Terms

A

ACCEPTANCES

The signature on a Bill of Exchange indicates that the person on whom it is drawn accepts the conditions of the Bill. In other words a Bill of Exchange that has been accepted.

ACCOUNTING POLICIES

The specific principles, bases, conventions, rules and practices adopted by an entity in preparing and presenting financial statements.

ACCURAL BASIS

Recognising the effects of transactions and other events when they occur without waiting for receipt or payment of cash or cash equivalent.

ACTUARIAL GAIN/LOSS

Gain or loss arising from the difference between estimates and actual experience in a company's pension plan.

AMORTISATION

The systematic allocation of the depreciable amount of an intangible asset over its useful life.

AMORTISED COST

Amount at which the financial asset or financial liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount and minus any reduction for impairment or un-collectability.

ASSOCIATE

An associate is an entity, including an unincorporated entity such as a partnership, over which the investor has significant influence and that is neither a subsidiary nor an interest in a joint venture.

AVAILABLE FOR SALE FINANCIAL ASSETS

Available for sale financial assets are those non derivative financial assets that are designated as available for sale or are not classified as loans and receivables, held to maturity investments or

financial assets at fair value through profit or loss.

B

BILLS SENT FOR COLLECTION

A Bill of Exchange drawn by an exporter usually at a term, on an importer overseas and brought by the exporter to his Bank with a request to collect the proceeds.

BONUS ISSUE

The issue of new shares to existing shareholders in proportion to their shareholdings. It is a process for converting a company's reserves (in whole or part) in to issued capital and hence does not involve an infusion of cash.

C

CAPITAL ADEQUACY RATIO

The percentage of risk-adjusted assets supported by capital as defined under the framework of risk-based capital standards developed by the Bank for International Settlements (BIS) and as modified to suit local requirements by the Central Bank of Sri Lanka.

CAPITAL RESERVE

Capital reserves consist of revaluation reserves arising from revaluation of properties owned by the Bank.

CASH EQUIVALENTS

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

CASH GENERATING UNIT (CGU)

The smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or group of assets.

CEDED INSURANCE ARRANGEMENTS

An arrangement where an insurance company passes the part or all of its risks from its insurance

policy portfolio to a reinsurance firm.

COLLECTIVELY ASSESSED LOAN IMPAIRMENT PROVISIONS

Also known as portfolio impairment provisions. Impairment assessment on a collective basis for homogeneous groups of loans that are not considered individually significant and to cover losses that has been incurred but has not yet been identified at the reporting date. Typically assets within the consumer banking business are assessed on a portfolio basis.

COMMERCIAL PAPER

An unsecured, short-term debt instrument issued by a corporation, typically for the financing of accounts receivable, inventories and meeting short-term liabilities. The debt is usually issued at a discount, reflecting prevailing market interest rates.

COMMITMENT TO EXTEND CREDIT

Credit facilities available to clients either in the form of loans, bankers' acceptances and other on-balance sheet financing or through off-balance sheet products such as guarantees and letters of credit.

CONTINGENCIES

Conditions or situations at the reporting date, the financial effect of which are to be determined by the future events which may or may not occur.

CONTRACTUAL MATURITY

Contractual maturity refers to the final payment date of a loan or other financial instrument, at which point all the remaining outstanding principal will be repaid and interest is due to be paid.

CORPORATE GOVERNANCE

The process by which corporate entities are governed. It is concerned with the way in which power is exercised over the management and direction of entity, the supervision of executive actions and accountability to owners and others.

CORRESPONDENT BANK

A Bank in a foreign country that offers banking facilities to the customers of a Bank in another country.

COST INCOME RATIO

Operating expenses excluding loan loss provision as a percentage of total operating income.

COST METHOD

Cost method is a method of accounting for an investment whereby the investment is recognised at cost. The investor recognises income from the investment only to the extent that the investor receives distributions from accumulated profits of the investee arising after the date of acquisition. Distributions received in excess of such profits are regarded as a recovery of investment and are recognised as a reduction of the cost of the investment.

COST-PUSH INFLATION

A continuous increase in average price levels due to an increase in production costs.

CREDIT RATINGS

An evaluation of a corporate's ability to repay its obligations or likelihood of not defaulting, carried out by an independent rating agency.

CREDIT RISK

Credit risk is the risk of financial loss to the Bank if a customer or counter party to a financial instrument fails to meet its contractual obligations, and arises principally from the loans and advances to customers and other banks and investment in debt/equity securities.

CURRENCY RISK

The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

CURRENCY SWAPS

The simultaneous purchase of an amount of a currency for spot settlement and the sale of the

same amount of same currency for forward settlement.

D

DEBT RESTRUCTURING / RESCHEDULING

This is when the terms and provisions of outstanding debt agreements are changed. This is often done in order to improve cash flow and the ability of the borrower to repay the debt. It can involve altering the repayment schedule as well as debt or interest charge reduction.

DEFERRED TAX

Sum set aside in the financial statements for taxation that may become payable in a financial year other than the current financial year.

DELINQUENCY

A debt or other financial obligation is considered to be in a state of delinquency when payments are overdue. Loans and advances are considered to be delinquent when consecutive payments are missed. Also known as 'Arrears'.

DERECOGNITION

Removal of a previously recognised financial asset or financial liability from an entity's Statement of Financial Position.

DERIVATIVES

A derivative is a financial instrument or other contract, the value of which changes in response to some underlying variable (eg. an interest rate), that has an initial net investment smaller than would be required for other instruments that have a similar response to the variable, and that will be settled at a future date.

DEPRECIATION

The systematic allocation of the depreciable amount of an asset over its useful life.

DIVIDEND COVER

Profit after tax divided by gross dividends. This ratio measures the number of times dividend

is covered by the current year's distributable profits.

DIVIDEND YIELD

Dividend earned per share as a percentage of its market value.

DOCUMENTARY LETTERS OF CREDIT (L/Cs)

Written undertakings by a Bank on behalf of its customers, authorising a third party to draw on the Bank up to a stipulated amount under specific terms and conditions. Such undertakings are established for the purpose of facilitating international trade.

E

EARNINGS PER SHARE (EPS)

Profit attributable to ordinary shareholders, divided by the number of ordinary shares in issue.

ECONOMIC VALUE ADDED (EVA)

A measure of productivity which takes into consideration cost of total invested equity.

EFFECTIVE INTEREST RATE

Rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instruments or when appropriate a shorter period to the net carrying amount of the financial asset or financial liability.

EFFECTIVE TAX RATE

Income tax expense for the year divided by the profit before tax.

EQUITY INSTRUMENT

Equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.

EQUITY METHOD

The equity method is a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition changes in the investor's share of net assets of the investee. The profit or loss of the investor includes the investor's share of the profit or loss of the investee.

EMBEDDED DERIVATIVES

An embedded derivative is a component of a hybrid (combined) instrument that also includes a non-derivative host contract with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative.

ESOP (EMPLOYEE SHARE OPTION PLAN)

A method of giving employees shares in the business for which they work.

EX-DIVIDEND DATE

A classification of trading shares when a declared dividend belongs to the seller rather than the buyer.

A stock will be given ex-dividend status if a person has been confirmed by the company to receive the dividend payment. The date on or after which a security is traded without a previously declared dividend or distribution.

F

FAIR VALUE

Fair value is the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction.

FINANCE LEASE

A lease in which the lessee acquires all the financial benefits and risks attaching to ownership of the asset under lease.

FINANCIAL ASSET OR FINANCIAL LIABILITY AT FAIR VALUE THROUGH PROFIT OR LOSS

Financial asset or financial liability that is held for trading or upon initial recognition designated by the entity as 'at fair value through profit or loss'.

FINANCIAL INSTRUMENT

Financial Instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

FINANCIAL RISK

The risk of a possible future change in one or more of a specified interest rate, financial instrument

price, commodity price, foreign exchange rate, index of prices or rates or credit rating or credit index or other variable provided in the case of a non financial variable that the variable is not specific to the party to the contract.

FOREIGN EXCHANGE INCOME

The gain recorded when assets or liabilities denominated in foreign currencies are translated into Sri Lankan Rupees on the reporting date at prevailing rates which differ from those rates in force at inception or on the previous reporting date. Foreign exchange income also arises from trading in foreign currencies.

FORWARD EXCHANGE CONTRACT

Agreement between two parties to exchange one currency for another at a future date at a rate agreed upon today.

G

GOODWILL

An asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized.

GROSS DIVIDENDS

The portion of profit inclusive of tax withheld distributed to shareholders.

GROUP

A group is a parent and all its subsidiaries.

GUARANTEES

Primarily represent irrevocable assurances that a bank will make payments in the event that its customer cannot meet his / her financial obligations to third parties. Certain other guarantees represent non-financial undertakings such as bid and performance bonds.

H

HEDGING

A strategy under which transactions are effected with the aim of providing cover against the risk

Glossary of Financial / Banking Terms

of unfavourable price movements (interest rate, foreign exchange rate, commodity prices, etc.).

HELD TO MATURITY INVESTMENTS

Non derivative financial assets with fixed or determinable payments and fixed maturity that an entity has the positive intention and ability to hold to maturity.

I

IMPAIRED LOANS

Loans where the Group does not expect to collect all the contractual cash flows or expects to collect them later than they are contractually due.

IMPAIRMENT

This occurs when recoverable amount of an asset is less than its carrying amount.

IMPAIRMENT ALLOWANCES

Impairment allowances are provisions held on the Statement of Financial Position as a result of the raising of a charge against profit for the incurred loss. An impairment allowance may either be identified or unidentified and individual (specific) or collective (portfolio) respectively.

INCREMENTAL COST

Costs that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument.

INCURRED BUT NOT ENOUGH REPORTED (IBNER)

The reserves for claims that become due with the occurrence of the events covered under the insurance policy, but have not been reported yet.

INCURRED BUT NOT REPORTED (IBNR)

An estimate of the liability for claim-generating events that have taken place but have not yet been reported to the insurer or self-insurer.

INDIVIDUALLY SIGNIFICANT LOANS

Exposures which are above a certain threshold decided by the

Bank's management which should be assessed for objective evidence, measurement, and recognition of impairment on an individual basis.

INDIVIDUALLY SIGNIFICANT LOAN IMPAIRMENT PROVISIONS

Also known as specific impairment provisions. Impairment is measured individually for assets that are individually significant to the Group. Typically assets within the corporate banking business of the Group are assessed individually.

IRREVOCABLE COMMITMENT

A loan amount that may be drawn down, or is due to be contractually funded in the future.

INTANGIBLE ASSET

An identifiable non-monetary asset without physical substance held for use in the production / supply of goods / services or for rental to others or for administrative purposes.

INTEREST MARGIN

Net interest income as a percentage of average interest earning assets.

INTEREST RATE SWAP

An agreement between two parties (known as counterparties) where one stream of future interest payments is exchanged for another based on a specified principal amount.

INTEREST RATE RISK

The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

INTEREST SPREAD

This represents the difference between the average interest rate earned and the average interest rate paid on funds.

INSURANCE RISK

Risk, other than financial risk, transferred from the holder of a contract to the issuer.

INVESTMENT PROPERTIES

Investment property is property (land or a building - or part of a building - or both) held (by the

owner or by the lessee under a finance lease)

to earn rentals or for capital appreciation or both, rather than for use or sale.

INTEREST COVER

A ratio showing the number of times interest charges is covered by earnings before interest and tax.

J

JOINT CONTROL

Joint control is the contractually agreed sharing of the control over an economic activity and exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control.

JOINT VENTURE

A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control.

K

KEY MANAGEMENT PERSONNEL

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly.

L

LETTER OF CREDIT (L/C)

Written undertakings by a Bank on behalf of its customer (typically an importer), authorising a third party (e.g. an exporter) to draw drafts on the Bank up to a stipulated amount under specific terms and conditions. Such undertakings are established for the purpose of facilitating international trade.

LIABILITY ADEQUACY TEST (LAT)

Assessment on each reporting date whether the recognized insurance liabilities are adequate, using current estimates of future cash flows under the insurance contract.

LIQUID ASSETS

Assets that are held in cash or in a form that can be converted to cash readily, such as deposits with other Banks, Bills of Exchange and Treasury Bills.

LIQUIDITY RISK

The risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities.

LOANS AND RECEIVABLES

Non derivative financial assets with fixed or determinable payments that are not quoted in an active market other than those intended to sell immediately or in the near term and designated as fair value through profit or loss or available for sale on initial recognition.

LOSS GIVEN DEFAULT (LGD)

LGD is the percentage of an exposure that a lender expects to lose in the event of obligor default.

M

MARKET CAPITALISATION

Number of ordinary shares in issue multiplied by the market value of each share at the year end.

MARKET RISK

This refers to the possibility of loss arising from changes in the value of a financial instrument as a result of changes in market variables such as interest rates, exchange rates, credit spreads and other asset prices.

MATERIALITY

The relative significance of a transaction or an event, the omission or misstatement of which could influence the decisions of users of financial statements.

N

NET ASSET VALUE PER SHARE

Shareholders' funds divided by the number of ordinary shares in issue.

NET-INTEREST INCOME

The difference between what a Bank earns on assets such as loans

and securities and what it pays on liabilities such as deposits, refinance funds and inter-bank borrowings.

NON CONTROLLING INTEREST

Equity in a subsidiary not attributable, directly or indirectly to a parent.

NET PREMIUM METHOD

A Net Premium Valuation is an actuarial calculation, used to place a value on the liabilities of a life insurer.

O

OFF BALANCE SHEET TRANSACTIONS

Transactions that are not recognised as assets or liabilities in the Statement of Financial Position, but which give rise to contingencies and commitments.

ONEROUS CONTRACT

A type of contract where the costs involved with fulfilling the terms and conditions of the contract are higher than the amount of economic benefit received.

OPERATIONAL RISK

This refers to the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events.

P

PARENT

A parent is an entity that has one or more subsidiaries.

PAST DUE

A financial asset is past due when a counterparty has failed to make a payment when contractually due.

PRICE EARNINGS RATIO (P/E RATIO)

Market price of an ordinary share divided by earnings per share (EPS).

PROBABILITY OF DEFAULT (PD)

PD is an internal estimate for each borrower grade of the likelihood that an obligor will default on an obligation.

PRUDENCE

Inclusion of a degree of caution in the exercise of judgement needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated.

R

REGULAR WAY TRADES

A type of trade that is settled through the regular settlement cycle required for the particular investment being traded. The settlement cycle is the time that the regulations of the securities market allows for the buyer to complete payment and for the seller to deliver the goods being purchased.

REPURCHASE AGREEMENT

This is a contract to sell and subsequently repurchase government securities at a given price on a specified future date.

RETURN ON AVERAGE ASSETS (ROAA)

Profit after tax expressed as a percentage of average total assets, used along with ROE, as a measure of profitability and as a basis of intra-industry performance comparison.

RETURN ON AVERAGE EQUITY (ROAE)

Profit after tax less preferred share dividends if any, expressed as a percentage of average ordinary shareholders' equity.

REVENUE RESERVE

Reserves set aside for future distribution and investment.

REVERSE REPURCHASE AGREEMENT

Transaction involving the purchase of government securities by a Bank or dealer and resale back to the seller at a given price on a specific future date.

RIGHTS ISSUE

Issue of shares to the existing shareholders at an agreed price, generally lower than market price.

RISK-WEIGHTED ASSETS

Used in the calculation of risk-based capital ratios. The face amount of lower risk assets is discounted using risk weighting factors in order to reflect a comparable risk per rupee among all types of assets. The risk inherent in off-balance sheet instruments is also recognised, first by adjusting notional values to balance sheet (or credit) equivalents and then by applying appropriate risk weighting factors.

S

SEGMENT REPORTING

Segment reporting indicates the contribution to the revenue derived from business segments such as banking operations, leasing operations, stock broking and securities dealings, property and insurance.

SHAREHOLDERS' FUNDS

Shareholders' funds consist of stated capital, statutory reserves, capital and revenue reserves.

SPECIFIC IMPAIRMENT PROVISIONS

Impairment is measured individually for loans that are individually significant to the Bank.

STATUTORY RESERVE FUND

Reserve created as per the provisions of the Banking Act No. 30 of 1988.

SUBSIDIARY

A subsidiary is an entity, including an unincorporated entity such as a partnership, that is controlled by another entity (known as the parent).

SUBSTANCE OVER FORM

The consideration that the accounting treatment and the presentation in financial statements of transactions and events should be governed by their substance and financial reality and not merely by legal form.

T

TIER I CAPITAL

Consists of the sum total of paid up ordinary shares, non cumulative, non redeemable preference shares, share premium, statutory reserve fund, published retained profits, general and other reserves, less goodwill.

TIER II CAPITAL

Consists of the sum total of revaluation reserves, general provisions, hybrid capital instruments and approved subordinated debentures.

TOTAL CAPITAL

Total capital is the sum of Tier I capital and Tier II capital.

TRANSACTION COSTS

Incremental costs that is directly attributable to the acquisition, issue or disposal of a financial asset or financial liability.

U

UNEARNED PREMIUM RESERVE

The premium corresponding to the time period remaining on an insurance policy.

UNIT TRUST

An undertaking formed to invest in securities under the terms of a trust deed.

V

VALUE ADDED

Value added is the wealth created by providing banking services less the cost of providing such services. The value added is allocated among the employees, the providers of capital, to government by way of taxes and retained for expansion and growth.

Y

YIELD TO MATURITY

Discount rate which the present value of future cash flows would equal the security's current price.

Branch Network

Central Province – 25

Kandy - 14

- » Akurana
- » Digana
- » Galaha
- » Gampola
- » Geliyoia
- » Kandy
- » Kandy City Centre
(Extension Office)
- » Katugastota
- » Kundasale
- » Kurunduwatte
- » Nawalapitiya
- » Peradeniya
- » Pilimathalawa
- » Rikillagaskada

Matale - 03

- » Dambulla
- » Galewela
- » Matale

Nuwara Eliya - 08

- » Bogawanthalawa
- » Ginigathhena
- » Hatton
- » Maskeliya
- » Nuwara Eliya
- » Pussellawa
- » Ragala
- » Thalawakele

Eastern Province - 25

Ampara - 11

- » Akkaraipattu
- » Ampara
- » Dehiattakandiya
- » Kalmunai
- » Karaitivu
- » Ninthavur
- » Pottuvil
- » Samanthurai
- » Thandavenvely
- » Thirukkivil
- » Uhana

Batticaloa - 05

- » Batticaloa
- » Eravur
- » Valachchenai
- » Kaluwanchikudy
- » Kattankudy

Trincomalee - 09

- » Kantale
- » Kinniya
- » Marathamunai
- » Mullipathana
- » Muttur
- » Trinco Metro
- » Serunuwara
- » Trincomalee
- » Uppuveli

Northern Province - 22

Jaffna - 13

- » Atchchuveli
- » Chankanai
- » Chavakachcheri
- » Chunnakam
- » Jaffna
- » Jaffna Metro
- » Kaithady
- » Kodikamam
- » Manipay
- » Nelliady
- » Point Pedro
- » Thirunelvly
- » Velanai

Kilinochchi - 02

- » Kilinochchi North
- » Kilinochchi South

Mannar - 03

- » Mannar
- » Mallavi
- » Nanattan

Mullaitivu - 02

- » Mullaitivu
- » Mulliyawalai

Vavuniya - 02

- » Kurumankadu
- » Vavuniya

Southern Province - 25

Galle - 09

- » Ambalangoda
- » Batapola
- » Elpitiya
- » Galle
- » Hikkaduwa
- » Karapitiya
- » Koggala
- » Pitigala
- » Yakkalamulla

Hambantota - 8

- » Ambalantota
- » Angunakolapelessa
- » Hambantota
- » Middeniya
- » Sooriyawewa
- » Tangalle
- » Tissamaharama
- » Walasmulla

Matara - 08

- » Akuressa
- » Deniyaya
- » Devinuwara
- » Dickwella
- » Hakmana
- » Matara
- » Urubokka
- » Weligama

North Central Province - 10

Anuradhapura - 07

- » Anuradhapura
- » Anuradhapura Metro
- » Kekirawa
- » Medawachchiya
- » Nochchiyagama
- » Padavi Parakramapura
- » Thambuttegama

Polonnaruwa - 03

- » Aralaganwila
- » Medirigiriya
- » Polonnaruwa

North Western Province - 18

Kurunegala - 09

- » Alawwa
- » Galgamuwa
- » Giriulla
- » Hettipola
- » Kuliypitiya
- » Kurunegala
- » Kurunegala Metro
- » Nikaweratiya
- » Wariyapola

Puttalam - 09

- » Anamaduwa
- » Chilaw
- » Dankotuwa
- » Madampe
- » Marawila
- » Norochchole
- » Puttalam
- » Udappuwa
- » Wennappuwa

Sabaragamuwa Province - 11

Kegalle - 04

- » Mawanella
- » Kegalle
- » Pinnawala
- » Warakapola

Ratnapura - 07

- » Balangoda
- » Embilipitiya
- » Godakawela
- » Kahawatta
- » Kalawana
- » Pelmadulla
- » Ratnapura

Uva Province - 12

Badulla - 06

- » Badulla
- » Bandarawela
- » Haputale
- » Mahiyanganaya
- » Passara
- » Welimada

Monaragala - 06

- » Buttala
- » Bibile
- » Kataragama
- » Monaragala
- » Siyambalanduwa
- » Wellawaya

Western Province - 103

Colombo - 65

- » Aluthkade
- » Athurugiriya
- » Avissawella
- » Bambalapitiya
- » Boralesgamuwa
- » Borella
- » Cinnamon Gardens
- » City Office
- » Dehiwela
- » Dematagoda
- » Grandpass
- » Greenpath
- » Hanwellla
- » Head Office Branch
- » Homagama
- » Hulftsdorp
- » International Water Management Institute (Pay Office)
- » Jampettah
- » Sri Jayawardenapura Hospital (Pay Office)
- » Kaduwela
- » Kelaniya
- » Kiribathgoda
- » Kirulapone
- » Kohuwela
- » Kollupitiya
- » Kolonnawa
- » Kotahena
- » Kottawa
- » Kotte
- » Maharagama

- » Pettah Metro
- » Malabe
- » Maligawatte
- » Maradana
- » Mirihana
- » Moratumulla
- » Moratuwa
- » Mount Lavinia
- » Mutwal
- » Narahenpita
- » Nawala
- » Nawaloka (Pay Office)
- » Nawam Mawatha
- » Nugegoda
- » Overseas School of Colombo (Pay Office)
- » Padukka
- » Pamankada
- » Panchikawatte
- » Peliyagoda
- » Pettah
- » Piliyandala
- » Ratmalana
- » Sea Street
- » SLPA (Pay Office)
- » Thalangama
- » Thalawathugoda
- » Asiri Central Hospital (Pay Office)
- » Thimbirigasyaya
- » Wellawatte
- » Wijerama
- » World Trade Centre
- » Orian City (Pay Office)

- » Pension Department (Pay Office)
- » Lotus Road (Pay Office)
- » Lanka Hospital PLC (Pay Office)

Gampaha - 29

- » Airport Departure Counter (Pay Office)
- » Biyagama
- » Delgoda
- » Divulapitiya
- » Ekala
- » Gampaha
- » Ganemulla
- » Hendala
- » Ja-Ela
- » Kadawatha
- » Kandana
- » Katunayake
- » Kirindiwela
- » Kochchikade
- » Marandagahamula
- » Minuwangoda
- » Mirigama
- » Negombo
- » Negombo Metro
- » Nittambuwa
- » Pamunugama
- » Pugoda
- » Ragama
- » Seeduwa
- » Sri Lankan Airlines (Pay Office)

- » Veyangoda
- » Wattala
- » Weliweriya
- » Yakkala

Kalutara - 09

- » Aluthgama
- » Bandaragama
- » Beruwala
- » Horana
- » Ingiriya
- » Kalutara
- » Mathugama
- » Panadura
- » Wadduwa

Notice of Meeting

Notice is hereby given that the Forty Eighth (48th) Annual General Meeting of Hatton National Bank PLC (the "Bank") is convened on Thursday, the Thirtieth (30th) day of March 2017 at the Auditorium on Level 22 of "HNB Towers" at No. 479, T.B. Jayah Mawatha, Colombo 10, at 10.00 in the forenoon when the following business will be transacted:

- i. To receive and consider the Annual Report of the Board of Directors along with the Financial Statements of the Bank for the year ended 31st December 2016 and the Auditor's Report thereon.
- ii. To declare a final dividend as recommended by the Board of Directors and to consider and if thought fit, to pass the following resolutions:

Ordinary Resolution - Declaration of Dividend and approval of its method of satisfaction

IT IS HEREBY RESOLVED:

- (a) THAT a final dividend of Rupees Seven (Rs 7/-) per share constituting a total sum of Rs 2,896,708,318/- be paid on the issued and fully paid ordinary (voting) and (non-voting) shares of the Bank for the financial year ended 31st December 2016 based on the issued ordinary voting shares and ordinary non-voting shares as at February 23, 2017, subject to any necessary revision being made to such amount to be distributed in order to include and accommodate the dividends pertaining to any new shares to be issued by the Bank to its employees under the Hatton National Bank PLC ESOP scheme;
- (b) THAT such dividend be paid out of exempt dividends received (if any), dividends received on which Withholding Tax has already been paid by the paying companies (if any), and the balance out of the profits of the Bank, which balance would be liable to a Withholding Tax of ten per centum (10%).
- (c) THAT the shareholders entitled to such dividend would be those shareholders (holders of both ordinary voting shares and ordinary non-voting shares), whose names have been duly registered in the Register of Shareholders and those shareholders whose names appear on the Central Depository Systems (Pvt) Ltd ('CDS') as at end of trading on the date on which the requisite resolution of the Shareholders in regard to the final dividend is passed ('entitled Shareholders');
- (d) THAT the said final dividend of Rs 7/- per share be distributed and satisfied partly by the payment of cash and partly by the allotment and issue of new ordinary voting shares and ordinary non-voting shares (the "distribution scheme") based on the share prices of ordinary voting shares and ordinary non-voting shares as at February 23, 2017 in the following manner, subject however to any necessary revision being made to the amount of dividends to be distributed and the number of shares to be issued, (i) in order to include and accommodate the dividends pertaining to any new shares that may be issued by the Bank to its employees under the Hatton National Bank PLC ESOP scheme and / or (ii) pursuant to any changes to the applicable law:
 - (i) By way of a cash distribution
A cash distribution of (A) a sum of Rs 1,157,648,737/- be made to the holders of ordinary voting shares and (B) a sum of Rs 290,705,422/- be made to the holders of ordinary non-voting shares respectively, on the basis of Rupees Three and Cents Fifty (Rs 3.50/-) per each share (less Withholding Tax)
 - (ii) By way of the allotment of and issue of new shares

A. For voting shares:

THAT a sum of Rs 1,157,648,737/- (less any Withholding Tax) be distributed to the holders of ordinary voting shares in the form of a scrip dividend at the rate of Rupees Three and Cents Fifty (Rs 3.50/-) per each share, by the issue of a total of 4,510,319 ordinary voting shares computed on the basis of one (1) ordinary voting share for every 73.3333333 ordinary voting shares currently in issue (which computation is based on a valuation of Rs. 231/- per each ordinary voting share).

B. For non-voting shares

THAT a sum of Rs 290,705,422/- (less any Withholding Tax) be distributed to the holders of ordinary non-voting shares in the form of a scrip dividend at the rate of Rupees Three and Cents Fifty (Rs 3.50/-) per each share, by the issue of 1,308,174 ordinary non-voting shares computed on the basis of one (1) ordinary non-voting share for every 63.4920635 non-voting shares currently in issue (which computation is based on a valuation of Rs 200/- per each ordinary non-voting share).

- (e) THAT the shares arising from the aggregation of the residual fractions consequent to the scrip dividend be disposed of in the market by a trustee to be nominated by the Board of Directors and the proceeds to be distributed to a charitable organization.
- (f) THAT (a) the new ordinary voting shares to be issued in pursuance of the distribution scheme shall, immediately consequent to the allotment thereof to the entitled Shareholders rank equal and pari passu in all respects with the existing issued and fully paid ordinary voting shares of the Bank and (b) the new ordinary non-voting shares to be issued in pursuance of the distribution scheme shall, immediately consequent to

the allotment thereof to the entitled Shareholders rank equal and pari passu in all respects with the existing issued and fully paid ordinary non-voting shares of the Bank, and shall be listed on the Colombo Stock Exchange.

- (g) THAT the new ordinary voting shares and ordinary non-voting shares to be so allotted and issued shall not be eligible for the payment of dividend declared hereby.
- (h) THAT accordingly the Bank's management be and is hereby authorized to take all necessary steps to give effect to the aforesaid proposed issue of new ordinary voting shares and ordinary non-voting shares of the Bank.

Special Resolution – Approval of the holders of voting shares under section 99 of the Companies Act No. 7 of 2007, for the issue of shares by scrip dividend

IT IS HEREBY RESOLVED THAT the issue by the Bank of (a) 4,510,319 ordinary voting shares to the holders of ordinary voting shares on the basis of one (1) ordinary voting share for every 73.3333333 ordinary voting shares currently in issue and (b) 1,308,174 ordinary non-voting shares to the holders of ordinary non-voting shares on the basis of one (1) ordinary non-voting share for every 63.4920635 ordinary non-voting shares currently in issue, by way of a scrip dividend [subject to any necessary revision being made to the number of shares to be so issued (i) to include and accommodate any dividends pertaining to any new shares to be issued by the Bank to its employees under the Hatton National Bank PLC ESOP scheme and / or (ii) pursuant to any changes to the applicable law], be and is hereby approved.

- iii. To re-elect Ms Sanjivani Jayawardena, who retires at the Annual General Meeting, as a Director of the Bank in terms of Article 34 of the Articles of Association of the Bank.
- iv. To re-elect Mr Rusi Captain, who retires at the Annual General Meeting, as a Director of the Bank in terms of Article 34 of the Articles of Association of the Bank.
- v. To re-elect Mr. Amal Cabraal, who retires at the Annual General Meeting, as a Director of the Bank in terms of Article 34 of the Articles of Association of the Bank.
- vi. To re-appoint Messrs Ernst & Young (Chartered Accountants) as the Bank's Auditors for the ensuing year and to authorize the Directors to fix their remuneration.
- vii. To authorize the Directors to determine payments for the year 2017 for charitable and other purposes.

By order of the Board of Hatton National Bank PLC,



K A L Thushari Ranaweera (Mrs)

Deputy General Manager (Legal) / Board Secretary
Colombo, Sri Lanka.

23rd February 2017

Notes :

1. A member entitled to attend or attend and vote at the meeting, is entitled to appoint a proxy to attend or attend and vote as the case may be, in his stead.
2. A proxy need not be a member of the Company. The Form of Proxy is enclosed.
3. The completed Form of Proxy should be deposited with the Board Secretary at the Registered Office of the Company at No. 479, T.B. Jayah Mawatha, Colombo 10 (at "HNB Towers", Level 18), not less than 24 hours before the time appointed for holding the meeting.

Notice of Meeting

Summary of Article 22 of the Articles of Association of Hatton National Bank PLC

PROCEDURE ON VOTING AND HOW A POLL IS TO BE TAKEN

- Voting at a meeting of shareholders shall, unless a poll is demanded, be by a show of hands, or voting by voice as may be determined by the Chairman.
- Subject to any rights or restrictions for the time being attached to any class or classes of shares, on a show of hands or voting by voice as aforesaid every member who is present at the meeting shall have one (01) vote, and on a poll every member who is present in person at the meeting shall be entitled to one (01) vote for each voting share held by him.
- A declaration by the Chairman of the meeting that a resolution is carried by the requisite majority is conclusive evidence of that fact, unless a poll is demanded.
- At a meeting of shareholders, a poll may be demanded on a particular question as provided for in the Companies Act No.7 of 2007 by,
 - the Chairman;
 - not less than five (5) shareholders having the right to vote at the meeting; or
 - a shareholder or shareholders representing not less than ten per centum (10%) of the total voting rights of all shareholders having the right to vote at the meeting.
- A poll may be demanded either before or after the vote is taken on a resolution. A demand for a poll may be withdrawn any time before the poll is taken.
- If a poll is taken, votes shall be counted according to the votes attached to the shares of each shareholder present and voting.
- In the case of an equality of votes, whether on a show of hands or on a poll, the Chairman of the meeting shall be entitled to a second or casting vote.
- A declaration by the Chairman of the meeting that a resolution has been carried, or carried unanimously or by a particular majority, or lost, and an entry made to that effect in the minute book, shall be conclusive evidence of the fact without proof of the number or proportion of the votes recorded for or against such a resolution.

Form of Proxy [Voting]

I/We of being *a member/members of the Hatton National Bank PLC, hereby appoint..... of or failing him/her, Rienzie Anicetus Fernando Arseculeratne or failing him, Antonio Jonathan Alles or failing him, Mirihana Arachchige Rose Chandralatha Cooray or failing her, Lokuwithanage Rohan Karunaratne or failing him, Lintotage Udaya Damien Fernando or failing him, Don Tiburtius Sujeewa Handapangoda Mudalige or failing him, Don Sanjivani Clarinda Jayawardena or failing her, Rusi Sohli Captain or failing him, Damian Amal Cabraal or failing him, Palitha Srideva Chulakumara Pelpola or failing him, Eugen Duliksha Pratharp Soosaipillai or failing him, Appu Hennadige Don Anthony Nilanth de Silva as *my/our proxy, to represent *me/us at the Forty Eighth (48th) Annual General Meeting of the Bank to be held at the Auditorium on Level 22 of "HNB Towers" at No. 479, T B Jayah Mawatha, Colombo 10, on the Thirtieth (30th) day of March, 2017 at 10.00 in the forenoon and at any adjournment thereof.

(i)	To declare the recommended dividend of Rs 7/- per share as the final dividend for 2016 and (a) to adopt Ordinary Resolution - Declaration of Dividend and approval of its method of satisfaction	In favour	<input type="checkbox"/>
		Against	<input type="checkbox"/>
	(b) to adopt Special Resolution – Approval of the holders of voting shares under section 99 of the Companies Act No. 7 of 2007, for the issue of shares by way of scrip dividend	In favour	<input type="checkbox"/>
		Against	<input type="checkbox"/>
(ii)	To re-elect Ms Sanjivani Jayawardena as a Director of the Bank	In favour	<input type="checkbox"/>
		Against	<input type="checkbox"/>
(iii)	To re-elect Mr Rusi Captain as a Director of the Bank	In favour	<input type="checkbox"/>
		Against	<input type="checkbox"/>
(iv)	To re-elect Mr. Amal Cabraal as a Director of the Bank	In favour	<input type="checkbox"/>
		Against	<input type="checkbox"/>
(v)	To re-appoint Messrs Ernst & Young (Chartered Accountants) as the Bank's Auditors for the ensuing year/ authorize the Directors to fix their remuneration	In favour	<input type="checkbox"/>
		Against	<input type="checkbox"/>
(vi)	To authorize the Directors to determine payments for charitable and other purposes	In favour	<input type="checkbox"/>
		Against	<input type="checkbox"/>

Mark your preference with "✓"

Signed this day 2017.

Signature/s
.....
.....
.....

Form of Proxy [Voting]

Please provide the following details:

Shareholder's NIC No / Company Registration No. :

Folio No / Number of Shares held. :

Proxy holder's NIC No (if not a Director) :

** Delete inappropriate words*

Instructions to complete proxy

1. The full name and the registered address of the shareholder appointing the Proxy should be legibly entered in the Form of Proxy, duly signed and dated.
2. The completed Proxy should be deposited with the Board Secretary, at the Registered Office of the Bank at No. 479, T B Jayah Mawatha, Colombo 10 ("HNB Towers", Level 18), not less than 24 hours before the time appointed for holding the Meeting.
3. The Proxy shall -
 - (a) in the case of an individual, be signed by the shareholder or by his attorney, and if signed by an attorney, a notarially certified copy of the Power of Attorney should be attached to the completed Proxy if it has not already been registered with the Bank.
 - (b) in the case of a company or corporate body, either be under its Common Seal or signed by its attorney or by an officer on behalf of the Company or corporate body in accordance with the Articles of Association or the Constitution of that Company or corporate body.
The Bank may but shall not be bound to, require evidence of the authority of any such attorney or officer.
 - (c) in the case of joint-holders, the first joint-holder has the power to sign the proxy without the concurrence of the other joint-holder/s.
4. Every alteration or addition to the Proxy must be duly authenticated by the full signature of the shareholder signing the Proxy. Such signature should as far as possible be placed in proximity to the alteration or addition intended to be authenticated.

Form of Proxy [Non-Voting]

I/We
 of
 being *a member/members of the Hatton National Bank
 PLC, hereby appoint.....

..... of
 or failing him/her, Rienzie Anicetus Fernando Arseculeratne
 or failing him, Antonio Jonathan Alles or failing him, Mirihana Arachchige Rose Chandralatha Cooray or failing her, Lokuwithanage Rohan
 Karunaratne or failing him, Lintotage Udaya Damien Fernando or failing him, Don Tiburtius Sujeewa Handapangoda Mudalige or failing him, Don
 Sanjivani Clarinda Jayawardena or failing her, Rusi Sohli Captain or failing him, Damian Amal Cabraal or failing him, Palitha Srideva Chulakumara
 Pelpola or failing him, Eugen Duliksha Pratharp Soosaipillai or failing him, Appu Hennadige Don Anthony Nilanth de Silva as *my/our proxy, to
 represent *me/us at the Forty Eighth (48th) Annual General Meeting of the Bank to be held at the Auditorium on Level 22 of "HNB Towers" at
 No. 479, T B Jayah Mawatha, Colombo 10, on the Thirtieth (30th) day of March, 2017 at 10.00 in the forenoon and at any adjournment thereof.

Signed this day 2017.

Signature/s

Please provide the following details:

Shareholder's NIC No / Company Registration No. :

Folio No / Number of Shares held. :

Proxy holder's NIC No (if not a Director) :

Note - See reverse hereof for instructions to complete the proxy.

** Delete inappropriate words*

Form of Proxy [Non-Voting]

Instructions to complete proxy

1. The full name and the registered address of the shareholder appointing the Proxy should be legibly entered in the Form of Proxy, duly signed and dated.
2. The completed Proxy should be deposited with the Board Secretary, at the Registered Office of the Bank at No. 479, T B Jayah Mawatha, Colombo 10 ("HNB Towers", Level 18), not less than 24 hours before the time appointed for holding the Meeting.
3. The Proxy shall -
 - (a) in the case of an individual, be signed by the shareholder or by his attorney, and if signed by an attorney, a notarially certified copy of the Power of Attorney should be attached to the completed Proxy if it has not already been registered with the Bank.
 - (b) in the case of a company or corporate body, either be under its Common Seal or signed by its attorney or by an officer on behalf of the Company or corporate body in accordance with the Articles of Association or the Constitution of that Company or corporate body.

The Bank may but shall not be bound to, require evidence of the authority of any such attorney or officer.
 - (c) in the case of joint-holders, the first joint-holder has the power to sign the proxy without the concurrence of the other joint-holder/s.
4. Every alteration or addition to the Proxy must be duly authenticated by the full signature of the shareholder signing the Proxy. Such signature should as far as possible be placed in proximity to the alteration or addition intended to be authenticated.

Investor Feedback Form

To request information or submit a comment / query to the Company, please complete the following and return this page to -

Chief Strategy Officer,

Hatton National Bank PLC,

No. 479, T.B. Jayah Mawatha (Darley Road) Colombo 10.

Sri Lanka

Email : rajive.dissanayake@hnb.lk

Name		
Permanent Mailing Address		
Contact Numbers	(Tel)		
		Country Code	Area Code
			Number
	(Fax)		
		Country Code	Area Code
			Number
E-mail		
Name of Company (If Applicable)		
Designation (If Applicable)		
Company Address (If Applicable)		

Queries / Comments

Please tick "✓" the appropriate box

	Yes	No
Would you like to receive soft copies of the HNB annual and interim reports via e-mail?	<input type="checkbox"/>	<input type="checkbox"/>
Would you like to receive news and press releases of HNB via e-mail?	<input type="checkbox"/>	<input type="checkbox"/>
Would you like to receive any information on our products / services?	<input type="checkbox"/>	<input type="checkbox"/>

Corporate Information

NAME OF COMPANY

HATTON NATIONAL BANK PLC

LEGAL FORM

A public limited Company incorporated on 5th March 1970 under the Laws of the Republic of Sri Lanka. The Company was re-registered under the Companies Act No 7 of 2007 on 27th September 2007. It is a Licensed Commercial Bank under the Banking Act.

COMPANY REGISTRATION NUMBER

PQ 82 (Previous PBS 613)

ACCOUNTING YEAR END

31st December

STOCK EXCHANGE LISTING

The ordinary shares and the unsecured subordinated redeemable debentures of the Bank are listed on the Colombo Stock Exchange in Sri Lanka.

REGISTERED OFFICE

"HNB Towers"
No. 479, T B Jayah Mawatha (Darley Road),
P O Box 837, Colombo 10, Sri Lanka.

HEAD OFFICE

"HNB Towers",
No. 479, T B Jayah Mawatha (Darley Road),
P O Box 837,
Colombo 10, Sri Lanka.

Cable Address : HATNABANK

Telephone Nos : +94 11 2664664

: +94 112662772

: +94 11 4764764

Fax No : +94 112662832

Swift : Bic Code - HBLILKLX

e - mail : moreinfo@hnb.net

Web : www.hnb.net

CREDIT RATINGS

The Bank has been assigned a national long term rating of AA-(lka) by Fitch Ratings Lanka Limited and a Foreign Currency Issuer rating of B1 by Moody's Investors Service.

BOARD OF DIRECTORS

Mr Rienzie Arseculeratne (*Chairman*)
Mr Jonathan Alles (*Managing Director / CEO*)
Ms M A R C Cooray
Dr L R Karunaratne
Mr L U D Fernando
Mr Sujeewa Mudalige
Ms D S C Jayawardena
Mr R S Captain
Mr Amal Cabraal
Mr Palitha Pelpola
Mr D Soosaipillai
Mr Nilanth de Silva

BOARD SECRETARY

Ms K A L Thushari Ranaweera
*Attorney-at-Law, LL.M (Cambridge),
Dip in Int'l Affairs (BCIS)*

AUDIT COMMITTEE

Mr Sujeewa Mudalige (*Chairman*)
Dr L R Karunaratne
Mr Amal Cabraal
Mr Nilanth de Silva

NOMINATION COMMITTEE

Mr Rienzie Arseculeratne (*Chairman*)
Ms M A R C Cooray
Mr R S Captain
Mr Palitha Pelpola

HR & REMUNERATION COMMITTEE

Mr Rienzie Arseculeratne (*Chairman*)
Mr L U D Fernando
Mr Sujeewa Mudalige
Mr Amal Cabraal

BOARD INTEGRATED RISK MANAGEMENT COMMITTEE

Ms M A R C Cooray (*Chairperson*)
Mr L U D Fernando
Ms D S C Jayawardena
Mr D Soosaipillai
Mr Jonathan Alles - *Managing Director/CEO*
Mr Damith Pallewatte - *Chief Risk Officer*
Ms Mohini Seneviratne - *Head of Compliance*

JOINT VENTURE COMPANIES

Acuity Partners (Pvt) Ltd 50%
(*Financial Services*)

SUBSIDIARY COMPANIES

HNB Assurance PLC 60%
(*Insurance Services*)
Sithma Development (Pvt) Ltd 100%
(*Property Development*)
HNB Grameen Finance Limited 51%
(*Financial Services*)

AUDITORS

Ernst & Young
Chartered Accountants
201, De Saram Place
Colombo 10, Sri Lanka.

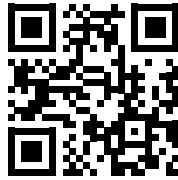
INVESTOR INFORMATION

Institutional Investors, Stockbrokers and Security Analysts requiring financial information should contact the Chief Strategy Officer
"HNB Towers", Level 16,
No. 479, T B Jayah Mawatha (Darley Road),
Colombo 10, Sri Lanka.

Telephone : +94 11 2661555

Fax : +94 11 2662815

e-mail : rajive.dissanayake@hnb.lk



www.hnb.net



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Fax No : +94 112662832, e - mail : feedback@hnb.lk