

Everyone says we're Number



Integrated Report 2018

**We say,
you're our
Number**



For over 130 years, HNB has honed a legacy of superior service and a reputation of strength and stability, along the way inspiring the trust and love of the thousands of Sri Lankans that we partner in progress.

This year, we are proud to report that the renowned Banker Magazine UK has ranked your Bank first among Sri Lankan banks in its list of the Top 1000 World Banks for 2018. This is a powerful endorsement of the corporate transformation we are crafting: a purposeful effort to unleash the ultimate potential of every aspect of your Bank to fulfil the dreams and aspirations of every one of our stakeholders.

This recognition and the many others detailed herein, give us an opportunity to thank the customers, employees, investors, partners and regulators; the people and communities whose loyalty and trust we acknowledge with gratitude.

In an era of rapid evolution towards a whole new world of banking, we reaffirm our commitment to be your partner in progress.

In these uncertain and unpredictable times, our sincere pledge is to remain steady and strong, and to be worthy of your trust and loyalty.

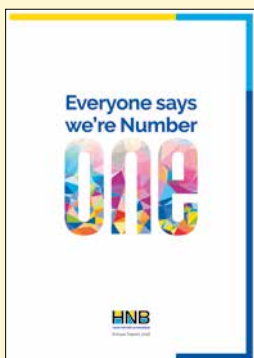
Today we are Number 1.

And that's because at HNB, you're our Number 1.

You have made us who we are.

And so we simply say, Thank You.

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At HNB we clearly understand how retail and commercial banking now has to meet increasingly complex criteria of governance, sustainability and value addition, in order to stay relevant and deliver what is required, quickly, consistently and well. In shaping our '2020 and beyond' strategy we aimed high, striving to discern and fulfil our stakeholders' every hope and aspiration now and over the years to come, because we believe that our long experience of transforming lives in a diversity of regions, serving many communities for generations, makes HNB the bank best positioned to lead the nation into the future.

This report details our operations for the year under review, describing how we continue to serve the nation through our commitment to job creation and national development, supporting economic and social development through our many SME, micro-finance and loan programmes designed to advance rural economies. We also continue our drive to become Sri Lanka's most technologically advanced bank, bringing our digital services and products to people whenever they need them, wherever they are.

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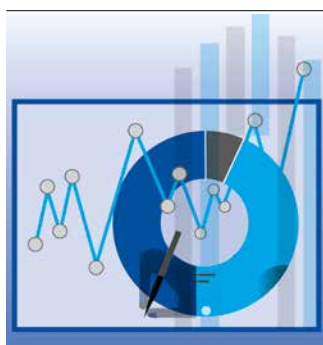
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VISION

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

Scan the QR Code with your smart device to view this report online.



or download it @ <https://www.hnb.net/2018#integrated-report-2018>

Read our HNB Corporate Governance and Risk Management Report 2018



or download it @ <https://www.hnb.net/2018#corporate-governance-risk-management-report-2018>

About Our Report

We continue our quest for excellence in corporate reporting with an even leaner collection of reports which comply with legal requirements and international best practice. Our objective is to communicate the relevant material information in a concise but comprehensive manner to provide shareholders with a balanced review of our performance during the year.

INTEGRATED ANNUAL REPORT 2018

This report is primarily for providers of financial capital and will be of interest to other stakeholders as it summarises information on all material issues impacting our performance.

Frameworks Applied

- Companies Act No.7 of 2007
- Sri Lanka Financial Reporting Standards issued by the Institute of Chartered Accountants of Sri Lanka
- IR Framework issued by the International Integrated Reporting Council (refer annexure page 327 for application of <IR> guiding principles)
- GRI Standards
- Communicating Sustainability issued by the Colombo Stock Exchange

Assurance has been provided by Ernst & Young on the Financial Statements including the Notes to the Accounts.

DNV GL has provided assurance on the Sustainability Report.

CORPORATE GOVERNANCE, RISK & CAPITAL MANAGEMENT REPORT

This report is intended for providers of financial capital and regulators who require deeper insights into the Bank's approach to managing risk and financial capital.

Frameworks Applied

- Code of Best Practice on Corporate Governance issued by the Institute of Chartered Accountants of Sri Lanka
- Banking Act Direction No.11 of 2007 and subsequent amendments thereto
- Directions issued by Central Bank of Sri Lanka on Risk Management including the Basel Capital Accord (II)
- Baseline Security Standards
- Sri Lanka Financial Reporting Standards issued by the Institute of Chartered Accountants of Sri Lanka
- Companies Act No.7 of 2007
- ISO 31000 – Enterprise Risk Management
- ISO 27001 – Information Security
- PCIDSS – Payment Card Industry Data Security Standards

Assurance has been provided by Ernst & Young to Central Bank of Sri Lanka on Compliance with the Banking Act Direction No.11 of 2007 and subsequent amendments.

Scope & Boundary - Whilst financial information presented is consolidated, the non-financial information presented is only for the Bank as we are in the process of further strengthening the process of data management systems within the group to ensure increased system reliability and completeness.

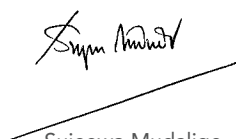
The Management of Hatton National Bank PLC has reviewed and approved the relevant content of all reports and recommended the report to the Board Audit Committee and Board for their approval as per delegation of authority.

The Board acknowledges its responsibility to ensure that the Annual Integrated Report provides a balanced view of its performance in 2018 and is of the opinion that it addresses all material issues that it believes may have a bearing on the Group's capacity to create value over the short term.

The reports were unanimously approved by the Board on 20th February 2019 and are signed on its behalf by



Dinesh Weerakkody
Chairman



Sujeewa Mudalige
Board Audit Committee



Jonathan Alles
Managing Director/CEO

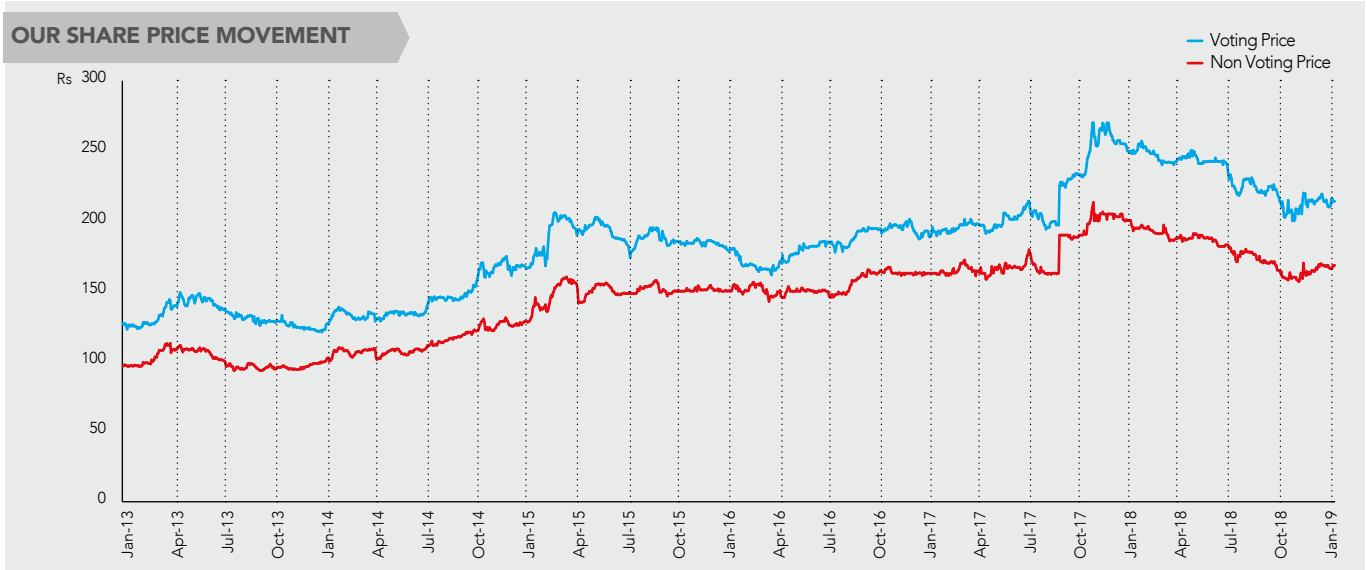
Colombo, Sri Lanka
20th February 2019

INNOVATIONS IN 2018

- Performance highlights have separate statements for Economic, Social and Environmental Performance
- Business line reviews highlight value to Group and value to external stakeholders facilitating a balanced assessment of performance
- Segregated digital capital from manufactured capital in recognition of its strategic significance and described how we nurtured this capital more fully
- Adopted and reported compliance with the new Code of Best Practice on Corporate Governance issued in December 2017
- Further refined the combined Corporate Governance and statutory report of the Board, eliminating repetition while conforming to regulatory requirements
- Streamlined the reporting suite to just two reports

Why invest with us?

Leading positions in regional geographies, competitive differentiation, a track record of consistent growth, a strong and committed leadership, highly experienced, long-serving management team and a strong independent board all combine to make the Bank a very attractive investment opportunity.



FITCH RATINGS

The Bank's national long term rating by Fitch Ratings (Lanka) Ltd is

AA-(lka)

OUR STRENGTHS

- ◆ **Wide reach**
- ◆ **Comprehensive product proposition**
- ◆ **Strong capital position**
- ◆ **Robust business model**
- ◆ **The most diversified financial services sector group**

Our competitive differentiation is centered on agility and customisation across the value chain. HNB offers integrated solutions, with service offerings and operating models tailored to client requirements and market maturity.

GROUP ASSETS

Rs 1,149 Bn

We guarantee efficient capital and funding structures

INVESTOR RATIOS

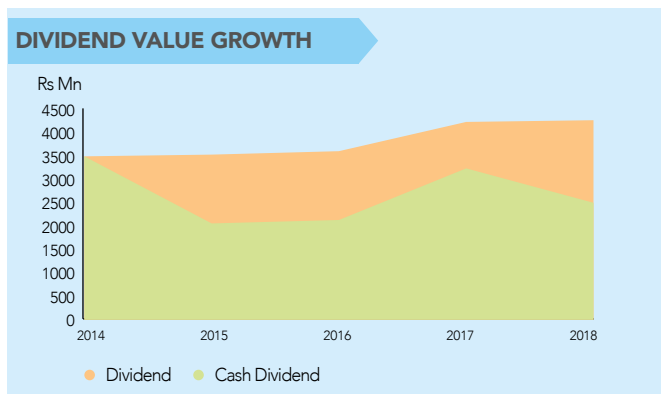
Price to Book Value

0.8 times

Price Earnings

6 times

Our stock continues to be relatively undervalued



RECOGNITION

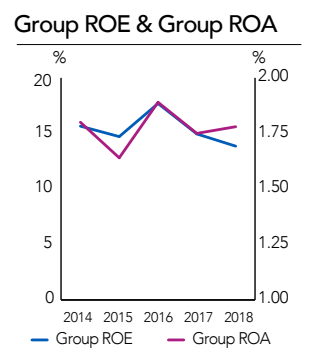
Best Investor Relations
Silver award from CFA Sri Lanka

Best Corporate Governance Disclosure
Silver Award at CA Sri Lanka Annual Report Awards

CSE RANKING

No. 5

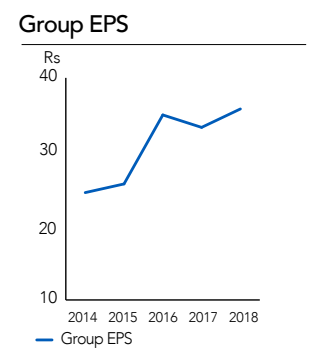
by Market Capitalisation



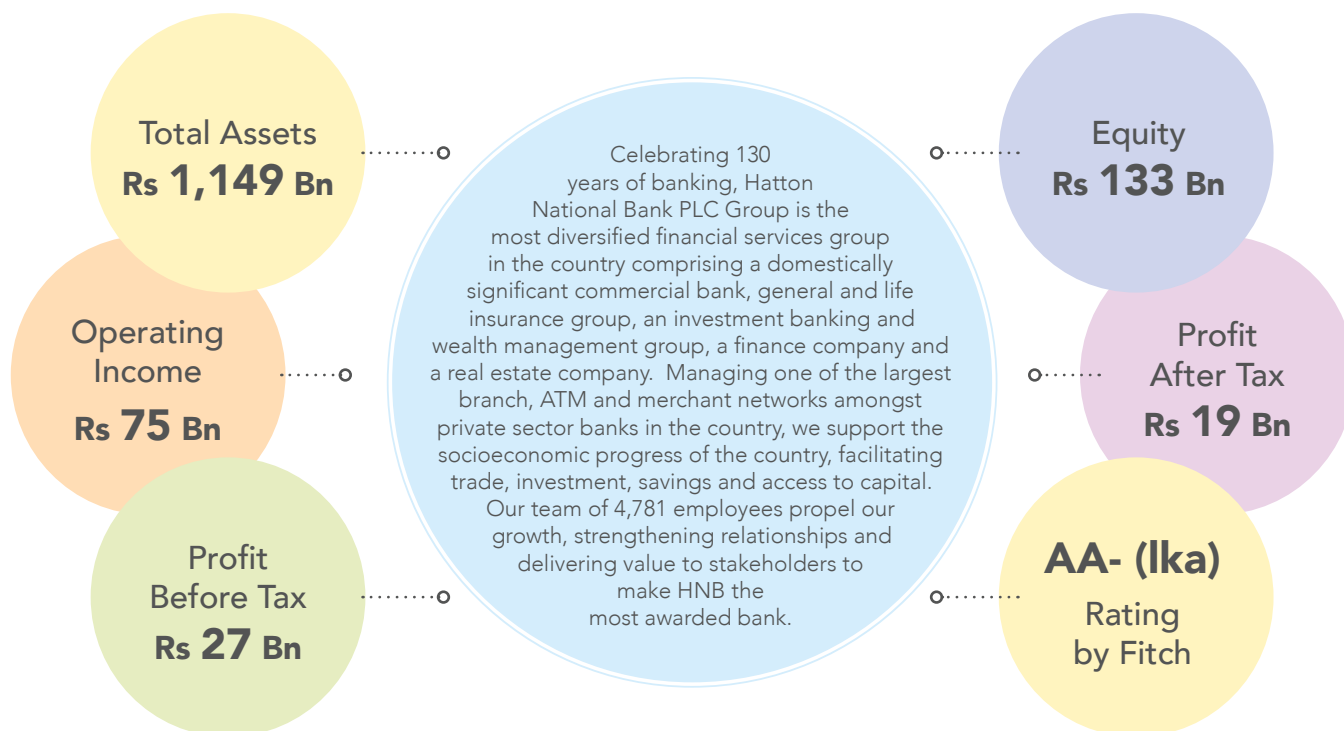
OUR LEADERSHIP

- ◆ **Governance and accountability**
- ◆ **Retention and succession planning**
- ◆ **Strategy, diversity and culture objectives**
- ◆ **Expertise and experience**

HNB has a well-constituted and diverse board, with expertise and experience relevant to strategy and the operating context within which the bank operates, underpinned by strong governance processes.



About Us



OUR BUSINESS


Our business verticals are determined on the principles of customer centricity and product specialisation, facilitating enhanced customer experiences and product innovation.

BANK	
Retail Banking Facilitates wealth creation of our customers through savings, investments, lending, remittance and transactional products. Total Operating Income Rs 19 Bn	Page 72
SME & Micro Finance Facilitates wealth creation of our customers through our savings, investments, lending, remittance and transactional products. Total Operating Income Rs 20 Bn	Page 76
Corporate Banking Supports growth aspirations of our customers by facilitating trade and investment. Total Operating Income Rs 14 Bn	Page 80
Transaction Banking Links customers to global opportunities supported by decades of expertise, global relationships and robust technology. Total Operating Income Rs 11 Bn	Page 82

SUBSIDIARIES	
Insurance Facilitates building resilience by enabling customers to hedge against perceived risks at business and personal levels. Total Operating Income Rs 9.6 Bn	Page 86
Investment Banking Offers a wide range of Investment Banking and wealth management services to customers. Total Operating Income Rs 0.9 Bn	Page 88
Finance Business (NBFI) Transitioning from a Grameen banking model to the business of a Finance company, we aspire to provide new opportunities for growth to our customers. Total Operating Income Rs 5.0 Bn	Page 90
Real Estate Owning the head office of the Group, this subsidiary delivers state of the art facilities for enhanced user experiences. Total Operating Income Rs 1.0 Bn	Page 92


CONNECTED

Customer Touchpoints

 **250**


684
Self Service Machines (SSMs)

Customers

 **2.5** Mn

Business Partners

950+
Correspondent Banks

 **15,000+**
Merchants

ECONOMIC IMPACT OF GROUP

Supporting Economic Growth

Rs **14.2** Bn
paid as Taxes

Rs **221** Bn
investments in GOSL Securities

Rs **179** Bn
disbursed as MSME Loans

Facilitated

Rs **221** Bn
of country's imports

Facilitated

Rs **85** Bn
of country's exports

SOCIAL IMPACT OF GROUP

 **4,781**
employees

 Supporting nearly **300,000**
Micro entrepreneurs

 Supporting over **100,000**
SME Businesses


 Investment in Infrastructure Development Projects
Rs **53** Bn

 **100%**
Corporate & SME loans screened for social and environmental compliance


AFFIRMATION

The Banker
TOP 1000
WORLD BANKS 2018
thebankerdatabase.com


Hatton National Bank
Sri Lanka
Country Ranking: 1




#1 Bank
Business Today




Best Retail Bank
The Asian Banker Magazine



Best SME Bank
Asia Money Magazine



Best Cash Management Bank
AsiaMoney
The Asian Banker
Euromoney



Best Corporate Citizen
(Runnerup)
Ceylon Chamber of Commerce

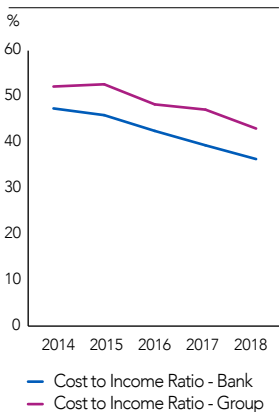
No 1 Bank in Sri Lanka
Top 1000 World Banks ranking, awarded by the Banker magazine UK

Performance Highlights

FINANCIAL

	2018 Rs Mn	Bank 2017 Rs Mn	Change %	2018 Rs Mn	Group 2017 Rs Mn	Change %
Financial Performance						
Income	121,356	106,295	14.2	138,251	119,759	15.4
Net interest income	47,580	39,649	20.0	53,636	45,461	18.0
Net fee and commission income	9,399	8,310	13.1	10,098	9,014	12.0
Total operating income	60,689	49,664	22.2	75,114	61,099	22.9
Net profit before taxation	29,321	27,072	8.3	33,006	28,363	16.4
Taxation (Incl. VAT, NBT & DRL on Financial Services, Deferred tax)	13,803	10,605	30.2	14,160	11,797	20.0
Net profit after taxation	15,518	16,467	(5.8)	19,149	16,741	14.4
Profit attributable to equity holders of the Bank	15,518	16,467	(5.8)	17,636	15,947	10.6
Financial Position						
Shareholders' funds (Capital and Reserves)	115,754	108,148	7.0	132,661	122,009	8.7
Deposits from customers	799,975	701,519	14.0	818,042	718,770	13.8
Gross loans and receivables to customers	771,693	649,547	18.8	794,186	666,768	19.1
Total assets	1,086,489	954,878	13.8	1,148,614	1,007,560	14.0
Profitability						
Return on assets (%)	1.52	1.82	(16.3)	1.64	1.67	(2.1)
Return on equity (%)	13.86	17.79	(22.1)	13.85	14.95	(7.4)
Cost to income ratio (%)	36.38	39.38	7.6	43.03	47.15	8.7
Investor Information						
Earnings per share (Rs)	31.50	34.40	(8.4)	35.80	33.31	7.5
Net assets per share (Rs)	234.96	219.64	7.0	269.28	247.79	8.7
Total dividend per share (Rs)	8.50	8.50				
Cash dividend per share (Rs)	5.00	6.50				
Regulatory Ratios						
Core capital ratio (%) (Minimum Req. - 2018 - 8.875%; 2017 - 7.75%)	12.80	13.72		13.16	13.74	
Total capital ratio (%) (Minimum Req. - 2018 - 12.875%; 2017 - 11.75%)	15.22	17.04		15.41	16.80	

Cost to Income Ratio



GROUP PAT

Rs 19.1 Bn

2017: Rs 16.7 Bn

GROUP EPS

Rs 35.80

2017: Rs 33.31

GROUP ASSETS

Rs 1.1 Tn

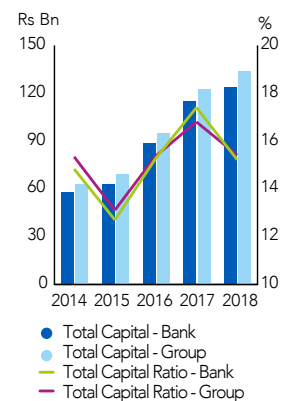
2017: Rs 1.0 Tn

GROUP NET ASSETS PER SHARE

Rs 269.28

2017: Rs 247.79

Capital Adequacy



SOCIAL PERFORMANCE

	Key Indicators	Unit	2018	2017
Social & Network Capital	No. of Customers	Nos	2,510,357	2,480,925
	Branches per 1,000,000 population	Nos	11	12
	Correspondent Banks	Nos	950	900
	Exchange Houses/Global Remittance Partners	Nos	90	83
	Total Loans Disbursed	Nos	80,179	70,478
	Strategic Philanthropy Spend	Rs Mn	423,360	339,740
Human & Intellectual Capital	No of Employees	Nos	4,781	4,348
	Retention Rate	%	93.6	96.0
	Investment in Training & Development	Rs Mn	49.1	38.2
	Training Coverage	%	94.5	100.0
	Gender Diversity Ratio (Male: Female)		58:42	60:40
	Employee Productivity (Revenue per Employee)	Rs Mn	25.4	24.5
Manufactured Capital	Branches	Nos	250	251
	SSMs	Nos	684	595
	Property, Plant & Equipment	Rs Bn	21.3	17.9
	Branches outside Western Province	No. of Branches	147	148

ENVIRONMENT IMPACT

	Key Indicators	Unit	2018	2017
	Online transaction volume growth	%	95	24
	Loans referred for impactful E&S screening to the Centre	Nos	76	49
	Energy Consumption	kWh	12,402,649	10,256,611
	Solar Power Generated	kWh	2,534,869	2,100,400
	Solar Power Generated as a % of Energy Consumption	%	17	17
	Carbon Footprint per Sqft	kg/sqft	3.9	4.0
	Paper Reused/Recycled	%	100	100
	Paper Disposed	kg	56,876	81,783

Our pledge to remain steady and strong



It is important that we keep our eyes on the vision, strategise with more vigor and exercise more vigilance in oversight on key initiatives for growth as headwinds from the operating environment are likely to be significant. As a systemically important domestic Bank, HNB will continue to seek ways to foster inclusive growth, enhance productivity and support growth of the country's financial sector while delivering value to all stakeholders.

Dear Shareholders,

It is my pleasure and privilege to welcome you to the 50th Annual General Meeting of Hatton National Bank PLC in my first year as Chairman and present to you, on behalf of your Board of Directors, the Annual Report of the Company for the financial year ended 31st December 2018 reflecting the performance of your Bank in its 130th year of operations.

Hatton National Bank PLC delivered a Group Profit after Tax of Rs 19.1 Bn in 2018, the highest delivered by a public listed financial services Group in the country. Total assets of the Bank grew at 13.8% during the year, and now stands at Rs 1,086 Bn accounting for over 9% of total assets of the banking sector of the country. The Group remains resilient with a Total Capital Ratio of 15.41%, comfortably above the enhanced regulatory requirement of 12.875% which came into effect on 1st July 2018. Interwoven into the economic fabric of our country with over 2.5 Mn customers, 4,781 employees and thousands of collaborative relationships, our business model focuses on building mutually a beneficial growth and nurturing a strong domestic franchise. Importantly, these numbers will inspire us to set the bar higher and deliver sustainable performance.

Our broad-based presence in the financial services sector enables the Group to provide a wide range of solutions to customers while leveraging Group synergies to enhance overall customer experience. A total market capitalisation of Rs 101 Bn makes HNB the fifth largest Company listed on the Colombo Stock Exchange accounting for 3% of total market capitalisation as at 31st December 2018. Prestigious awards bestowed on the Bank by institutions of national and international repute as set out in this Report serve as testimony to the overall value delivered to all our stakeholders.

PERFORMANCE

2018 was a year marked with many challenging policy changes globally and domestically, making the unexpected the new normal and resilience a key business imperative. Global growth is expected to be 3.7% and in line with 2017, impacted by the rising trade protectionism, uncertainty over Brexit, escalating political tensions in Europe and rising oil prices. Rising interest rates in the US posed challenges to emerging markets as capital inflows slowed leading to BOP and exchange rate pressure in emerging economies. Growth in 2019 is also forecast at 3.7% underscoring expectations that these 2018 macro factors will continue in the absence of manifest efforts to mitigate them. Inaction on climate change remains a key concern as many economies including our own, deal with its impacts which include declines in agriculture sector output, increased costs of disaster recovery, food supply chain disruptions and knock on effects on industry and commerce.

Sri Lanka's growth is estimated at 3.8% for 2018 and of note are the efforts taken by the Central Bank of Sri Lanka (CBSL) and the Government to minimise the impact on the economy after the recent political crisis. It is a matter of regret that Sri Lanka's sovereign ratings were downgraded late last year. Of concern is the resultant increase in cost of Sri Lanka's sovereign debt, which is clearly unsustainable. The CBSL has negotiated with regional

central banks and funds such as SAARC Swap Framework to obtain foreign currency SWAP facilities with the aim of strengthening the country's foreign exchange reserves. Fiscal and macroeconomic measures are already in place and the recent increase in exports are expected to minimise the pressure on the exchange rate and foreign reserves. Tourism development is increasingly viewed as an important tool in promoting economic growth. A review of key economic data is indispensable to provide a balanced view of the country's economic performance. Agriculture, industry and service sectors recorded positive growth of 4.3% YoY, 1.8% YoY and 4.4% YoY respectively during the first nine months of 2018. Agriculture growth was supported by favourable weather conditions while the industry sector was adversely impacted by the subdued performance of the construction, mining and quarrying sub-sectors. Growth in the services sector was broad based as financial services, trade and other services reflected increased activity. Inflation was maintained within policy targets despite increased oil prices and food supply pressures. The trade deficit increased as import growth of 10.3% during the first 11 months of 2018 outpaced export growth of 5.1% which exacerbated the pressure on exchange rates resulting in devaluation of the rupee by 19.6% against the US dollar. The impact on the Balance of Payments was cushioned by increased exports of services and earnings from tourism.

AT A GLANCE

Value Delivered to Shareholders

- Most Profitable Listed financial services sector Group
- Group Profit After Tax Rs 19.1 Bn
- Group Total Assets Rs 1,149 Bn
- Group ROE 14%
- Group ROA 1.6%

Performance Context

- Global Growth 3.7%
- Emerging & Developing Markets Growth 4.7%
- Sri Lanka Growth 3.8%
- Financial Sector Growth 12%
- Defining Our Vision
- Be the Leading Commercial Bank by 2020
- Investment in IT of Rs 1.8 Bn and enhanced Board IT capacity

GROUP ASSETS

Rs 1,149 Bn

2017: Rs 1,008 Bn

GROUP PROFIT AFTER TAX

Rs 19.1 Bn

2017: Rs 16.7 Bn

Chairman's Message

Defining a strategy that is fit for purpose, building on our achievements over a 130 year history is at the top of your Board's agenda. Supported by a team from Deloitte, we have developed a vision and articulated a strategy that will future proof the Bank to become more efficient and transform customer experience.

A RESILIENT FINANCIAL SECTOR

The banking sector has displayed resilience to both domestic and external challenges in 2018, delivering 9.5% nine month growth in Total Assets which stood at Rs 11,273.1 Bn at the end of the third quarter of 2018. Credit growth moderated to 12.8% due to the increase in Non-Performing Assets from 2.5% in 2017 to 3.6% by September 2018 and the tightening of monetary policy in the first half of the year. Interest income increased in line with the risks assumed by banks as economic growth remained subdued resulting in increased Net Interest Margins. Fee-based income also increased in line with external trade growth although imports were hampered by policy changes which deterred investments, and increased the cost and complexity of doing business. Profitability of the sector declined marginally due to increased impairment charges and higher operating costs. Foreign currency exposures of the sector also increased during the year as foreign currency asset growth outpaced foreign currency liability growth. Liquidity tightened marginally by the close of the year as indicated by the statutory liquid assets ratios of 28.8% and 44.5% (Sept 2018) for the Domestic Banking Units and Overseas Banking Units respectively but remain well above prudential requirement of 20%. Capital adequacy was also above regulatory requirements with the Core Equity ratio at 12.60% and Total Capital ratio of 15.90% at the end of September 2018.

OUR VISION

Defining a strategy that is fit for purpose, building on our achievements over a 130 year history is at the top of your Board's agenda.

Supported by a team from Deloitte, we have developed a vision and articulated a strategy that will future proof the Bank to become more efficient and transform the customer experience. Broadly, our strategy will look to accelerate organic growth and where necessary to implement a policy of targeted acquisitions in Sri Lanka and overseas.

Corporate values were also redefined in line with the new vision, shaping the culture to support our aspirations. Key Performance Indicators have been reset, setting clear goals for Corporate Management and paving the way for improved oversight of performance by the Board.

The digital transformation of the Bank is key to realising our vision. This transformation project seeks to replace legacy systems with state of the art functionalities to take us in to a new era of banking focused on empowering customers with efficient

processes. Progress on this project has been a regular agenda item for the Board and we have enhanced the collective skills of the Board to facilitate deliberation and discussion on the subject.

We are seeing new paradigms emerge around big data, analytics and the cloud. The interaction of these new technologies will affect the industry for many years to come. Board appointments during the year, reflect its strengthened capacity to make informed judgments in view of the projects significance. Early deliverables have been on target and we will continue our vigilance to ensure that outcomes meet expectations.

Ensuring that all employees are fully engaged in this transformation and aligned to our new vision is key to its success. Your Board has been active in ensuring that rewards are aligned with the KPI's and that adequate resources have been allocated to build the Bank's Bench Strength to realise our vision of building future ready employees and a sustainable talent pipeline for succession, a mission critical metric of our current and future success.

We understand that our market is exposed to technology enabled disruption and that our employees too need to be agile to compete and cater to our clients' needs to give them more choice. The emergence of Artificial Intelligence (AI) has already helped banks to understand better the data assets they hold and how they can deliver wholesome benefits more beneficially with technologies like block chain and

DIVIDEND PER SHARE

Rs **8.50**

2017: Rs 8.50

TOTAL MARKET CAPITALIZATION

Rs **101 Bn**

2017: Rs 116 Bn

Distributed Ledger Technology (DLT) which enhance trust and speed to market, at a lower cost to the customer.

Reviewing the performance of the Bank, it is encouraging to note early signs of transformation such as the growth in digital transactions, improved turnaround times of a number of processes and the readiness of the leadership team of the Bank to up their game.

COMMITMENT TO RESPONSIBLE BANKING

Responsible banking is synonymous with sustainability and support our goal of building a resilient Bank. Delivering value to stakeholders is embedded into our business model as a sine qua non for long term sustainable value creation. Evidence of our commitment to the UN Sustainable Development Goals is clearly set out in this Annual Report, supporting high levels of awareness of these goals and inspiring our team to align their work accordingly. We continue to drive integrated thinking in our strategy, which is the final object of the Integrated Reporting Framework ensuring that we focus on delivering value to stakeholders while focusing on our key issues.

The foundation for responsible banking is sound corporate governance and HNB is committed to upholding the highest standards in this regard. During the year, we adopted the revised Code of Best Practice on Corporate Governance issued by the Institute of Chartered Accountants of Sri Lanka in December 2017 and have effected the necessary changes to facilitate full compliance. At its core, it is about balancing stakeholder interests which is the foundation for sustainability with integrated thinking.

OUTLOOK

Global forecasts for growth remain flat at 3.8% for 2019. The outlook for the country is also challenging given the low growth forecasts for 2019. It is important that we keep our eyes on the vision, strategise with more vigour and exercise more vigilance in oversight on key initiatives for growth as headwinds from the operating environment are likely to be significant. As a systemically important domestic Bank, HNB will continue to seek ways to foster inclusive growth, enhance productivity and support growth of the country's financial sector while delivering value to all stakeholders.

We start from a position of strength in 2019 with a strong balance sheet, a trusted domestic franchise, time tested relationships and an affinity to technology. Looking back on our journey, it is evident that we have been truly partners in growth with our customers, business partners and suppliers and it is this commitment to shared prosperity and for a greatly improved customer experience that will continue to fuel our growth in the future.

APPRECIATIONS

I place on record my appreciation of the able stewardship provided by our former chairman Mr Rienzie Arsecularatne. I also thank our former Directors Mrs M A R C Cooray who retired

on 15th February 2019 after completing nine years with the Bank and Miss D S C Jayawardena who resigned w.e.f. 28th June 2018 for their valuable contribution on the Board.

On behalf of the Board, I thank the team of the HNB Group for their dedication and commitment to delivering the results set out in this Annual Report. I wish to convey my appreciation to Mr Jonathan Alles, Managing Director and Chief Executive Officer and other Chief Executive Officers of the group companies who have inspired their teams to reach higher in a very challenging and difficult year. I also thank all of our employees for their dedication and hard work and look forward to their continuing contribution to the success of the Bank.

I conclude by thanking CBSL and all our stakeholders for their continued confidence in us and look to your continued support into the future.



Dinesh Weerakkody
Chairman

Colombo, Sri Lanka
20th February 2019

The foundation for responsible banking is sound Corporate Governance and HNB is committed to upholding the highest standards in this regard. During the year, we adopted the revised Code of Best Practice on Corporate Governance issued by the Institute of Chartered Accountants of Sri Lanka in December 2017 and have effected the necessary changes to facilitate full compliance.

At HNB, you're our Number One...



Hatton National Bank PLC was ranked as the number one bank among Sri Lankan banks in the top 1000 world banks listing by The Banker Magazine in 2018, a fitting milestone to mark our 130th year of operations. It is testimony to the enduring relationships we have forged in all corners of this beautiful country from our inception in the central hills, transforming to cater to the needs of an increasingly discerning customer. We are poised to lead the country to an exciting era of banking with customer centricity at its core, as we realise our digital aspirations.

Dear Shareholders,

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A BALANCED PERFORMANCE

HNB Group delivered a profit after tax of Rs 19.1 Bn recording a profit growth of 14.4% and Balance sheet growth of 14%, taking the Group's Total Assets to Rs 1.15 Trillion. We have built the most diversified financial services sector group in the country and our Group earnings were more broadbased in 2018 with subsidiaries contributing 19% of Profit After Tax, cushioning the impact of increased impairment charges and taxation of the banking sector and demonstrating the resilience of the Group. The Bank accounted for 81% of Group Profits and 94.6% of Group Assets.

Bank's Net Interest Income increased by 20% supported by portfolio growth of 17.2% and increased net interest margins reflecting both rising interest rates and careful attention to pricing risk. Fee and Commission Income increased by 13% albeit below expectations due to the fiscal measures imposed to curtail imports. Accordingly, total operating income grew by 22.2% to Rs 60.7 Bn in what proved to be a challenging year serving as testimony to our franchise and the indomitable spirit of our team.

The moderation in economic growth combined with SLFRS 9 implementation, led to an increase in impairment charges from Rs 3.0 Bn to Rs 9.3 Bn with the charge accounting for 15.3% of Total Operating Income.

It is noteworthy that Net Operating income grew by 10.2% to Rs 51.4 Bn despite the charge for impairments, reflecting the resilient performance of the Bank. Operating expenses grew by 12.9% reflecting inflationary pressures as well as an increased number of staff as we expanded our team to meet our growth aspirations. Despite this, the Bank's cost income ratio improved from 39.4% to 36.4% reflecting the progress made on streamlining processes and driving operational efficiencies. Consequently, Profit before VAT, NBT and the newly imposed Debt Repayment Levy was Rs 29.3 Bn reflecting a growth of 8.3% over the previous year.

Taxation played a key role in the profitability of the Bank and therefore, the Group. The Debt Repayment Levy (DRL) which came into operation in the 4th quarter of 2018 amounted to Rs 698.7 Mn, increasing the VAT, NBT and DRL component by 26.8% to Rs 6.3 Bn. The effective rate of income tax increased from 25.3% to 32.4% largely due to abolition of tax exempt status on SLDB and debenture interest income with effect from 1st April 2018 with the new Inland Revenue Act. Consequently, Operating Profit before VAT, NBT and DRL of Rs 29.3 Bn reflecting year

on year growth of 8.3% was transformed into Profit After Tax of Rs 15.5 Bn.

Total assets of the Bank grew by 13.8% to Rs 1.1 Tn, marking a milestone in the Bank's annals. It was supported by a prudent 18.8% growth in gross loans which amounted to Rs 771.7 Bn at the close of the year while debt instruments grew by 15% to Rs 213 Bn.

The total deposits of the Bank grew by 14% while initiatives implemented to support CASA growth, enabled the Bank to maintain the CASA ratio at 34.6% amidst unfavourable market conditions. Equity growth of 7% supported asset growth and stability of capital ratios. Core capital and Total Capital ratios stood at 12.80% and 15.22% respectively, comfortably above the regulatory requirements and the Bank's own risk appetite.

BUSINESS LINE REVIEW

Corporate banking delivered a sterling performance with a Total Operating Income of Rs 14.4 Bn driven by strong customer relationships combined with a relevant portfolio of products that enabled delivery of customised solutions. NII growth of 24.2% to Rs 11.3 Bn was supported by asset growth of 21.1% to Rs 358.2 Bn as we adopted a cautious approach to credit growth in line with prevailing macro-economic conditions. Fee income was driven through highly specialised offerings such as trustee and custodian services and cash management. Deposit growth of 15.2% to Rs 133.5 Bn was also largely attributable to expansion of our award winning cash management services. Impairment of Rs 3.3 Bn was mainly due to a few

AT A GLANCE

Alignment to Vision 2020

- Customer centricity at the core
- The preferred employer
- Driving digitisation
- Optimising efficiency

ASSETS

Rs 1,086 Bn

2017: Rs 955 Bn

PROFIT BEFORE VAT AND TAX

Rs 29.3 Bn

2017: Rs 27.1 Bn

Managing Director/CEO's Message

Total assets of the Bank grew by 13.8% to Rs 1.1 Tn, marking a milestone in the Bank's annals. It was supported by a prudent 18.8% growth in gross loans which amounted to Rs 771.7 Bn at the close of the year while debt instruments grew by 15% to Rs 213 Bn.

large loans. High levels of customer satisfaction and employee satisfaction affirm the service excellence of this key business line which manages one of the largest corporate banking portfolios in the country.

Retail banking business which has been recognised by the Asian Banker as the Best in Sri Lanka for ten years, also delivered a solid performance contributing Rs 18.7 Bn to total operating income and recording a loan book growth of 16.5% and deposit growth of 14.8%. Personal loans and leasing were the highest contributors to growth of the retail loan book. Cards drove growth of fee income, maintaining its leadership position in acquiring and increasing penetration in card issuance as we managed increased pressure on acquiring margins. Onboarding of clients to digital channels continues to be a key focus to deliver convenience and we are encouraged by the customer migration observed during the year supporting growth in digital revenues. We will continue to focus on this key customer segment to enhance customer experiences through improved turnaround times and digitisation of services.

SME focused on product innovation introducing technology to this sector to drive customer productivity, supporting growth of customers through dedicated SME cells. HNB Expo Credit, SME Business Card, HNB Assurance package were just some of the products that supported growth of this vital sector. Recognised as the Best SME Bank in Sri Lanka by Asiamoney, SME also delivered a strong performance recording a Total Operating Income of Rs 18.5 Bn supported by strong NII growth of 13.3%. Impairment charges of Rs 6.1 Bn reflected the challenging environment in which this segment operated as customers faced numerous challenges ranging from adverse weather patterns, delays in government payments and weakening consumer demand.

Microfinance supports financial inclusion and works with specialised institutions to support the Bank's goals for inclusive growth. Adjudged the best microfinance bank in Sri Lanka by the International Finance magazine, this key growth area delivered Total Operating Income of Rs 1.4 Bn supported by deposit growth of 40.6% and loan growth of 25.9%. Performance was supported by introducing value chain financing for corporates and changing our operating model to partner microfinance institutions.

Treasury contributed Rs 8.2 Bn to Group Total Operating Income. Asset growth was curtailed to 9% while liability growth was 42% reflecting the tight liquidity conditions that prevailed during the year. Handling some of the largest volumes in the country, HNB's treasury has been acknowledged as the Best Treasury in

Sri Lanka by the Asian Banker, testimony to our robust and efficient processes and a highly specialised talent pool.

HNB Assurance delivered a profit after tax of Rs 2.7 Bn amounting to an 197% increase over 2017. This was mainly attributable to improved performance of the subsidiary HNB General Insurance Ltd., which contributed Rs 230 Mn, cost efficiencies which enabled curtailing cost increases to 8% and a deferred tax asset of Rs 1.2 Bn. HNB Assurance maintains its position as one of the fastest growing insurers implementing a strategy of customer segmentation and targeted marketing combined with risk selection and effective pricing of risk.

HNB Finance changed its name from HNB Grameen and is now positioned as a full service finance company. Total Operating income of Rs 5,043 Mn supported by a strong loan book growth of 35.5% and strong credit control which curtailed impairment charges while rising interest rates posed a challenge. PBT increase of 4.7% was absorbed by an 79.9% increase in income tax which increased the effective taxation rate from 26.1% in 2017 to 44.8% in 2018.

Acuity Partners, our joint venture, delivered a profit attributable to shareholders of Rs 609.6 Mn supported in turn by its venture capital arm, Lanka Ventures PLC in a share of profit of Rs 212 Mn and recognition of a deferred tax asset. Acuity consolidated its market position in a challenging industry, leveraging expertise and group synergies.

A NEW VISION

The leadership of the Bank revisited our vision and strategy with a view to challenging ourselves to deliver a quantum leap forward with the assistance of external consultants. The outcome is our Vision 2020 to become the #1 bank in Sri Lanka in terms of customer centricity, reputation, digitisation, preferred employer and profitability. Clear measures for success were also established ensuring that everyone had a common understanding of key performance indicators. We also aligned performance management to Vision 2020 with the assistance of external consultants to drive performance at all levels. We also engaged external consultants to have a fresh look at staff profiles and match people to the right role according to skills and competencies to optimise performance. Technocrats will drive our business verticals as we establish centres of excellence to drive high levels of specialisation.

CUSTOMER CENTRICITY

Our success is dependent on customer satisfaction which is managed through a holistic focus on delivering value to our customers. HNB is transforming to create an even more customer centric business model, which will go beyond traditional metrics of financial value set out in the business line reviews this year to developing new metrics that define customer experiences, supporting continuous improvement in this key aspect.

Launch of HNB Connect, our 24/7 fully integrated omni-channel contact centre, was a key initiative to take customer connectivity to the next level. Powered by a dedicated team of 80 Customer Engagement Associates and Specialists, the HNB Connect team offers speedy and effective solutions to customer inquiries. Our target of zero drops on inquiries coupled with metrics to track successful resolution of inquiries to the complete satisfaction of our customers within first contact are the key criteria for measuring effectiveness of this initiative. It will also provide insights into customer concerns, shaping our strategy to enhance value delivered to customers.

We also completed a full year's service with the Centre of Aspirations which was set up to support customers' repayment through courteous reminders, thereby avoiding additional charges and supporting the Bank's recoveries.

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GROSS LOANS

Rs 772 Bn

2017: Rs 650 Bn

DEPOSITS

Rs 800 Bn

2017: Rs 702 Bn

Delivering a strong pipeline of initiatives and innovations supporting enhanced customer experiences is a key priority for 2019, shaping the industry and how Sri Lankans Bank.

BUILDING OUR REPUTATION

Our domestic franchise is a key competitive advantage, driving our growth as we seek to be the most admired bank. This requires strong governance mechanisms and a positive organisation culture where everyone is challenged to high standards of performance and conduct, safeguarding our reputation. Operational excellence across business verticals and support functions is key to ensuring that our reputation grows as we reach new heights in performance. High levels of visibility and transparency, service excellence and solid financial performance shape our reputation. Awards and accolades affirm our positioning among peers in various aspects which all serve to ensure that we become the most admired bank in Sri Lanka.

Managing Director/CEO's Message

A comprehensive employee value proposition drives our positioning as a preferred employer. Driven by a dynamic Human Capital function, our team members derive value from opportunities for development and growth within the organisation with attractive remuneration, rewards and recognition for performance.

PREFERRED EMPLOYER

A comprehensive employee value proposition drives our positioning as a preferred employer. Driven by a dynamic Human Capital function, our team members derive value from opportunities for development and growth within the organisation with attractive remuneration, rewards and recognition for performance.

Our Human Capital Team had to deliver on multiple fronts as talent acquisition and development, driving culture change and leadership development accelerated in an unprecedented manner as an inspired and competent team are pivotal to our transformation. Activities were realigned to develop people aligned to the Bank's vision, values, core objectives to ensure that our teams have the competencies relevant to a future ready organisation.

Developing our leadership and future leaders was also a focus area as Vision 2020 gave urgency to strategic goals. It was imperative that we picked up our pace of execution, accelerating delivery within a three year time frame. Accepting the challenge, our leadership was supported by the development of future leaders and cross functional teams to deliver on multi-faceted programmes. Future leaders were provided with mentoring, coaching and counselling opportunities designed to support their development. Cross functional teams driving our transformation have worked together to deliver on a number of projects with encouraging outcomes.

Employee engagement levels continue to be high across multiple channels making for a vibrant organisation culture. The role of the Chief Employee Experience Officer established in 2017 continues to be a popular channel with employees backed by a proactive Human Capital department that supports resolution of issues. Comprehensive development plans ensure that our team is provided opportunities for development and career progression, underpinning our growth and talent pipelines.

FUTURE FIT

Our digital transformation is pivotal to our Vision 2020 as it becomes the game changer, delivering enhanced experiences for our customers and employees. We are upgrading our core banking system as well as the Loan Origination System while investing in technology to support innovation, efficiencies and enhanced user experiences. We are also deploying data analytics to gain insights into customer behaviours and preferences, leveraging our information assets which will support innovation

and risk management. A pipeline of digital innovations providing solutions to internal and external customers will ensure that HNB remains future fit as detailed in our first Digital Capital report on page 52.

PROFITABILITY & EFFICIENCY

We are transforming to deliver increased value to stakeholders while driving efficiencies to do more with less. This has been a key thrust over the past few years and our results are testimony to the successful delivery of this key strategy as set out in the adjacent graph. Our cost efficiency ratio has improved from 47.4% in 2014 to 36.4% in 2018, decreasing at a faster rate than industry as we embedded efficient work practices into our culture. A holistic transformation programme led by the cost optimisation committee focusses on optimising costs while enhancing customer and staff experience without compromising volumes, controls and top line growth. Solar panel installations for branches, paperless office, adopting revenue sharing models and driving employee productivity are some of the key areas of impact which supported the improvement in cost efficiencies. I commend the Committee for seamlessly integrating the social and environmental concerns into their solutions, making HNB a truly future fit corporate citizen.

2019 & BEYOND

HNB Group has delivered a strong performance despite significant economic headwinds and political and policy uncertainty. Built on values that have always

NET ASSETS

Rs **116** Bn

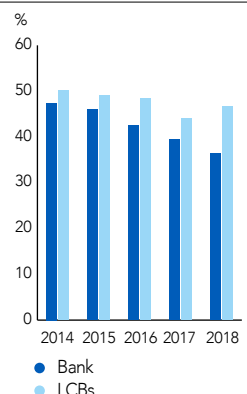
2017: Rs 108 Bn

CAPITAL ADEQUACY RATIO

15.22%

2017: 17.04%

Cost to Income



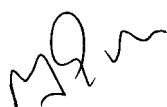
been in sync with industry ideals that are being articulated and promoted only now, HNB has been a visionary that has supported the transformation of an inclusive banking industry. A clear vision that leverages the strong foundations of a resilient institution will support our transformation to cope with the challenges forecast for both local and global growth in 2019.

Global growth is forecast to decline from 3.7% in 2018 to 3.5% in 2019 and reflect concerns over trade tensions and tightening financial conditions. Sri Lanka's growth forecast for 2019 is 4.5%, an increase from the 2018 estimate of 3.5% as estimated by the Asian Development Bank. Key concerns for 2019 will include high interest rates, a weaker rupee, tighter liquidity, government consumption and political uncertainty. We expect our operating environment to present challenges and have put in place strategies and processes to drive performance towards realising our Vision 2020. On a positive note, we expect our exports to strengthen as the rupee becomes more competitive and the decline in oil prices will also support both the trade deficit and an easing in inflationary pressures.

APPRECIATIONS

It's been my privilege to conduct the Bank's performance, and like an orchestral performance, it requires the combined talents and dedication of many to deliver an outstanding one. I thank the Chairman, Mr Dinesh Weerakkody, and the Board for their strategic leadership and oversight of performance which enabled us to deliver solid growth and profitability. An inspired and talented team worked hard to deliver on many fronts, growing in capability and confidence as they embraced change at an accelerated pace; I extend my sincere appreciation to my entire team for their efforts and unfailing camaraderie. My team and I are grateful for the cooperation and guidance provided by officials of the Central Bank of Sri Lanka in facilitating compliance with regulations.

HNB has been extremely fortunate in having loyal customers across all our business segments who have grown with us and supported our growth in numerous ways. We are extremely appreciative of your confidence and count on your continued enthusiastic onboarding of products in our pipeline, designed to enhance your experience. We extend our thanks to all the business partners who facilitated various aspects of our performance and look forward to innovating for growth in the future. I thank our shareholders for their continued participation and interest and look forward to delivering value in 2019.



Jonathan Alles
Managing Director/CEO

Colombo, Sri Lanka
20th February 2019

The Board of Directors



DINESH WEERAKKODY
Chairman



JONATHAN ALLES
Managing Director
/ Chief Executive Officer



ROSE COORAY (MS)
Director



ROHAN KARUNARATNE (DR)
Director



SUJEEWA MUDALIGE
Director



RUSI CAPTAIN
Director



AMAL CABRAAL
Director



PALITHA PELPOLA
Director



DULIKSHA SOOSAIPILLAI
Director



A N DE SILVA
Director



DAMIEN FERNANDO
Director



MADU RATNAYAKE
Director



PRAWIRA RIMOE SALDIN
Alternate Director



THUSHARI RANAWEERA
Company /Board Secretary

- ▼ Board Audit Committee
- ◆ HR & Remuneration Committee
- Nomination Committee
- ✳ Board Integrated Risk Management Committee
- Related Party Transactions Review Committee
- ▮ Strategy & Investment Review Committee
- ⊕ Procurement & Assets Disposal Committee
- ❖ Board Credit Committee
- Chairman/Chairperson

The Board of Directors

DINESH WEERAKKODY

HNB:

Chairman

Appointed: May 2018

Independent, Non-Executive Director

Appointed: June 2017

Skills & Experience:

A former Chairman of Commercial Bank of Ceylon PLC, Employees Trust Fund Board of Sri Lanka. He was also a Director of DFCC Bank and an adviser to the Prime Minister.

Holds an MBA (University of Leicester, UK) and is a Fellow of the Chartered Institute of Management Accountants (UK) and of the Certified Management Accountants (Sri Lanka). Also holds a BTEC (UK) Certificate in Information Technology, an Advanced Diploma in Business Administration (ABE UK) and is a Professional Member of the Singapore Human Resource Institute. He was conferred an honorary membership by the Institute of Personnel Management of Sri Lanka for his contribution to HR.

Other Current Appointments:

Chairman of the National Human Resources Development Council of Sri Lanka and The International Chamber of Commerce of Sri Lanka. Holds several honorary advisory roles in the current government.

Currently serves in a number of private sector and MNC boards and its Chairs/ Member of the Audit Committee and the Remuneration Committee in several of those Companies. He is a Council member of the Employers' Federation of Ceylon and the Institute of Directors of Sri Lanka. He is a member of the CIMA Asia Pacific Industry Advisory Body and the National Health Development Fund of the Ministry of Health.

He is the recipient of a Jaycees Ten Outstanding Young Persons Award in 1999 and an International Associations of Lions Clubs National Achievers Award in 2008 for the advancement of good governance in the public sector.

Mr Weerakkody has published widely on Economics, Banking and Finance, HR, Leadership, Management, International Relations and development issues. He is an author of six books and is a regular business speaker / commentator.

JONATHAN ALLES

HNB:

Managing Director /Chief Executive Officer

Appointed: July 2013

Executive Director

Appointed: May 2013

Skills & Experience:

An experienced banker counting over 32 years in the industry with experience having served several international banks including HSBC-Dubai, Saudi British Bank-Riyadh, HSBC (Sri Lanka) and National Bank of Abu Dhabi. Holds an MBA from the University of Stirling, UK and is an Associate Member of the Institute of Bankers of Sri Lanka.

Other Current Appointments:

Chairman of HNB Finance Ltd and Acuity Partners (Pvt) Ltd. He is the immediate past Chairman/Director of Lanka Financial Services Bureau Ltd, Lanka Ventures PLC and LVL Energy Fund. He is the Vice Chairman of the Banking, Financial & Insurance Services Group of the Employers' Federation of Ceylon, a Member of the Main Committee of the Ceylon Chamber of Commerce and the Sri Lanka Institute of Directors. Mr Alles was recently appointed as Chairman of Asian Bankers Association for the period 2018-2020. He is a former member of the Advisory Committee of Sri Lanka Business & Biodiversity Platform.

Mr Alles is a dynamic Banker and a corporate leader; he has contributed to HNB's macro development with the Bank now operating through 250 customer centres, using cutting edge technological platforms and enabling a new paradigm in Sri Lanka's banking culture. Under his leadership, HNB has received recognition from numerous international and local institutions and continues to set new benchmarks in the Sri Lankan banking industry.

ROSE COORAY (MS)

HNB:

Non-Executive Director

Appointed: February 2010

Skills & Experience:

Counts over 43 years of experience in the financial sector, of which over 35 years is with the Central Bank of Sri Lanka, retiring as a Deputy Governor. Has extensive experience in policy making, programme/project implementation particularly in the area of regional development and microfinance, and in negotiation of loans and bilateral trade agreements. Has business experience across different industries, having served as the Government representative on a number of boards.

Holds an MSc from the University of Strathclyde, UK and BA (Hons) from the University of Ceylon, Peradeniya.

Other Current Appointments:

Chairperson of HNB Assurance PLC, HNB General Insurance Limited, Sithma Development (Private) Limited, Ceylon Guardian Investment Trust PLC and Ceylon Investments PLC .

Director of HNB Finance Limited and Guardian Capital Partners PLC.

Previous Appointments:

Director General Fiscal Policy and Economic Affairs, Ministry of Finance.

Government Director on the Boards of DFCC Bank, Sri Lanka Institute of Information Technology, Sri Lanka Telecom, Ceylon Electricity Board, De La Rue Currency & Security Print (Pvt) Ltd, Export Development Board, National Housing & Development Authority and Monetary Board Representative on West Coast Power (Pvt) Ltd.

Vice Chairperson, Institute of Bankers of Sri Lanka

ROHAN KARUNARATNE (DR)**HNB:**

Independent, Non-Executive Director

Appointed: October 2011

Skills & Experience:

Consultant Engineer, counts over 34 years' of experience in Civil Engineering. Wide business experience gained from leadership roles held in a range of industries.

Holds a PhD in Management and an MBA from the Sussex University (UK). A Civil Engineering Graduate and advanced Diploma holder in HIET (Chennai – India), is a Fellow of the International Institute of Management (HK) and a Fellow of the Ceylon Institute of Builders.

Other Current Appointments:

President of the Ceylon Institute of Builders (CIOB), Chairman of South Asian Lead Construction Institute of Overseas Training Academy, Advisory Panel Member of the Ministry of Megapolis & Western Development and Export Development Board.

Chairman of A.K.K Engineers (Pvt) Ltd, Associated Motor Finance Co Ltd, Hybrid Airports (Pvt) Ltd, Master Builders International (Pvt) Ltd, Pinthaliya Holiday Resorts & Spa, Arpico Finance PLC and a Director of Helanko Hotels & Spa (Pvt) Ltd.

Deputy Chairman, International Institute of Management.

Previous Appointments:

Past Chairman of the National Construction Association of Sri Lanka, inaugural Chairman of Human Resources Development (Pvt) Ltd and Advance Construction Training Academy and a Director of Property Development Ltd (BOC), Sino Lanka Hotels & Spa (Pvt) Ltd., and Canwill Holdings (Pvt) Ltd.

SUJEEWA MUDALIGE**HNB:**

Independent, Non-Executive Director.

Appointed: April 2012

Skills & Experience:

Counts over 26 years' of extensive experience in public accounting practice and in industry.

A Fellow of the Institute of Chartered Accountants of Sri Lanka, Fellow of the Chartered Institute of Management Accountants (UK), a Fellow of the Association of Chartered Certified Accountants (UK) and a Fellow of the Certified Public Accountants (Australia).

Other Current Appointments:

Managing Partner/Chief Executive Officer - Pricewaterhouse Coopers Director - Chairman – Mercantile Services Provident Society (MSPS)

Previous Appointments:

Past President of the Institute of Chartered Accountants of Sri Lanka (CA – Sri Lanka), Member of the Securities and Exchange Commission of Sri Lanka (SEC) and Chairman of SEC audit committee.

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.

Past President- Confederation of Asian and Pacific Accountants (CAPA)

Past Chairman of the Sri Lanka Accounting Standards Committee.

RUSI CAPTAIN**HNB:**

Non-Executive Director

Appointed: April 2012

Skills & Experience:

Experience gained in diverse business and leadership roles.

Secondary education at Millfield, U.K. and the University of Miami, Florida

Other Current Appointments:

Director of Polypak Secco Ltd, Paints & General Industries Ltd, Paints & General (Exports) Ltd, CIC Holdings PLC, Propertex Development Ltd, Austin Gloves (Ceylon) Ltd, CEI Plastics Ltd, Ranweli Ltd, Agriland Ltd, Forest Creek Park Ltd, Body Bar Ltd, Horahena Investments Ltd, Palmland Ltd, Parkland Ltd, Cisco Specialty Packaging (Pvt) Ltd, Randiya Farms Ltd, Link Natural Products (Pvt) Ltd and Chacra Capital Holdings (Pvt) Ltd.

AMAL CABRAAL**HNB:**

Non-Executive Director

Appointed: April 2014

Skills & Experience:

Counts over 30 years of business experience in General Management, Marketing and Sales in Sri Lanka, U.K., India and Bangladesh.

Executive Education Alumnus of INSEAD-France and holds a MBA from the University of Colombo. A Chartered Marketer and a Fellow of the Chartered Institute of Marketing – U.K.

Other Current Appointments:

Non-Executive Chairman of Ceylon Beverage Holdings PLC, Lion Brewery (Ceylon) PLC and CIC Feeds Group of companies. Independent non-executive Director of John Keells Holdings PLC, Sunshine Holdings PLC, Silvermill Investment Holdings (Pvt) Ltd and a Member of the Supervisory Board of Associated Motorways (Private) Ltd. Member of the Monetary Policy Consultative Committee of the Central Bank of Sri Lanka. Committee Member of the Ceylon Chamber of Commerce and Management Committee of the Mercantile Services Provident Society.

Previous Appointments:

Chairman and CEO of Unilever Sri Lanka

The Board of Directors

PALITHA PELPOLA

HNB:

Independent, Non-Executive Director

Appointed: April 2015

Skills & Experience:

Experience gained in diverse business and leadership roles.

Institute of Cost & Management Accountants Part III

Other Current Appointments:

Chairman, Ceybank Asset Management Limited. Chairman, Coconut Cultivation Board, Kapruka Fund Board Member, Tea Rubber & Coconut Fragmentation Board, Coconut Development Authority.

Previous Appointments:

Has served the Government of Sri Lanka through various appointments including Private Secretary to the President, Private Secretary to the Minister of Mahaweli Development and Lands & Land Development, Special Advisor to the Minister of Plantation Industries, Senior Advisor of the Ministry of Enterprise Development & Investment Promotion. Managing Director of Mahaweli Economic Agency.

Chief Executive Officer of Leader Publications Ltd and Media Consultant of World Health Organization.

Executive Director of Sri Lanka Foundation, Los Angeles, California, USA.

DULIKSHA SOOSAIPILLAI

HNB:

Independent, Non-Executive Director

Appointed: April 2015

Skills & Experience:

Over 30 years' of experience in Finance, Strategy, Risk Management & Compliance in the financial services sector.

A Fellow of the Institute of Chartered Accountants of Sri Lanka and a Fellow of the Institute of Certified Management Accountants of Sri Lanka.

Other Current Appointments:

Independent Non-Executive Director of Commercial Credit and Finance PLC and serves in many of its board sub-committees. Independent Non-Executive Director of Udapussellawa Plantations PLC and Hapugastenne Plantations PLC and serves on many of its Board Sub-Committees.

Previous Appointments:

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.

Managing Director of the Maldives Finance Leasing Company Pvt Ltd for more than 7 years and the Chief Executive Officer of Ceylease Financial Services Ltd - a subsidiary of the Bank of Ceylon.

Chief Operating Officer of Dunamis Capital PLC, the holding Company of the First Capital Group of Companies and the Kelsey Group of Companies.

A N DE SILVA

HNB:

Independent, Non-Executive Director

Appointed: April 2015

Skills & Experience:

Over 40 years' of experience in commercial banking and Bank Management.

Elected an Associate of the Chartered Institute of Bankers, London, UK in December 1978, on successful completion of its professional examinations.

Has been exposed to extensive training attachments in Banking and Management both locally and overseas with Dresdner Bank, AG, Germany, National Institute of Bank Management, Pune, India, Centre for Financial Engineering in Development, Washington DC USA, Mt Eliza Campus - Monash University, Melbourne, Australia.

Team Member of HNB's User Group Heads who evaluated IT Systems in the U.K. and India.

Participated in a study tour of the South African Banking System organised by the Institute of Bankers, South Africa.

Played a key role in HNB's acquisitions of Indosuez Bank and Habib Bank AG Zurich.

Other Current Appointments:

Independent Non-Executive Director, Malwatte Valley Plantations PLC and Holco Ceylon (Private) Ltd.

Previous Appointments:

Former Acting Chief Executive Officer and Chief Operating Officer, Union Bank of Colombo PLC, former Director, Lanka Clear Limited and former Alternate Director, Credit Information Bureau of Sri Lanka (CRIB).

Former Deputy General Manager (Corporate Banking), Hatton National Bank PLC.

DAMIEN FERNANDO

HNB:

Non-Executive Director

Appointed : October 2018

Skills & Experience:

Mr Fernando is a Fellow member of Chartered Institute of Management Accountants of United Kingdom and was awarded a Masters Degree in Business Administration from Postgraduate Institute of Management, University of Sri Jayawardenapura in 1992.

Other Current Appointments:

Mr Fernando is a Director of Addison (Pvt) Ltd and HealthCey (Pvt) Ltd. He has held Board and other positions in several sectors including Finance, Life & General Insurance, Assets management & Unit Trusts, Management of healthcare, food & beverages, manufacturing and in retail.

Previous Appointments:

Mr Fernando served as a non-executive Director in the HNB board from April 2012 to March 2017. He has also served as the executive Director of Sri Lanka Insurance Corporation Ltd from year 2003

– 2009. He was a Director of Distilleries Co. of Sri Lanka PLC from February 2006 – December 2008. Mr Fernando also served in the Director boards of Lanka Hospitals Corp. PLC (Sept.2006 – June 2009 and May 2009 – June 2016), Melstacorp PLC (June 2010 – Dec. 2011), Pelwatte Sugar PLC (April 2011 – Nov. 2011) and National Asset management Ltd (Sept.2007 – April 2010).

MADU RATNAYAKE

HNB:

Independent/Non-Executive Director
Appointed : October 2018

Skills & Experience:

A Chartered Engineer, Group CIO and the Centre Head for Virtusa Sri Lanka. He holds an MBA from the Postgraduate Institute of Management (Sri Jayawardenapura) and a First Class Honours Degree in Software Engineering from City University in London.

Has over 20 years' experience in IT, digital transformation, project and service delivery. He has experience in large scale business transformation program design and execution, driving corporate innovation, cyber security, solution architecture, customer support, consultancy and general management in UK, USA, Australia, India and Sri Lanka. He has delivered multi-million dollar projects to Fortune 1000 companies with geographically spread software teams.

Other Current Appointments:

Founder Director and former Chairman of Sri Lanka Association for Software and Services Companies (SLASSCOM), the industry body for IT and BPM in Sri Lanka and the former Chairman of Sarvodaya Fusion, the ICT4D arm of Sarvodaya, the largest NGO in Sri Lanka; He represents the IT industry on the boards of several leading universities/Institutions.

Previous Appointments:

Has served as a Director of Sanasa Development Bank from December 2014 to January 2016 and Sri Lanka Institute of Information Technology.

PRAWIRA RIMOESALDIN

HNB:

Alternate Director to Mr Rusi Captain – Director, HNB PLC
Appointed: July 2018

Skills & Experience:

Appointed as alternate Director in July 2018. He is a fellow of the Institute of Chartered Accountants of Sri Lanka, a fellow of the Chartered Institute of Management Accountants of London and a Certified Management Accountant Australia. Mr Saldin is an alumni of the Asia Institute of Management and serves as Chairman of Industrial Association of Sri Lanka.

Mr Saldin has over 30 years of experience in Finance, Operations and General Management.

Other Current Appointments:

He is presently the Director/CEO of Polypak Secco Ltd, a Director of Paints & General Industries Ltd and Polytex Properties and Investments Ltd. He is also the Chairman of Chemanex PLC and a Director of CIC Holdings PLC and serves in the Board of Directors of a number of companies in the CIC Group including Akzo Nobel Paints Lanka Ltd. Mr Saldin serves as the Chairman of the Audit Committee of CIC Holdings PLC.

Previous Appointments:

Mr Saldin has served as the Commercial Director and Group Finance Director of CIC Holdings PLC for the period 1995 - 2005. He was the Country Controller & Group Finance Director for Shell Sri Lanka for the period 2005 – 2010 and also the Group Chief Operating Officer, Browns Group of Companies PLC and the Managing Director of Brown Investments PLC from 2010 - 2014.

THUSHARI RANAWEERA (MRS)

HNB:

Company /Board Secretary
Appointed: January 2012

Skills & Experience:

She is an Attorney-at-Law and counts over 27 years of experience in Banking.

Mrs Ranaweera holds a Master's Degree in Law (LLM) – University of Cambridge, U.K. and a Diploma in International Affairs – Bandaranaike Centre for International Studies, Sri Lanka.

Other Current Appointments:

Deputy General Manager – Legal of HNB.

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 /
Chief Transformation Officer



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



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)
Deputy General Manager - HR
/ Chief Human Resource Officer



JUDE FERNANDO
M.B.A. (Sri J), A.I.B. (Sri Lanka)
Deputy General Manager
- SME & Mid Market



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 / Deputy
General Manager - Internal Audit



SANJAY WIJEMANNE
B.Sc. - Business & Finance
(Mount Saint Mary's Uni. - USA)
Deputy General Manager
- Retail Banking



ASANGA UDUWELA
M.B.A. (Sri J), B.Sc. Special (Pera)
Deputy General Manager
- Operations



DAMITH PALLEWATTE
M.B.A. (PIM-SJP), B.Sc. Mgmt. (Hons.)
London School of Economics, F.R.M.
(GARP), A.C.I
Deputy General Manager
- Risk / Chief Risk Officer /
Chief Information Security Officer



KALUM WIJESOORIYA
LL.B (Sri Lanka)
Assistant General Manager -
Deposits & Remittances / Chief
Employee Experience Officer



**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
Chief Financial Officer



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



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)
Assistant General Manager
- Trade & Financial Institutions



**CHANDANA
PANDITHARATNE**
Assistant General Manager
- Services



HISHAM ALLY
M.I.M. (Sri Lanka)
Assistant General Manager
- Islamic Banking



RUWAN BAKMEDENIYA
M.Sc. (IT) - Uni. of Keele (UK)
Assistant General Manager
- Information Technology /
Chief Information Officer

Senior Management



NIROSHINI WETTASINHA
Attorney-at-Law & Notary Public
Head of Legal



AYANTHI FERNANDO
Chief Manager
- Corporate Banking



CHAMMIKA WEERASINGHE
M.B.A. (Sri J), M.C.I.M. (UK)
Head of Marketing



VIRAJ MENDIS
Head of Credit Operations



PRASAD BASTIANZ
M.B.C.S. (UK), C.I.T.P.
Chief Manager
- Payment Systems



INDRAJITH SENADHIRA
M.B.A. (Sri J), M.A.L.S. (Colombo), LL.B
(Sri Lanka), Attorney-at-Law, Dip. in
Marketing (S.L.I.D.A.), Dip. in Credit
Mgmt. (S.L.I.C.M.)
Head of Human Capital
Management



SISIRA ATAPATTU
Chief Manager / Senior
Regional Head - Greater
Colombo Region 1



NISHANTHA WEERASINGHE
M.B.A. (AIB), A.I.P.F.M. (UK)
Chief Manager
- Head Office Branch



GUHADASS THIVAKARAN
Head of Recoveries



MOHINI SENEVIRATNE
B.A. (Hons.) - UK, M.B.A. - UK
Head of Compliance /
Compliance Officer



UPUL HETTIARACHCHI
M.B.A. (Manipal), N.D.H.R.M. (I.P.M.)
Chief Manager / Senior
Regional Head
- South Western Region 1



VINODH FERNANDO
Chief Manager / Senior
Regional Head
- North Western Region 1



MAJELLA RODRIGO
A.C.M.A (UK), M.B.A (Colombo), B.Sc.
(Colombo)
Head of Project Finance



NEIL RASIAH
M.B.A. - Finance (Australia), M.A. - Fin.
Econ. (Colombo), B.Sc. (Colombo), A.I.B.
(Sri Lanka), Dip. in Int. Trade (IBSL)
Chief Manager / Senior Regional
Head - Colombo Region 1



SAUMYA ARYASINHA
Chief Manager / Regional Head
- Colombo Region 2



KAILAIVASAN INDRAVASAN
M.B.A. - Finance (Australia), C.M.A.
(Australia), A.I.B. (Sri Lanka)
Chief Manager – Mid Market



SUPUN DIAS
Dip. in Marketing (UK), M.C.I.M. (UK),
M.S.L.I.M, Chartered Marketer
Chief Manager / Head of
Business Development



KANCHANA KARUNAGAMA
M.B.A. (Sri J), A.I.B. (Sri Lanka), M.C.I.M.
(UK), A.I.C.M. (Sri Lanka)
Chief Manager - Head of
Personal Financial Services



VIJAYA VIDYASAGARA
M.B.A. - Finance (Colombo),
A.I.B. (Sri Lanka)
Chief Manager - Corporate
Banking



EOMAL MUNASINHA
M.B.A. Uni. of Ecowa (Australia)
Chief Manager / Head of Talent
Development

Senior Management



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



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), M.I.M.S.L.
Senior Manager - Legal (Recoveries)



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



MANORI MOHOTTI
Attorney-at-Law, Notary Public &
Commissioner for Oaths
Senior Manager - Legal



SIVARAJAH NANDAKUMAR
M.B.A. (Sri J), A.I.B. (Sri Lanka)
Senior Manager – Operations



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



AJITH FERDINANDO
Senior Manager - Centralised
Operations



**INDRAJITH
HAPUARACHCHIE**
M.B.A. (Manipal), B.I.T. (Colombo), A.C.S.
Senior Manager - Digital
Strategy & Solutioning



SHERAN PERERA
M.B.A. (UK), A.I.B. (Sri Lanka)
Senior Regional Head
- Uva Sabaragamuwa Region 1



PRIYANTHA SENEVIRATNE
A.C.I.
Senior Manager
- Treasury (Corporate Sales)



VISHWANATH GUNAWARDENA
Senior Manager
- Development Banking



SAMPATH KUKULEVITHANA
M.B.A. (Manipal), Dip. in Marketing (UK)
Senior Regional Head
- Southern Region 1



DILUNIKA JAYASINGHE
M.B.A. (USQ), A.C.A. (Sri Lanka), B.Sc. (Colombo), A.C.S.I. (UK)
Senior Manager
- Credit Risk Management



PRIYANKA WIJAYARATNE
M.B.A. (Sri J), A.C.M.A. (UK), B.Sc. (Colombo)
Senior Manager
- Strategic Planning



NEVILLE JAYAWARDENA
A.I.B. (Sri Lanka)
Regional Head
- Greater Colombo Region 2



V T SAMPANTNER
Senior Regional Head
- Central Region 1



SOTHIRATNAM MATHANAN
M.B.A. (Australia), F.A.B.E. (UK)
Senior Manager - Pettah



RAJEEV RAJARATNAM
A.I.B. (Sri Lanka)
Senior Manager
- Systems Implementation



THANGARAJAH THAYALAN
M.B.A. (Australia), A.I.B. (Sri Lanka), M.A.B.E.
Senior Manager - Foreign Exchange & Money Markets



PATHMANATHAN SRIKANTH
M.B.A. (Cardiff -UK), A.I.B. (Sri Lanka)
Head of Financial Institutions

Senior Management



**SOMASKANDASARMA
NARENTHIRAN**

M.B.A. (UK)

Senior Manager - Wellawatte



ROSHANTHA JAYATUNGE

A.I.B. (Sri Lanka)

Head of Cards



DEEPAL UDUKUMBURA

N.Dip. Technology (Hardy TTI), P.G. Dip.
Management (Rajarata)

Senior Regional Head
- North Central Region 1



ANURADHI DELAGE

A.C.A. (Sri Lanka), A.C.M.A. (UK),
B.Sc. Accountancy (Sri J)

Senior Manager - Finance



ROSHAN FERNANDO

M.B.A. (Colombo), B.Sc. Eng (Hons.)
(Moratuwa), M.I.E.T. (UK)

Chief Operating Officer - Sithma
Development (Pvt) Ltd / Senior
Manager - Facilities Management



RUKSHAN SENARATNE

M.B.A. (Malaysia)

Senior Manager – Centralised
Credit Operations



SURANGA PEIRIS

A.I.B. (Sri Lanka), CIMA Adv. Dip. MA,
M.B.A. - Finance (USQ-Australia)

Senior Manager - City Office



DAMIAN RANJIT

A.I.B. (Sri Lanka), Pg. Dip. in Business &
Financial Administration (ICASL)

Senior Regional Head -
Northern Region 1



VIRANGA GAMAGE

Attorney-at-law, LL.B (Sri Lanka), M.B.A.
(Colombo)

Senior Manager - Deposits



**VINDHYA
WIJEGUNAWARDANE**

M.B.A. (Cardiff Metropolitan Uni.), Advanced
Certificate in Marketing (CIM – UK)

Senior Manager / Head of
Customer Experience



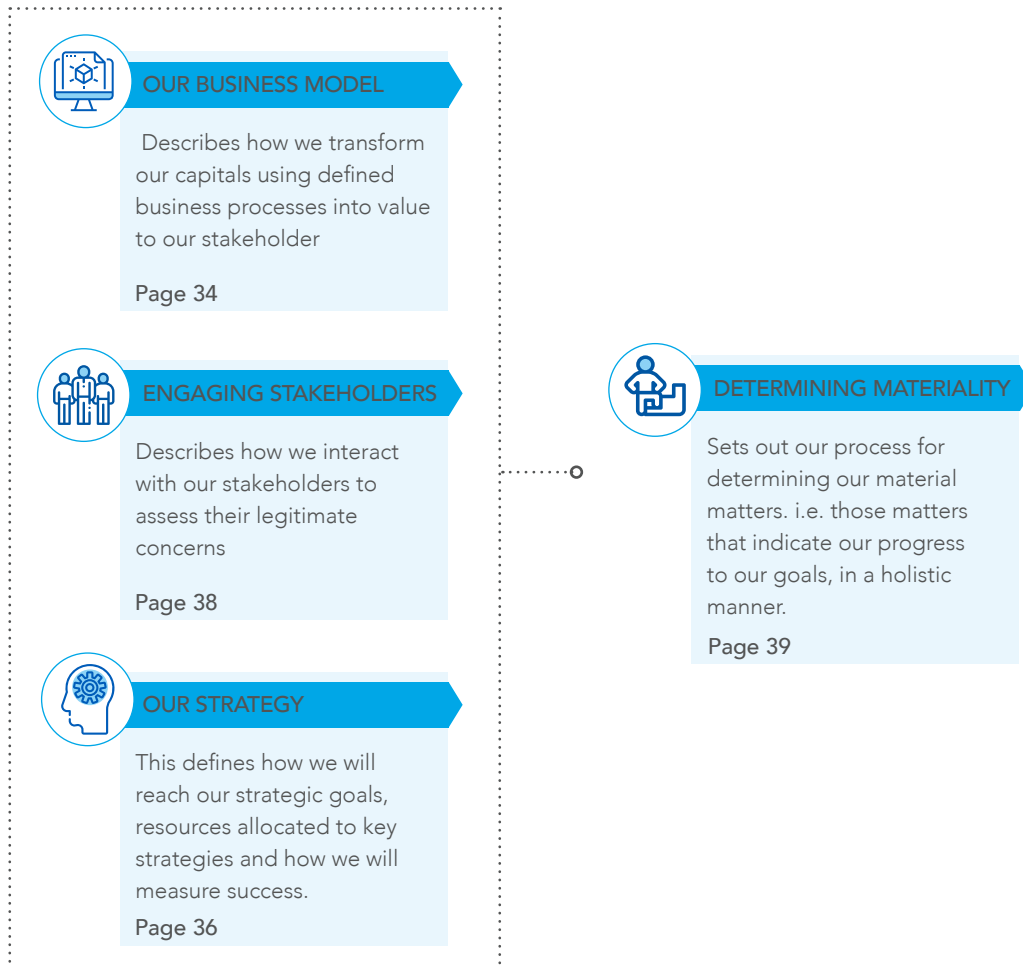
PASINDU DHARMASIRI

B.Sc. (Hons.) - IT (London Metropolitan
Uni. - UK), M.Sc. (IT) - (Charles Sturt Uni. -
Australia)

Head of Payment
& Cash Management

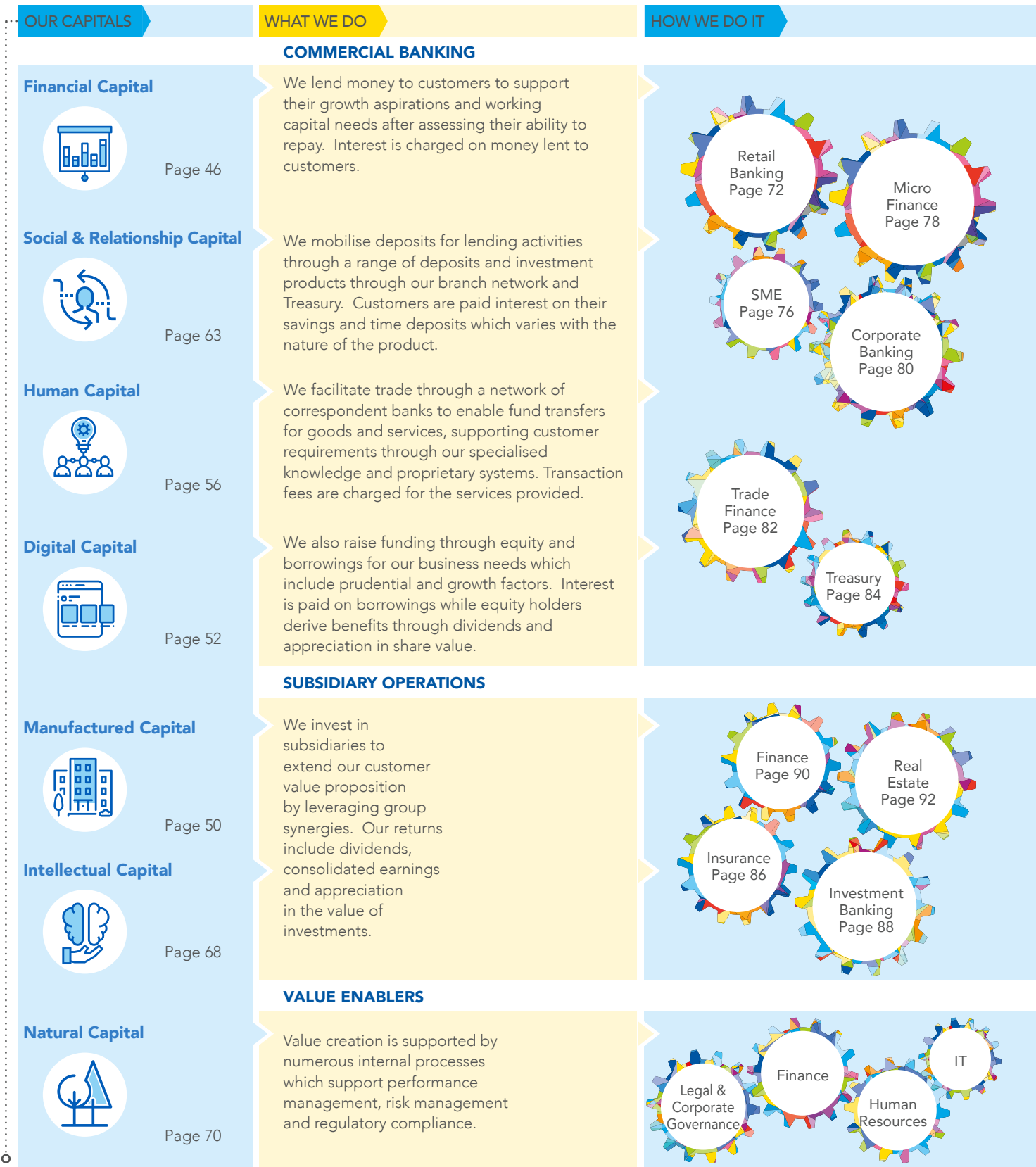
Overview of Our Business

Key elements necessary to understand our business are given in the following pages providing a clear picture of how we use our capitals to create value for the business and our stakeholders and how we intend to realise our aspirations. Together, they provide inputs to determine our material issues.



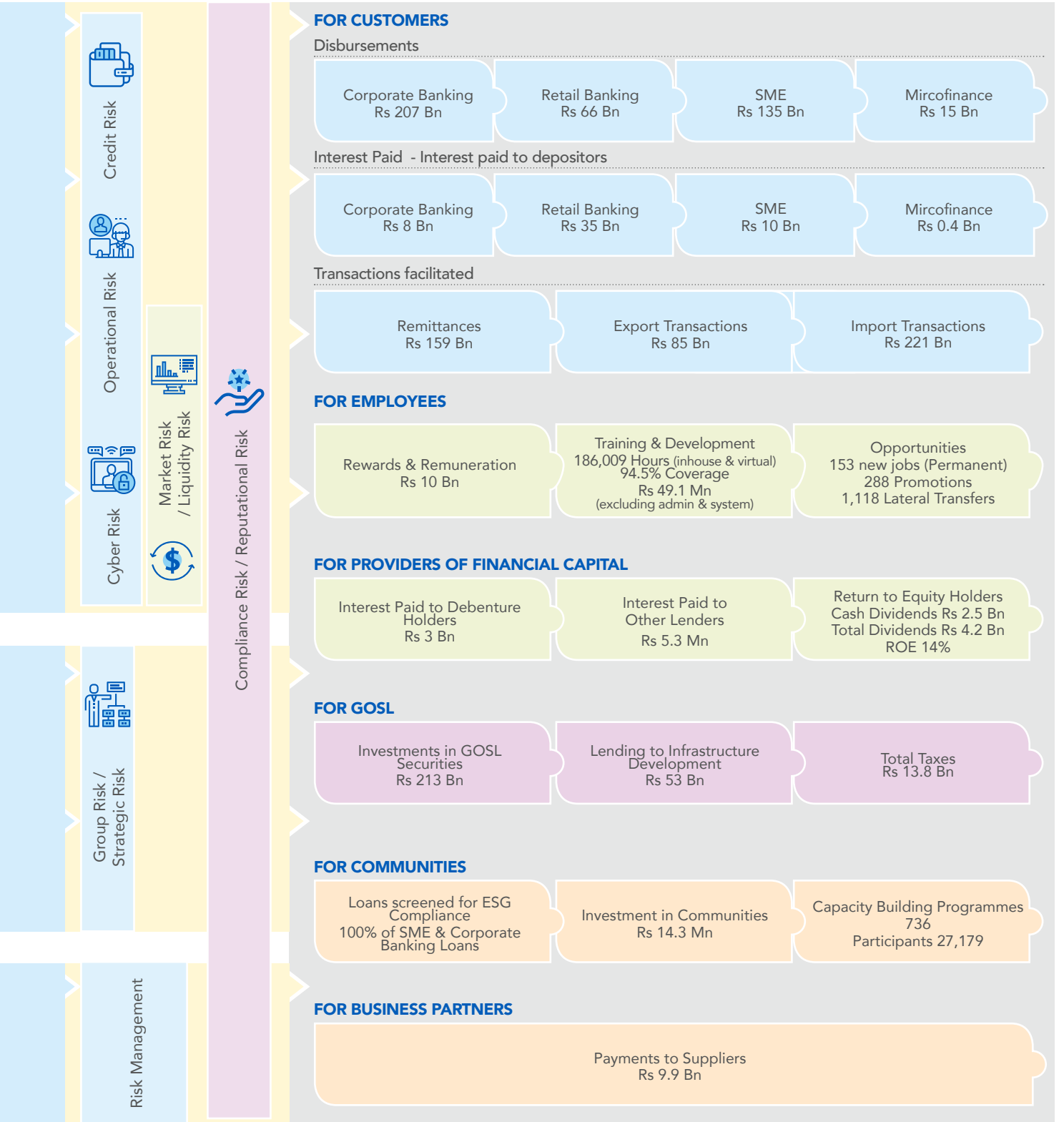
Our Business Model

As a diversified financial services group, we support capital formation and economic activity in the country while enabling customers to realise their socioeconomic aspirations and build financial resilience. Our business model below depicts how we engage our resources and relationships (capitals) to deliver value to stakeholders through specialised processes.



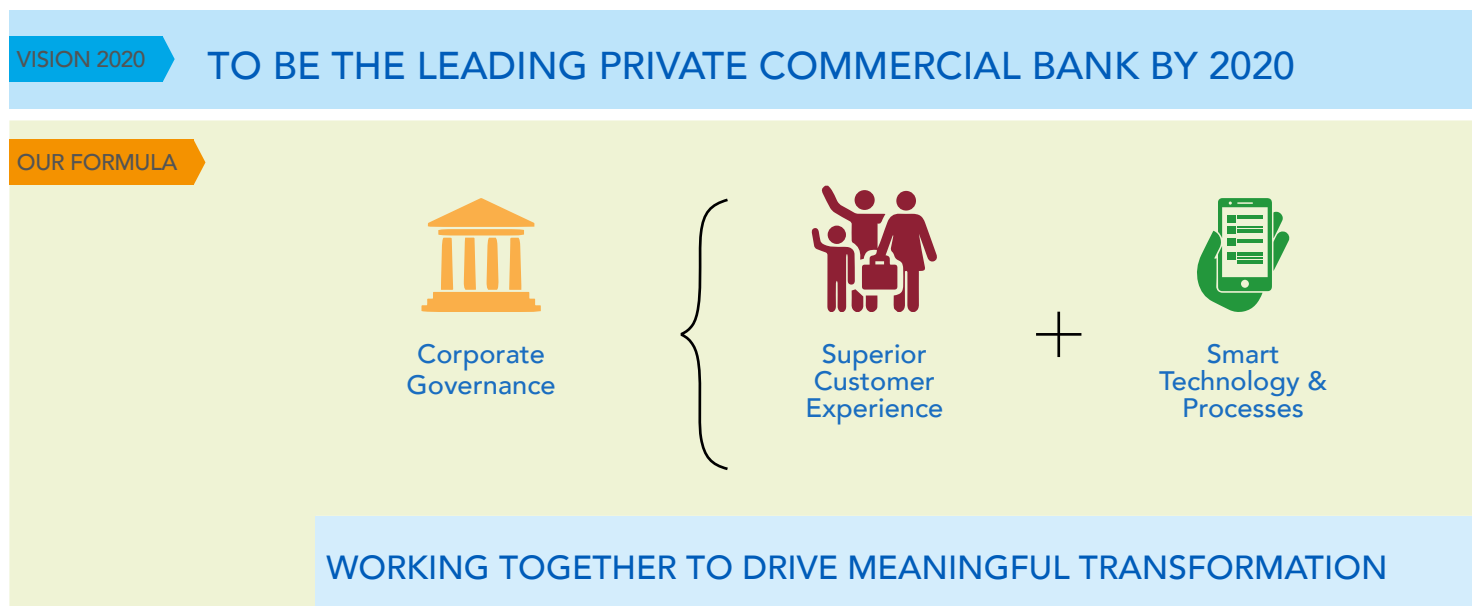
RISKS & OPPORTUNITIES

VALUE CREATED



Our Strategy

We revisited our vision and strategy, in consultation with a team of reputed foreign consultants, considering our growth aspirations, evolution of the industry globally, stakeholder feedback, risk management process and a thorough evaluation of our macro environment. The outcome of these high-level deliberations which involved extensive stakeholder engagement is given below.



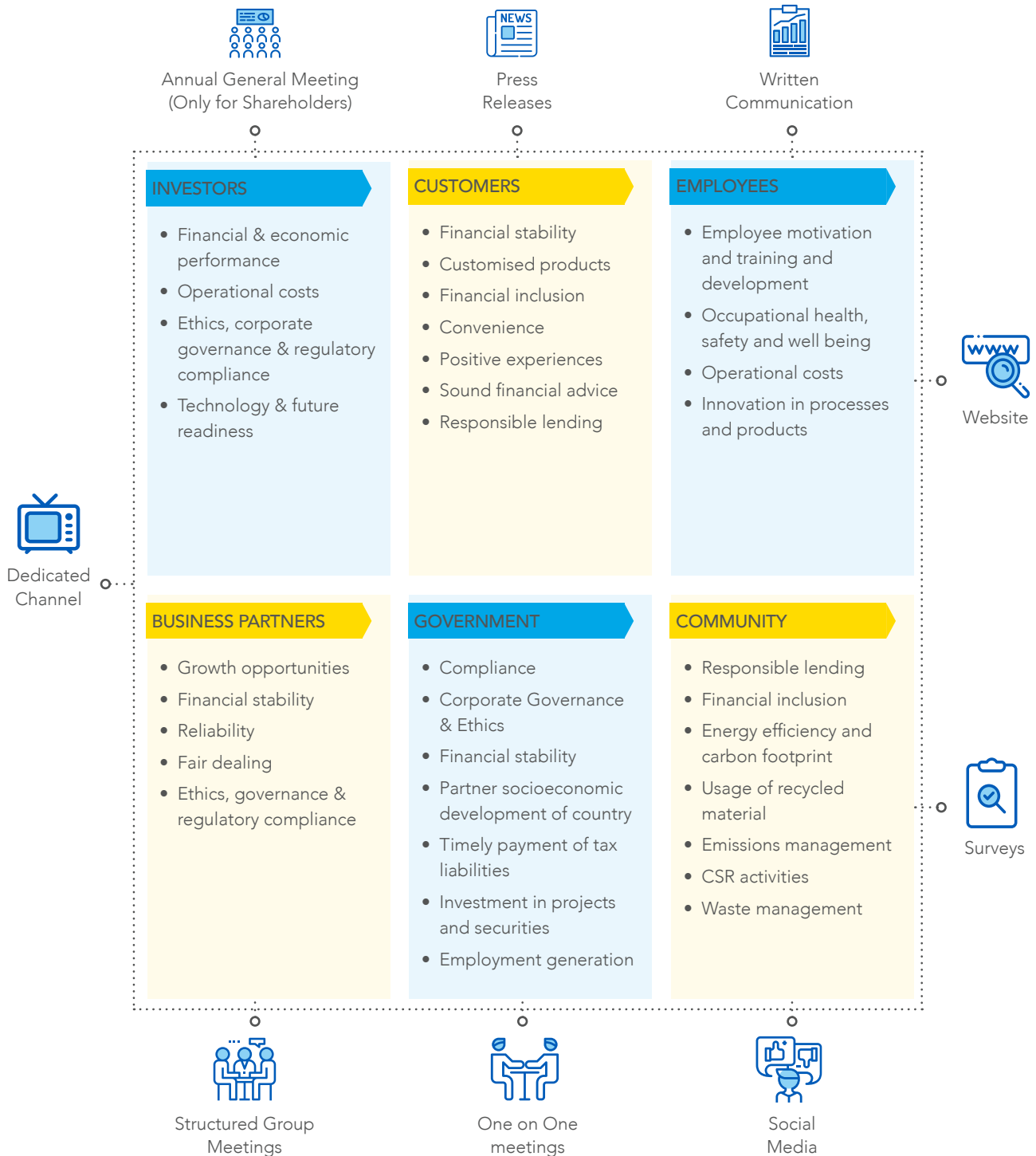
	Where we will play		How we will play
	Product proposition	Channel strategy & Branch operating model	Service excellence & process transformation
MEASURING SUCCESS	<ul style="list-style-type: none"> • New product revenue • Relevant product portfolio • Brand equity 	<ul style="list-style-type: none"> • Customer migration to alternate channels • Improved branch productivity 	<ul style="list-style-type: none"> • Net Promoter Score • Reduced customer complaints
RESOURCES ALLOCATED	Intellectual capital	<ul style="list-style-type: none"> • Rs 137 Mn on branch upgrades • 684 self- service machines 	<ul style="list-style-type: none"> • Cross functional team • Dedicated Service Excellence team • 24/7 omni channel contact centre
SIGNPOSTS	<ul style="list-style-type: none"> • Business line reviews • Financial capital • Digital capital 		<ul style="list-style-type: none"> • Social and relationship capital • Intellectual capital



Technology infrastructure & IT	Organisational structure & future readiness of people	Non-core strategic initiatives	
<ul style="list-style-type: none"> Digital Revenue System downtime Information Security 	<ul style="list-style-type: none"> Employee Engagement Score Higher retention rate Diversity & Inclusion 	<ul style="list-style-type: none"> Group profitability 	<ul style="list-style-type: none"> To be recognised as the most customer centric bank To be the market leader To be the most admired company in Sri Lanka To be the most preferred employer in Sri Lanka To be the most profitable company in Sri Lanka
<ul style="list-style-type: none"> Investments in digital capital Rs 1.3 Bn 	<ul style="list-style-type: none"> Rs 49 Mn on training Over186k training hours 		
<ul style="list-style-type: none"> Digital capital 	<ul style="list-style-type: none"> Human capital 	<ul style="list-style-type: none"> Financial capital Business line reviews -subsidiary performance 	

Engaging Stakeholders

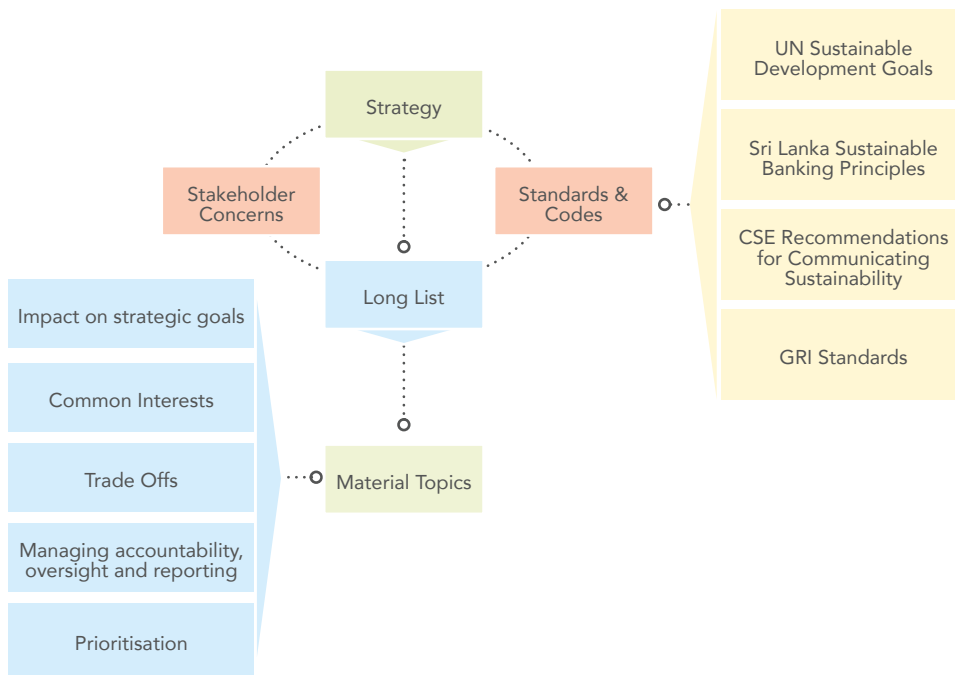
Strong stakeholder engagement is key to the long term value creation ability of the Group as it ensures that our business model is relevant to current needs of the communities we operate in. A key input to our strategic planning process, it provides useful feedback to understand where we need to improve and allocate resources. We use a combination of engagement mechanisms to listen to stakeholders as listed below.



All stakeholders have at least one dedicated grievance handling mechanism ensuring that concerns and complaints are recorded and resolved enabling us to monitor dissatisfaction in delivery of value to stakeholders and address the same on a case by case basis or through wider systemic initiatives where a holistic response is warranted. Value delivered to stakeholders is highlighted throughout the report reflecting our response to identified concerns.

Our Material Topics

Material issues are factors that our stakeholders are most concerned about and those that are critical to the success of our business. The 5 part materiality test developed in 2017 was used to prioritise these issues to develop the materiality heat map for 2018 as given below. They provide guidance in determining areas of potential opportunity and risk, and support resource allocation decisions to realise our vision. It also serves to determine the level of reporting required for these priorities as given below. The process is graphically depicted below.



	Material Topic	Reference to Standards/ Goal/ Principles
1	Customer satisfaction As we aspire to be recognised as the most customer centric bank, this is a high priority. <i>(Refer Social and Relationship Capital Report on page 63)</i>	GRI: 102, 416-419, 410 SLSBP: 3
2	Brand & reputation Our brand and reputation is critical as we need the trust of our customers and other stakeholders to grow. <i>(Refer Intellectual Capital Report on page 68)</i>	UNSDG: 16 GRI: 102, 413, 416-419, 410 , 205-206
3	Talent attraction, development and retention Dedicated resources nurture our value creators who propel our growth <i>(Refer Human Capital Report on page 56)</i>	UNSDG: 8 GRI: 404 SLSBP: 8
4	Technology and future readiness Enabling digitalisation and enhanced user experiences while facilitating scalability and cost efficiencies. <i>(Refer Digital Capital Report on page 52)</i>	UNSDG: 9 SLSBP: 7
5	Inclusive growth From inception, HNB has been an inclusive bank and we seek to be relevant across all customer segments <i>(Refer Financial Capital Report on page 46)</i>	UNSDG: 1, 10 GRI: 201, 203 SLSBP: 3 - 4

Our Material Topics

	Material Topic	Reference to Standards/ Goal/ Principles
6	<p>Financial stability and profitability</p> <p>This is critical to our ability to create value for all stakeholders and secure the trust of our customers who entrust management of their wealth to us.</p> <p><i>(Refer Financial Capital Report on page 46)</i></p>	GRI: 201, 203
7	<p>Ethics, governance & compliance</p> <p>Sound governance, legal and regulatory compliance and ethics determine reporting lines, roles and responsibilities and shape our organization culture</p> <p><i>(Refer Corporate Governance Report on page 93)</i></p>	UNSDG: 16 GRI: 205 - 206, 419, 417, 102 SLSBP: 1,6, 10
8	<p>Socio-economic impact</p> <p>As a DSIB, we recognize our responsibility to contribute positively to the country's socioeconomic progress</p> <p><i>(Refer Social and Relationship Capital Report on page 63)</i></p>	UNSDG: 1 – 4, 6 – 8, 10 – 11, 14, 17 GRI: 413, 203, 102 SLSBP: 3
9	<p>Responsible banking</p> <p>As custodians of wealth and providers of capital, we balance interests of depositors and lenders and manage risks associated with our business in a structured manner</p> <p><i>(Refer Business Reviews on page 72)</i></p>	UNSDG: 8,12, 9 GRI: 201, 205-206 SLSBP: 1 - 3, 5 - 7
10	<p>Business innovation</p> <p>Product and channel innovation provide a key competitive advantage as we strive to cater to changing customer demands</p> <p><i>(Refer Intellectual Capital Report on page 68)</i></p>	UNSDG: 9, 10 SLSBP: 7
11	<p>Business network relationships</p> <p>Managing relationships with correspondent banks, franchise owners, merchants, agents and suppliers and other business partners enables us to provide a seamless service to our clients</p> <p><i>(Refer Social and Relationship Capital Report on page 63)</i></p>	UNSDG:17 GRI: 205-206 SLSBP: 3, 9, 11
12	<p>Climate change</p> <p>We screen investments for environmental compliance, manage our own consumption patterns and contribute positively to minimize impacts from climate change</p> <p><i>(Refer Natural Capital Report on page 70)</i></p>	UNSDG: 13 GRI: 201,305, 308 SLSBP: 1 – 2, 5, 7

EVOLVING PRIORITIES

We reviewed our material topics and combined many topics from 2017 which improves our alignment with the IR Framework and reflects the business reality. This is an evolving conversation and we will continue to review our material topics on a holistic basis considering views of stakeholders together with our own strategy.

Rank 2018	Rank 2017	Material Topic	Rationale
1	1	Customer Satisfaction	Continues to be the key driver for growth
2	4	Brand & Reputation	Strengthening of our domestic franchise is key to delivery of strategic goals
3	8 and 12	Talent attraction, development and retention	Combines Employee training and Talent attraction & Retention. Moved up due to combination and our focus on talent as we transition to work in a digital era
4		Technology and future readiness	New topic considering increased investment and focus
5	9	Inclusive growth	Increased focus on reducing inequalities
6	3	Financial stability & profitability	Remains a key priority due to our business model
7	2 and 15	Ethics, Governance and Compliance	Combines Ethics & Governance and Anti-Corruption. Mature governance structures, policies and processes provide a solid foundation for growth.
8	3	Socio-economic impact	Moved down in priority as other topics moved up
9	5, 6 and 14	Responsible banking	Combines Responsible lending and Risk management and the scope has been widened to include all aspects of banking
10	7	Business innovation	Moved down as a material topic due to advancement of other material topics
11	17 and 22	Business network relationships	Combines Supplier and supply chain management and supplier assessment of human rights. Gained prominence due to a change in perspective
12	10, 11, 13, 18,19 and 21	Climate change	Combines Climate change and Conservation of Environment and Protection of habitats, Energy efficiency and carbon footprint, Waste, Water and Usage of recycled materials. Moved down due to prioritization of other material topics.
	16		Removed Thought Leadership for Sustainable Finance as leadership is now provided by the Sri Lanka Banks Association and the Bank is a signatory to the Sri Lanka Sustainable Banking Principles.

Market Review

2018 proved to be a challenging year for the banking industry amidst a sluggish domestic economy and rising global pressures. On the domestic front, the economy continued to be impacted by political and policy uncertainty which also resulted in the country being downgraded. This together with the global tightening of monetary policy led to funds flowing out of Sri Lanka and borrowing costs increasing.

PERFORMANCE HIGHLIGHTS

Global Economic Performance

World Output (Annual % change)

	2017	2018
Estimated		
World	3.7	3.7
Advanced Economies	2.3	2.4
United States	2.2	2.9
Euro Region	2.4	2.0
Japan	1.7	1.1
United Kingdom	1.7	1.4
Emerging Market and Developing Economies	4.7	4.7
Russia	1.5	1.7
China	6.9	6.6
India	6.7	7.3
Brazil	1.0	1.4

Source: IMF

Growth in Merchandise Trade Volume



GLOBAL ECONOMY

Despite losing some of the strong momentum registered in the second half of 2017, global economic growth in 2018 remained steady at 3.7%, in line with last year's growth rate. Growth became less synchronised as a number of advanced economies saw a more moderate growth compared to last year, while emerging markets and developing markets continued to grow at the same pace. The EU region and UK in particular witnessed a moderation of growth due to political uncertainty and slower export growth. Global growth however continued to be supported by robust growth in the US economy which benefited from sizable fiscal stimulus as well as growth in emerging markets and developing economies, which continued to benefit from domestic demand led growth and higher commodity prices.

Global trade too saw some levelling off, growing by 3.9% in 2018 compared to the growth of 4.7% in 2017. Escalating trade tensions, particularly between the US and its main trading partners as well as tighter credit market conditions in major economies contributed to this slow down.

Global inflation accelerated in 2018, due to rising commodity prices including rising oil prices during the year.

Tightening of monetary policy across the global economy continued against a backdrop of strengthening economic activity and labour markets as well as rising inflationary pressures in key advanced economies. The Federal Reserve raised the target range for the Federal funds rate on three occasions during the first nine months of 2018 while The Bank of England raised its Bank Rate by 25 basis points in August 2018. The European Central Bank (ECB) while maintaining an accommodative policy stance, announced the winding down of its net asset purchases commencing October 2018. Central banks of most emerging markets also tightened monetary policy to counter reversal of capital flows and pressure on exchange rates.

Outlook

The spill over effects of the tightening monetary policy stance adopted by key advanced economies are likely to be felt in 2019 with advanced economies seeing some slowing down of growth which may impact emerging and developing economies as well. Meanwhile escalating trade tensions between the US and key trading partners is also likely to have a negative impact on growth prospects of the global economy.

HNB's Response

Despite the environment not being the most conducive, HNB pursued growth within certain sub sectors and segments. Overall loan book growth of 17% was attained in 2018, despite GDP growth hovering around 3%.

HNB's Response

HNB's optimal mix with exposure to higher yielding segments and 35% lower cost CASA base enabled to maintain strong NIMs, which in 2018 was 102 bps above industry.

HNB concentrated on prudent expansion and driving growth among profitable as well as credit quality rich sectors and segments. This is reflected in our loan book growth being at parity with that of the industry for 2018 while maintaining Gross NPA at 2.78%, which is 82 bps below that of the sector average. Sector wise exposure of HNB banking book remains well diversified.

HNB's Response

Our best in class centralised trade unit continues to allow HNB to drive growth in import and export facilities across verticals. Export loan growth amounted to Rs 1.5 Bn (17.1%) in 2018 while our Import loan base increased by Rs 11.2 Bn (55.8%) with total Trade Turnover amounting to Rs 306.1 Bn. HNB Trade services contributed 2.9% to the Bank's NII and accounted for 21.3% of HNB's Fee Income.

SRI LANKAN ECONOMY

The economy grew at a modest pace of 2.9% year on year, during the third quarter of 2018. The growth was supported mainly by the agriculture sector and services sector which rebounded due to the improved weather conditions during the period. The services sector too recorded a growth mainly due to significant growth in the financial services subsector and expansion of wholesale, retail and other personal services activities. Industrial activities however remained subdued as a result of a decline in construction and mining and quarrying activities amidst the moderate expansion in the manufacturing activities.

The economy benefited from subdued inflationary pressures throughout much of 2018 with headline inflation based on CCPI decelerating to 3.3% as at the end of November 2018. Despite transitory upticks in some months resulting from volatile food prices and administrative price adjustments, headline inflation remained low during the year due to favourable supply side developments such as lower food prices.

Taking into consideration the favourable developments in inflation as well as the subdued economic performance during the last two years, the Central Bank moved away from a tighter monetary stance adopted since the latter part of 2015 by reducing upper bound of the policy interest rates corridor in April 2018. However, considering the impact of global developments on the economy, the Central Bank has since then maintained a neutral monetary policy stance. In November 2018, the statutory reserve ratio was reduced by 150 basis points in order to address the sustained rupee liquidity deficit in the domestic market. In order to maintain the Central Bank's neutral stance, policy rates were raised by 50 basis points simultaneously.

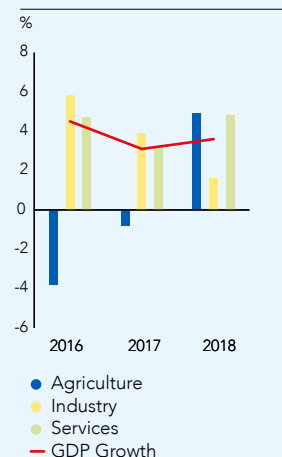
Performance on the external front however was less favourable with the BOP being negatively impacted by widening deficits on both the trade and capital accounts. The trade deficit widened during the first ten months of the year with the growth in import expenditure significantly outpacing the increase in export earnings. Despite the restoration of EU-GSP+, export earnings during the first 8 months of 2018 increased only by 5.8% while import expenditure expanded by 10.9% during the same period as a result of the surge in the import of fuel, vehicles and textiles and textile articles. Meanwhile the capital account was negatively impacted by outflows of foreign investments from the Government securities market and the secondary market of the Colombo Stock Exchange (CSE) as a result of rising global interest rates. The situation was exacerbated by the political turmoil towards the end of the year and the subsequent downgrading of the country's sovereign rating.

The exchange rate came under significant pressure during the year due to both domestic and external pressures. A widening trade deficit domestically was aggravated by heavy foreign investment outflows, due to broad-based strengthening of the US dollar in the global market as well as political uncertainty that prevailed during the last quarter of the year. As a result,

PERFORMANCE HIGHLIGHTS

Sri Lankan Economic Performance

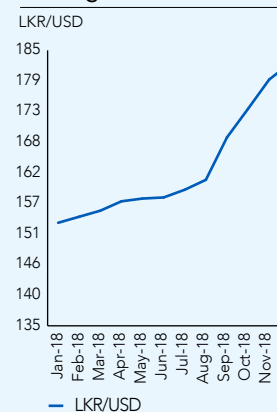
Annual GDP Growth Rate



Inflation: CCPI and NCPI YoY % Change



Exchange Rate Movement



Market Review

the Rupee depreciated by almost 15.9% against the US dollar during the year up to December 2018.

In December 2018, Sri Lanka's sovereign rating was downgraded on the premise of heightened political uncertainty and concerns regarding possible fiscal slippage.

Outlook

Continued policy uncertainty in the event of a prolonged political stalemate, a heavy external debt repayment schedule between 2019 and 2022 and waning investor confidence is likely to put a dampener on economic performance in 2019. Meanwhile the gradual slowing down of the global economy amidst tightening financial conditions could make 2019 a challenging year for the Sri Lankan economy.

BANKING SECTOR

Total banking sector assets expanded by 7.3% to Rs 11.0 Trillion in the first eight months of 2018 compared to a growth of 9.4% in the corresponding period of 2017. Loans and advances were the main contributor to this growth, expanding by 10.5% during the first eight months of 2018 despite a relatively challenging business environment. Loans and Advances to the private sector and State owned enterprises grew during the period while lending to the Central Government decreased during the period. Credit was mainly concentrated amongst consumption (19.7%), wholesale & retail trade (16.1%), construction (13.9%), manufacturing (10.2%) and agriculture, forestry & fishing (8.3%) sectors.

Asset quality showed a deterioration with the Gross NPL ratio increasing to 3.6% by end August 2018 from 2.5% as at end 2017 due to relatively slow economic growth and increasing pressure on disposable income.

The banking sector expansion was largely funded through deposits, which saw a growth of 9.3% during the first eight months of 2018. Time deposits continued to increase albeit at a slower pace than in 2017; while the CASA ratio decreased to 32.7% as at the end of August 2018 (end Aug 2017: 33.5%) due to the continued shift to term deposits on account of higher interest rates. Meanwhile banking sector borrowings continued to decline mainly due to the decline in foreign currency borrowings.

The Statutory Liquid Asset Ratio (SLAR) of the banking sector remained significantly higher than the regulatory minimum of 20.0%. Capital adequacy ratios of the sector too remained comfortably above Basel III requirements as at August 2018 although there are concerns that banks may face challenges in raising funds to meet the enhanced capital requirements under Basel III and to meet the impact of adopting the Sri Lanka Financial Reporting Standard 9 (SLFRs 9) which requires higher provisioning due to introduction of the expected credit loss model compared to the current incurred loss model.

Profitability of the Banking sector declined marginally due to an increase in non-interest expenses and rising pressure from loan

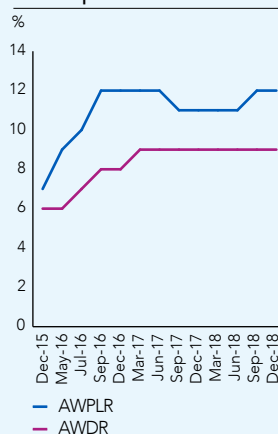
PERFORMANCE HIGHLIGHTS

Impact on the Banking Sector

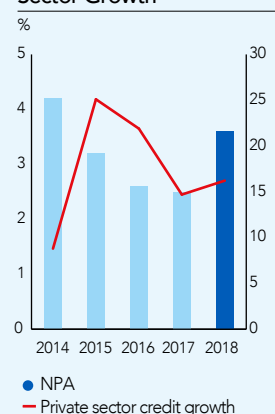
Key Banking Industry Indicators	2017	2018
Business Volumes (Rs bn)		
Assets	10,292.4	11,273.1
Loans & Advances	6,430.9	7,265.8
Asset Funding (% of Total Assets)		
Deposits	71.9	72.6
Borrowings	15.6	14.6
Profitability		
Return on equity	17.6	14.1
Asset quality		
Gross NPL ratio	2.5	3.6
Capital adequacy		
Core capital ratio (Minimum 5%)	12.4	12.4
Liquidity		
Liquid asset ratio (Minimum 20%)	31.3	28.8

Source: CBSL

Movement In Lending and Deposit Rates



Sector Growth



loss provisioning during the year. The Inland Revenue Act No 24 of 2017 (IRA) which became effective from 1 April 2018 removed tax exemptions on a number of interest income sources further impacting bottom lines of the banking sector.

Outlook

We expect operating conditions in 2019 to be challenging amidst sluggish economic conditions and high interest rates. We remain vigilant about the potential downside risk of deteriorating asset quality and rising NPL's but are optimistic about our Bank's strategy to navigate these difficult times.

Managing Our Capitals and Impacts

We manage our capitals recognising that they are a store of value that has to be nurtured and utilised to deliver value to stakeholders.



FINANCIAL CAPITAL

- As a financial services group, this is our inventory and our funding source and all other capitals support management of this capital.



HUMAN CAPITAL

- A team of 4,781 employees work together to realise our aspirations while we support theirs through structured development facilitating career progression



SOCIAL & RELATIONSHIP CAPITAL

- Comprises our external stakeholders who provide our social license to operate. The report specifically addresses customers, business partners, suppliers and communities.



INTELLECTUAL CAPITAL

- Comprises our proprietary systems, products, trade marks and the tacit knowledge of our people gathered over a 130 years of operations.



DIGITAL CAPITAL

- Comprises our computer equipment, networks and software developed inhouse and licenses acquired from third parties.



MANUFACTURED CAPITAL

- Comprises our islandwide branch network encompassing buildings and installations, office equipment and vehicles etc.



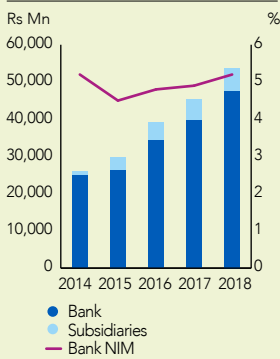
NATURAL CAPITAL

- Comprises the materials and energy used in providing financial services of which the key items are energy, paper and toner cartridges.

Financial Capital

Hatton National Bank PLC delivered a Group profit after tax of Rs 19.1 Bn recording a profit growth of 14.4% and total asset growth of 14% to Rs 1.15 Tn, as we consolidated our position as the most profitable listed financial services sector Group in the country. Earnings reflect focus on balanced growth, investments in digital capital to drive innovation and transformation as well as a challenging operating environment. A focus on driving customer experience, Group synergies and cost efficiencies ensures that top line growth and margins are sustained across business segments. Core capital ratios of 13.16% and 15.41% reflect our commitment to financial stability and balancing the long term and short term needs of the Group.

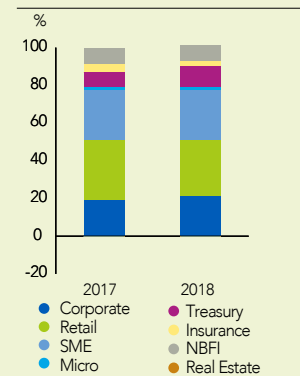
Net Interest Income Rs 53.6 Bn



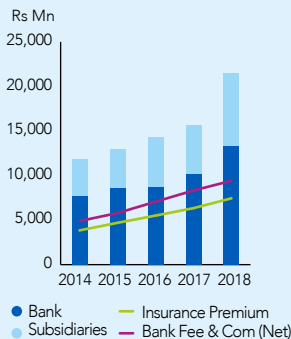
The Bank's NII growth of 20% was supported by growth in loan books and rising interest margins, as the benchmark AWPLR increased from 11.55% in 2017 to 12.09% by the close of 2018. AWDR declined during the year from 9.19% to 8.72% as liquidity eased due to prudential growth of loan books in response to macroeconomic conditions. CASA declined marginally from 35.5% to 34.6%, adding some pressure to net interest margins.

Retail banking and SME continued to be the largest contributors to NII while Corporate Banking and Treasury increased contribution through balance sheet growth. Growth of NII of subsidiaries also supported a 18% growth of Group NII.

Segment Analysis - NII



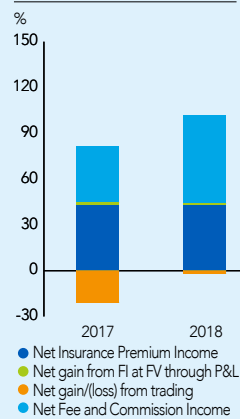
Non Interest Income Rs 21.5 Bn



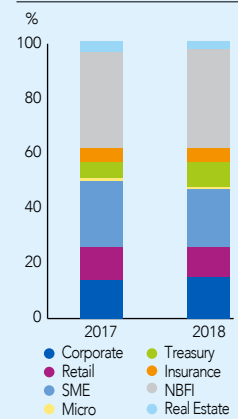
Non-interest income growth of 37.4% in the Group was supported by growth in Net Fee & Commission Income and Insurance premium of 12% and 17.5% respectively.

Net losses from trading of the Bank which reflects principally the revaluation of forex swaps, reduced significantly by 90% to Rs 356.6 Mn from a higher depreciated rupee and low volumes of swaps compared to the previous year. Bank fee income which accounted for 93.1%, was supported by increased credit card transaction volumes and customer migration to digital platforms. It is noteworthy that SME is the largest contributor to Net Fee & Commission Income accounting for 40.3% in 2018, albeit a decrease from 47.5% in 2017 as Corporate Banking, Treasury and Insurance segments increased their focus on this income source.

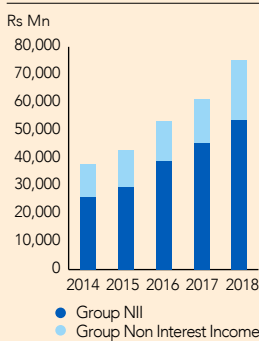
Composition of Non Interest Income



Segment Analysis - Non Interest Income

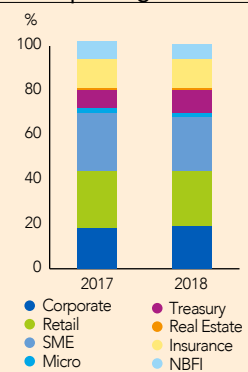


Total Operating Income Rs 75.1 Bn

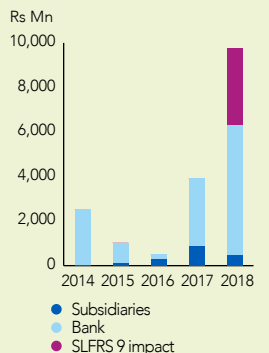


Group Total Operating Income growth was an encouraging 22.9% supported by both loan book and transaction growth. The non-interest income contributed 28.6% in 2018 compared to 25.6% in 2017 mainly due to exchange gains as a result of devaluation of the rupee during the period. Subsidiaries contributed 23.3% in 2017 and 20.6% in 2018 to the total operating income.

Segment Analysis - Total Operating Income



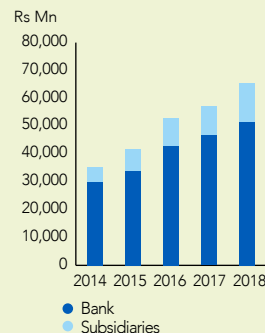
**Impairments
Rs 9.8 Bn**



Impairment charge for the Group increased to Rs 9.8 Bn, with Bank impairment rising to Rs 9.3 Bn for the year. The individual impairment declined by 10.4% over 2017, while the charge for collective impairment increased to Rs 4.3 bn from a reversal of Rs 1.4 bn in 2017. Although this was partly on account of the increase in NPAs from 2.28% to 2.78%, a phenomenon witnessed industry wide due to the stressed market conditions, approximately 60% of the increase in collective impairment charge was driven by the transition to SLFRS 9. Under the new standard, the provisioning model changed to an Expected Credit Loss approach as against an incurred loss approach under LKAS 39. In addition to loans, other financial investments such as investments in foreign currency denominated government exposures,

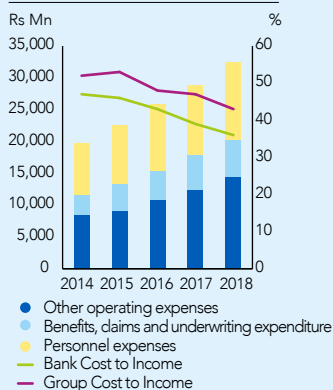
debentures and off balance sheet exposures such as LCs, acceptances, guarantees and undrawn loan commitments also attracted Expected Credit Loss provisions under SLFRS 9 which contributed towards the increase in overall impairment provisions. The downgrading of the sovereign during the latter part of the year further increased the impairment allowance on the investments in foreign currency denominated government exposures.

**Net Operating Income
Rs 65.3 Bn**



Net operating income grew by 14.3% despite the impact of impairment charges, demonstrating the resilience of Group earnings. Subsidiaries contributed 23% to Group Net Operating Income with the Bank accounting for the balance 77%.

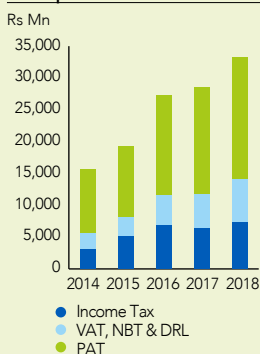
**Operating Expenses
Rs 32.3 Bn**



Growth of operating expenses was curtailed to 12.2% in 2018 as streamlining of processes drove both service excellence and a leaner cost profile. The Bank accounts for 68.3% of Group Operating Expenses which recorded increases of 12.6% and 15.7% in personnel and other operating expenses respectively, stemming from inflationary impact and expansion of operations. The higher growth in income enabled the Bank to improve its cost to income ratio further by 300 bps to 36.4%.

Benefits, claims and underwriting expenditure increased marginally by 3.5% although the Insurance Group recorded Total Operating Income growth of 15.8%. This was facilitated by a sharp focus on profitable customer segments and a decrease in claims stemming from natural disasters. Accordingly, the Group cost to income ratio improved by 412 bps to 43% as at end of the year.

**Group PBT Rs 26.5 Bn
Group PAT Rs 19.1 Bn**

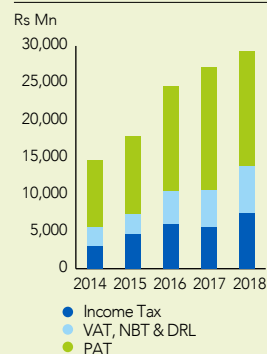


Group and Bank PBT increased by 14.6% and 4.1% respectively reflecting strong top line growth and focus on doing more with less across all business segments.

The impact of taxation on the Bank was significant. VAT, NBT and DRL increased by 26.8% for the Bank and 25.9% for the Group largely due to the introduction of the Debt Repayment Levy which became effective in the 4th quarter of 2018. Income tax increased by 33.1% for the Bank due to the removal of certain tax exemptions on investments under the new Inland Revenue Act in 2018. Further the tax provision for 2017 included a reversal of over provisions made during the previous years of assessment with the finalisation of the tax assessment in 2017. The tax charge for the Group increased by only 15% due to recognition of a deferred tax asset of Rs 1.2 Bn by HNB Assurance.

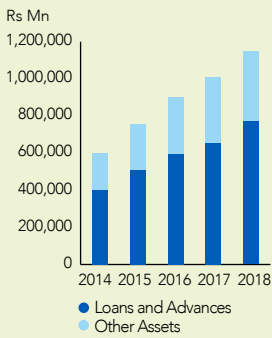
Accordingly, Group PAT increased by 14.4% to Rs 19.1 Bn while Bank PAT declined by 5.8% to Rs 15.5 Bn. Profit attributable to shareholders grew by 10.6% to Rs 17.6 Bn.

**Bank PBT Rs 23 Bn
Bank PAT Rs 15.5 Bn**



FOCUS ON GROWTH

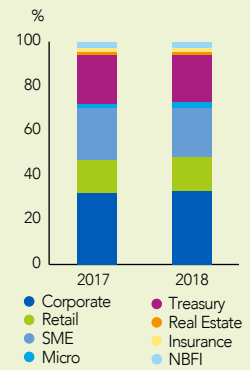
Group Assets Rs 1,149 Bn



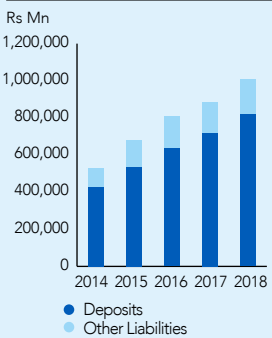
The Group's Total Assets grew by 13.8% to Rs 1,149 Bn in 2018 while the corresponding numbers for the Bank were 13.8% and Rs 1,086.5 Bn as the Bank's total assets crossed the Rs 1 Tn milestone. The loan book accounts for 67.1% of the Group's Total Assets while the loan book of the Bank accounts for 68.9% of the Bank's Total Assets. Total Asset growth was driven by 17.2% net loan book growth in the Bank which increased to Rs 749 Bn, while HNB Assurance also recorded 19% growth in their balance sheet. Overall, the Group adopted an approach of selective growth in business segments that facilitated balancing risk and reward in line with the risk appetite of the Bank taking into account the prevailing macroeconomic conditions.

Corporate Banking was a key contributor to growth of the Bank's balance sheet recording 21.1% growth as the loan book increased from Rs 295.9 Bn to Rs 358.2 Bn which accounted for 31.2% of the Group balance sheet. Retail and SME loan books account for 29% and 28% of the Group's balance sheet and recorded 16% and 15% growth rates during the year.

Segment Analysis - Group Assets



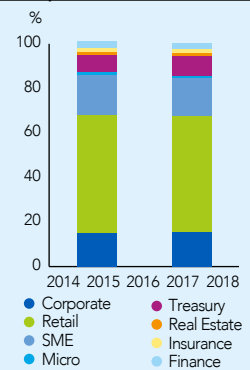
Group Liabilities Rs 1,011 Bn



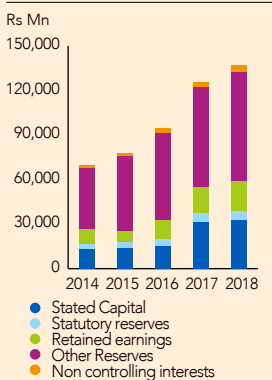
Group's total liabilities growth of 14.7% was driven by strong growth of deposits which accounted for 80.9% of total liabilities. Deposits of the Bank which accounted for 82.4% of Bank liabilities, recorded a 14% growth over the previous year improving to Rs 800Bn. Retail banking which accounts for 47.9% of Group liabilities grew at a steady 14.7% while SME segment the second largest contributor, accounted for 15.6% growing at 9.1%.

The CASA ratio for the Bank declined marginally by 0.9% to 34.6% as increasing interest rates attracted depositors to time deposits exerting pressure on cost of funds. Asset and liability growth was managed carefully during the year in response to the operating environment, balancing the short term and long term needs of the Group.

Segment Analysis - Group Liabilities



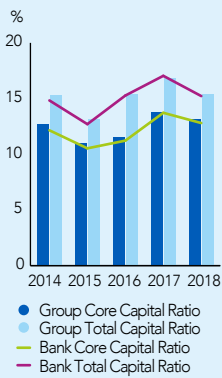
Equity Rs 132.7 Bn



With the transition to SLFRS 9 with effect from 1st January 2018, the cumulative impact of Rs 4Bn, arising from the change in the method of recognising impairment provisioning has been adjusted as the day one impact from the Statement of Changes in Equity. Accordingly, the attributable total equity of the Group which accounts for 11.6% of the funding of the Group, stood at Rs 132.7 Bn reflecting a growth of 8.7% while the equity of the Bank improved by 7% to Rs 115.8 Bn.

FINANCIAL STABILITY

Capital Ratios

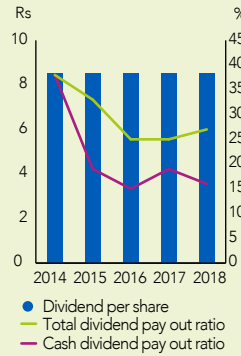


Capital ratios remain well above the regulatory requirements for Core Capital and Total Capital ratios reflecting prudent capital management as detailed further in the Risk Management Report.

With the transition to SLFRS 9, in line with the guidelines issued by the CBSL, the day one impact as detailed above, is staggered over a transitional period of four years for capital adequacy purposes commencing from 1st January 2018.

VALUE TO SHAREHOLDERS

Dividends



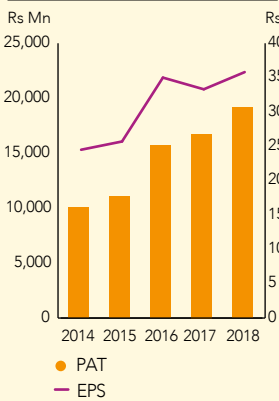
Shareholders derive value from dividends and enhanced value of shares. HNB's dividend policy seeks to maximise shareholder wealth, increase market capitalisation whilst ensuring there is sufficient capital for planned business expansion and maintaining a consistent stream of dividends to shareholders. Accordingly, the Bank paid an interim dividend of Rs 1.50 per share in 2018 and propose a final dividend of Rs 7.00 per share for both voting and non-voting ordinary shareholders consisting of a cash dividend of Rs 3.50 per share and a scrip dividend of Rs 3.50 per share.

HNB has maintained a total dividend of Rs 8.50 per share over the past five years, balancing needs of shareholders with business plans of the Bank and regulatory requirements to increase equity.

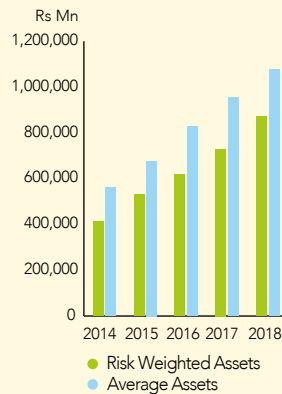
RETURN ON EQUITY

Return on Equity is the Bank's primary measure of value to shareholders. Here we describe its various components which all reflect on our performance. These metrics facilitate comparison across peers and industry sectors, enabling shareholders to make informed judgements about their investments.

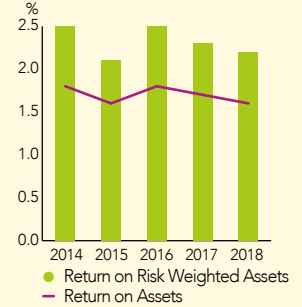
Profit After Tax



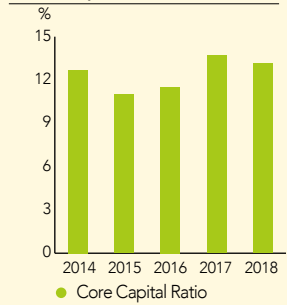
Risk Weighted Assets



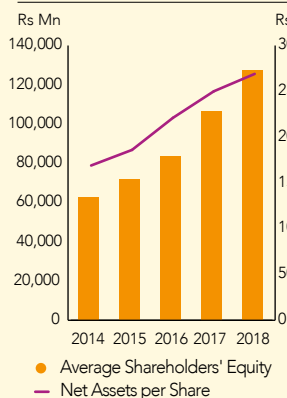
Return on Risk Weighted Assets



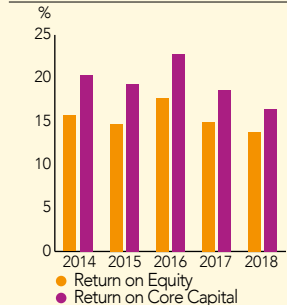
Core Capital Ratio



Average Equity



Return on Equity



Manufactured Capital

Our manufactured capital comprises the branch network but excludes the investments in Information Technology which has been defined as a separate capital this year considering its strategic significance. Our island wide branch network remains a core part of our customer value proposition, enabling customers to transact with the same confidence offered on our digital platforms according to their personal preference. The branches play a vital role in our business model, enabling us to reach new customers and providing visibility to support our brand.

OVERVIEW

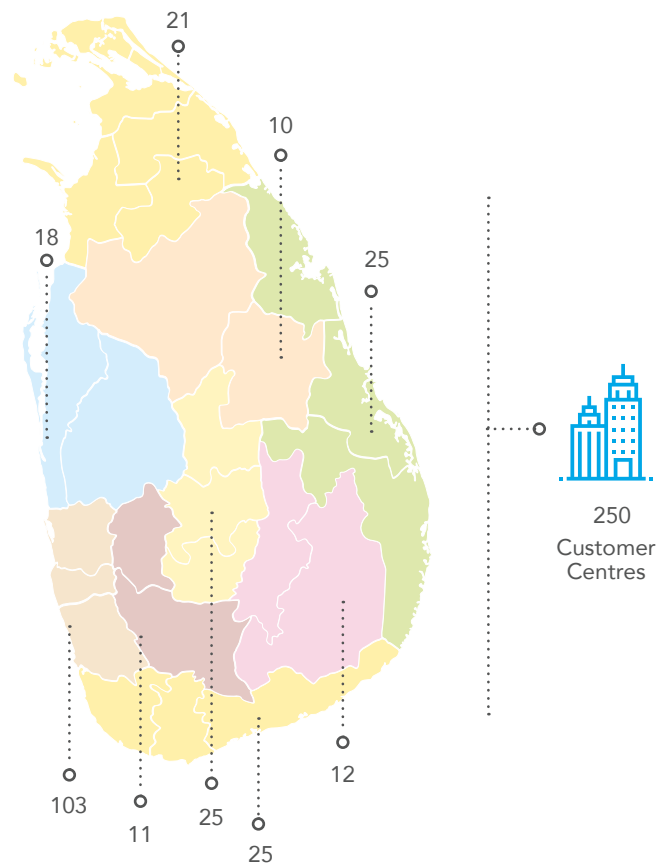
HNB manages one of the largest branch networks among private sector banks which has supported our growth and visibility in the market through 250 branches of which 50 are in locations owned by the Bank. Reflected in the balance sheet at a net book value of Rs 21.3 Bn, it comprises free hold land and building of Rs 17.6 Bn with Furniture Fittings & Equipment, Motor Vehicles and Leasehold Land and Buildings accounting for the balance. Occupying prime locations and revalued annually, Land & Buildings increase in value as real estate prices in prime locations continue to rise.

The Head Office of the Bank is owned by Sithma Developments, the real estate subsidiary of the Group and is reflected in the consolidated balance sheet at a net book value of Rs 15.9 Bn.

STRATEGY

Having invested significantly in branch expansion from 2010 to 2012, we are now turning our attention to building our digital platforms as described in the Digital Capital report on page 52. During the year, we merged the operations of our customer centre which was located at the Ministry of Finance with the operations of the World Trade Centre branch due to the relative ease of access the latter provides to the customers.

We will continue to maintain our branches as key customer touchpoints and plan to significantly enhance their experiences through higher levels of customer service and convenience. Branches are being upgraded to reflect the brand and 96 of our branches are now energy efficient, fit for the future buildings. Safety aspects and interiors also received upgrades to ensure that our team who occupy these premises on a day to day basis have a pleasant environment to work in. It also supports offering holistic solutions to customers leveraging group synergies as HNB Assurance agents are located in over 185 branches. We will continue to review the need for further expansion of branches in strategic locations as we recognize that they play a key role in our current business model.



HNB Branch Network 2018

BRAND

- Network of 250 branches across the country
- Reflect Brand
- Inspiring workspaces

FIT FOR THE FUTURE

- Solar energy to reduce emissions
- Access for disabled
- Smart buildings

COST EFFICIENT

- Energy efficient lighting
- Increased use of natural light
- Group synergies

MANAGING OUR CARBON FOOTPRINT

Our manufactured capital plays a key role in managing our carbon footprint. The installation of solar panels at 96 branches, the use of natural light, installation of LED lighting, use of building management systems and energy efficient lifts and chillers are key initiatives that support this goal.

Scope 1 and 2 emissions of the bank are derived mainly from the electricity consumption used by the head office and branches and is strongly correlated to the square area occupied. During 2018 the area occupied increased to support centralisation of specialised services and recruitment of 433 new employees. Accordingly, the Scope 1 and 2 carbon foot print of year 2018 shows an increase of 956 MT which is still lower than the carbon foot print of 2016. It is noteworthy that the energy intensity per square foot has decreased by 2.5% in 2018 reflecting numerous initiatives taken to reduce the carbon footprint. The energy intensity per employee increased by 10% during the year as floor space in use has provided for future expansion of our team.

Outlook

Efficient management of the branch network is key to ensuring that we continue to lead the industry in cost efficiencies. While we are near saturation point for installation of solar panels and increasing use of natural light, we will continue to explore other means of reducing our carbon footprint.



Opening of the Student Saving Unit at St. Sebastian College, Moratuwa.

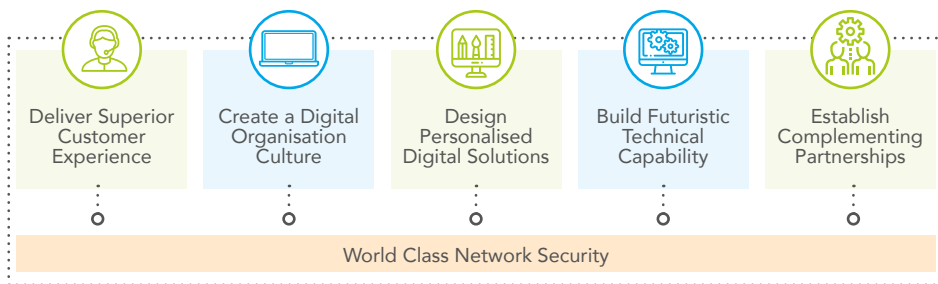


Relocation of the Customer Centre at Nawaloka Hospital, Colombo

Digital Capital

Digital Capital is key to realising our vision, supporting customer connectivity and experiences, facilitating transactions and safeguarding the information assets of the Bank. It encompasses the Group’s investment in technology reflected in the Balance Sheet at a net book value of Rs 1.8 Bn. This year, we have identified our digital capital separately from Manufactured Capital due to its strategic significance which outweighs the monetary value reflected in the financial statements. In a digital banking era, this is our nerve centre and this report sets out how we govern, nurture and account for value delivered to stakeholders.

IT STRATEGY



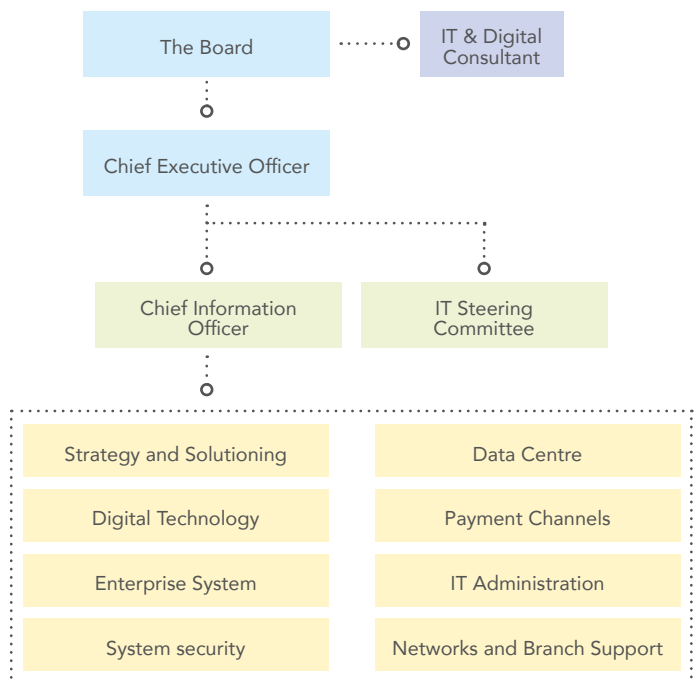
Having commenced the roll out of our IT strategy in 2017, under our three year strategic plan we have already delivered a significant portion of the key projects nevertheless the next two years would see the upgrading and implementation of several key systems. Data centre (DC), network and infrastructure security which cuts across all strategic pillars to be in line with ISO 27001 standards. Further DC services including related services which are the global benchmarks are planned for ongoing improvement.





IT GOVERNANCE

IT Governance has gained prominence over the years and the appointment of Mr M Rathnayake to the Board this year strengthens oversight by the Board. The governance structure is given alongside reflecting the scope of the IT function and the direct line to the CEO and Board.

The IT Steering Committee comprises heads of business verticals and IT vertical heads and is chaired by the CEO. The mandate of the committee is to monitor the progress of the various IT projects and also review areas that require further enhancements and assess the resources required therein.

IT policy was also a key area of focus during the year as we sought to clearly communicate expected user behaviours, shaping the digital culture of the Bank and supporting how we safeguard the information assets of the Bank and IT Risk Management.



 <p>Establish complementing partnerships</p>	 <p>Cyber Security Policy</p>	 <p>IT Recovery Policy</p>	 <p>IT Service Management Policy</p>
<p>Sets out a framework for classification and safeguarding of information assets of the Bank</p>	<p>Sets out the Bank's approach to cyber security and defines expected user behaviours</p>	<p>Sets clear plans for disaster recovery in line with the Bank's overall BCP</p>	<p>Implementing service standardisation with SLAs defined for service delivery</p>

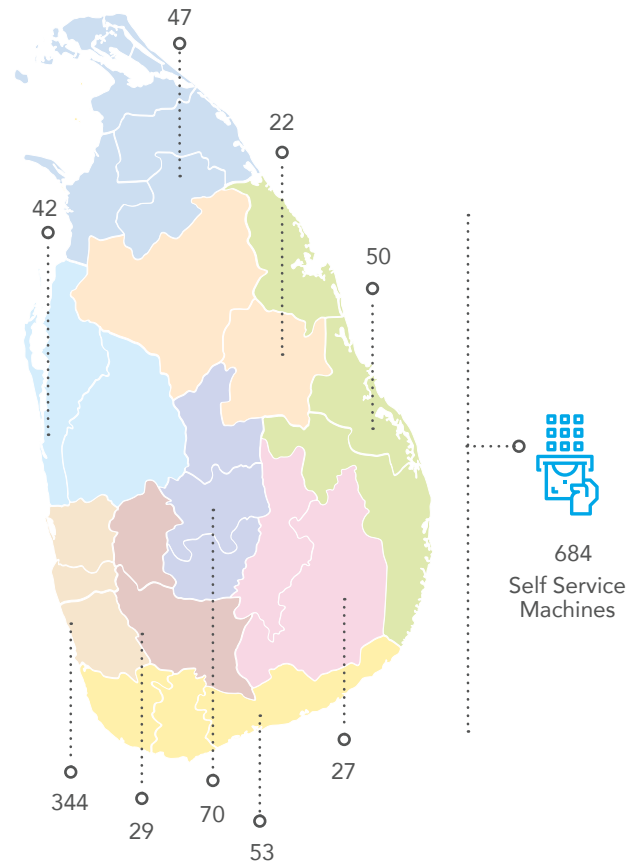
OVERVIEW OF OUR DIGITAL CAPITAL

The architecture of our digital capital is graphically described below. All systems connect with the core banking systems facilitating streamlined processing of transactions and scalability in operations. Safeguarding and nurturing our digital capital is carried out by a team of 120 IT professionals who are specialists in their subject areas together with domain knowledge including regulatory requirements.

Other key strengths include a strong market presence enabling the Bank to attract vendors of high repute and high quality talent. Our IT infrastructure is stable and has the ability to consolidate with computer infrastructure. Strong network infrastructure and security covering end points support safeguarding of information assets and integrity of systems.

NURTURING DIGITAL CAPITAL

Planned significant investments in digital capital facilitated the evolution of the Bank's IT infrastructure and capability in line with the IT strategic goals which support the 2020 vision of the Bank. Accordingly, the IT Department initiated and managed 60 business and technology projects of which 26 were completed during the year with the remainder scheduled to be completed in 2019.



HNB Bank Digital Network 2018



Technovation Awards

Digital Capital

Expansion of Payment Channels		Data Centre	IT Admin
Value added Machines	Cards	Server consolidation and Virtualisation	20,000 service calls with 98% resolution within 24hrs and 100% resolution within 48hrs
Upgraded 46 ATMs to Cash Recycling machines	Expanded HNB Momo to include 3,400+ devices	Infrastructure standardisation	Dedicated help desk for IT solutions with proactive calling for better housekeeping
Installed 64 Bulk Deposit Machines	Increased POS Terminals to 15,000+	Real Application Clustering	24x7 on call support with data driven preventive maintenance activities
		Upgrade database infrastructure monitoring tools	Implemented Skype for Business for Branch Managers and Regional Heads as an initiative to provide online collaboration for business units / branches

DELIVER SUPERIOR CUSTOMER EXPERIENCE

KPI

- Increase customer usage of ATM network by 90%
- Increase digital transaction volumes by 160%
- Increase customer migration to digital channels
- Maintain 99.4% uptime on ATM network
- Increase number of digital branches

Delivery of KPIs

ATM	Online Transactions	Reliability
Rs 20.5 Bn Deposits per month	159.7 % ↑ in volumes	99.4% Up Time on ATMs
Rs 27.9 Bn Withdrawals per month	95.3 % ↑ in Value	99% Uptime on POS

CREATE A DIGITAL ORGANISATION CULTURE

KPI

- High levels of IT literacy in Bank
- User training on relevant applications
- Roll out of IT Policies across Bank
- Operate Help Desk to support users

Delivery of KPIs

IT Literacy	Helpdesk	ITIL
10,565 Training Hours on IT	20,000+ queries supported	Training on ITIL standards
	98% resolved within 24 hours	Implementation of ITIL policy structures

DESIGN PERSONALISED DIGITAL PRODUCTS

KPI

- Lifestyle products aimed at providing a personalised experience while appealing to a broad market segment
- New market development and digitisation via innovation
- Aligning towards the overall country strategy of digital payments and making the brand capable of accepting new payment challenges

Delivery of KPIs

New Products	Enhancements of Existing Products	QR Payments
Tokenisation	HNB FitApp volumes ↑ 7 Bn	Justpay certification for issuing and acquiring
	School Payments ↑ by 10%	QR based payments via Apps

BUILD FUTURISTIC TECHNICAL CAPABILITY		
KPI	Delivery of KPIs	
	Adoption	Helpdesk
<ul style="list-style-type: none"> Standardisation of services via industry best practices New technology adoption Service excellence via supporting the branch network 	54,523 Online training hours	20,000+ queries supported 98% resolved within 24 hours

ESTABLISH COMPLEMENTING PARTNERSHIPS		
KPI	Delivery of KPIs	
	New Partnerships	Existing Partnerships
<ul style="list-style-type: none"> Build partnerships with fintech companies to enhance relevance to customers Build payment volumes through fintech partnerships Reliable service to fintech partners 	Transportation sector E Commerce solutions	Volume growth 25% Value growth 30%

Outlook

The Bank will gather momentum on its digital evolution as we plan to complete the projects which are in progress and launch another 7 projects in 2019. Our areas of focus are Digital Banking and Transactional Banking supporting the goal of migrating transactions to digital platforms, while we focus on upgrading the Core-Banking System as well as the Loan Origination System. Customer satisfaction is expected to improve as turnaround times and streamlined processes set new benchmarks for banking in a digital era. Our cost income ratio of 36.4% which is the trendsetter for the entire industry is expected to improve further.

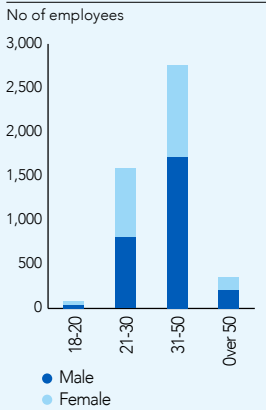
Human Capital

PERFORMANCE

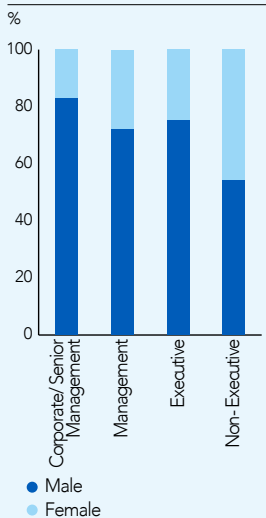
Employee Engagement

- 72.4% Participation rate in employee engagement survey
- Overall Employee Engagement Score of 63%
- 93.6% Retention Rate
- Learning Coverage Offered 94.5%
- Revenue per employee Rs 25.4 Mn

Employees by Age and Gender



Diversity - Gender / Employment Category



A fully engaged, future-ready workforce is a critical success factor in our transformational journey of achieving Vision 2020. Managing our talent is thus a business priority which continues to receive our highest attention. Consistently high retention rates, productivity rates and noteworthy employee engagement levels are indicative of the success of the HR policies and governance structures we have in place.

HR GOVERNANCE

A comprehensive HR policy framework and robust systems and processes guide nurturing of Human Capital, supported by a strong governance structure. The Human Capital Department is responsible for implementing the people strategy of the Bank and works in close consultation with the CEO and Board through the HR and Remuneration Committee and Nomination Committee to ensure alignment between HR strategy and business strategy.

	Board of Directors	Board HR & Remuneration Committee	Board Nomination Committee	MD/CEO	CHRO
Statutory governance	R	R	-	-	-
Regulatory governance	A	R	R	A	A
Executive governance	I	C	I	R	R

R - Responsible A- Accountable C- Consulted I-Informed

OUR TEAM PROFILE

Our team of 4,781 employees is as diverse in composition as the skills and experiences they bring to the table. 42% of our employees are women while almost 34% of our employees are from outside of the western province. We also maintain a healthy mix of employees from generations X, Y and Z enabling us to benefit from diverse skills, experiences and perspectives

Staff Category	Male	Female
Corporate management	3	16
Senior Management	9	41
Managers & Executives	194	628
Officers	375	666
Bank Associates	1,071	1,110
Secretaries	228	3
Support Staff	0	172
Contract Staff	135	130
TOTAL	2,015	2,766

ATTRACTING TALENT

Our recruitment strategies are closely aligned to the bank’s business strategy. We continuously evolve in response to changing labour market dynamics. We are strengthening our team with digital natives by recruiting individuals with strong tech backgrounds. We commenced recruiting trainee digital bank associates in February 2018 . We have recruited 16 during the year as well as information and cyber security auditors.

We have provided work place experience to graduate/ undergraduate/school leavers through internships. During the year we signed an MoU with the Department of Accounting, University of Sri Jayewardenepura and we continue to tie up with institutes and universities. Attracting the best talent in the country is our priority, we strive to ensure diversity and equal opportunity in talent acquisition policy. We recruited 452 in 2018 to our team creating youth employment. Of this batch, females accounted for 62%. All branches are well staffed to serve our customers.

DEVELOPING TALENT

Talent development at HNB is an ongoing process that involves targeted training, ensuring talent mobility, leadership development and continuous performance evaluation in order to build employee capacity over the long term.

We adopt a multi-pronged approach to developing and sustaining talent enabling us to offer career progression opportunities while building internal capacity and a vibrant leadership pipeline well equipped to steer the bank in to the future.

Training

Talent development at HNB is driven by the premise that individuals should be inspired to continuously learn, improve, grow in order to continue to push boundaries for themselves personally and for the organisation as a whole. Our training programmes are designed to enhance capacity, capability and competency by developing well rounded individuals while addressing key business challenges. Identification of training needs and development of programmes is an ongoing consultative process where the individual employee, line managers and Talent Development work collaboratively to identify and develop programmes that best suit competency requirements. The training completed in 2018 is given alongside.

During the year, total training hours delivered increased by almost 52% over 2017, with 128,260 training hours being delivered at our dedicated training (in house) facilities while 54,523 digital learning hours were delivered virtually through “HNB Talent Space”. External training accounted for 2% of training hours adding new perspectives. Almost 95% of our employees were offered training opportunities during the year. Meanwhile all inclusive training hours per employee stood at 40.1 (internal 39.4), well above the internationally recommended standards.

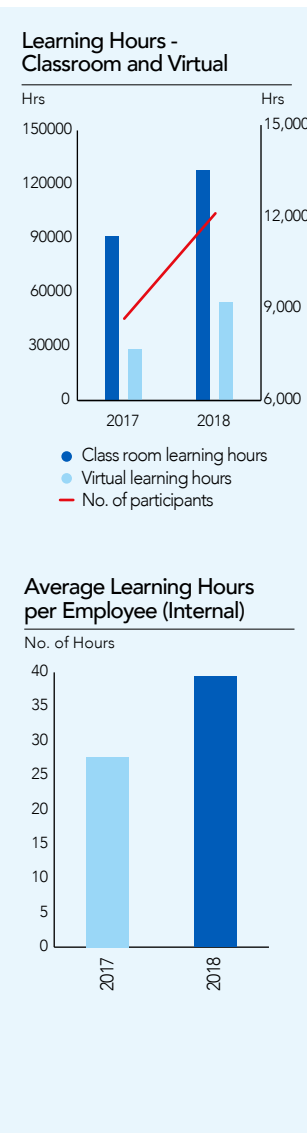
HNB Talent Space, our cloud based knowledge solution which includes online courses, library, discussion boards, examination

modules, gamified learning with ranks & badges has provided our employees an interactive and enjoyable mechanism to fulfil their training needs in a more customised and convenient manner. Almost 86% of our employees are now active users of Talent Space, an increase of 26% compared to last year. Meanwhile total engagements on Talent Space increased by almost 92% to 76,400 virtual engagements indicating an impressive adoption of digital learning.

Leadership Development

The Bank’s branded leadership development programmes, aimed at fast tracking career progression of high performing employees in different employee categories, continues successfully as indicative from consistently high retention and promotion rates.

During the year we introduced two new leadership development programmes. The Gung Ho! Leadership



Linking Training to our Business needs

Key Business Needs	No. of Learning Hours
Credit Quality Management	14,547
Superior Customer Service	7,781
Operations and Ethics	5,472
Information Security Awareness	51 members of the senior management attended classroom training & 1,878 participated on the virtual platform

Human Capital

ACCELERATED DEVELOPMENT AND PROGRESSION

- All career development programmes and leadership development programmes are closely linked to competency framework and performance appraisal process.

CONTINUOUS PROFESSIONAL DEVELOPMENT

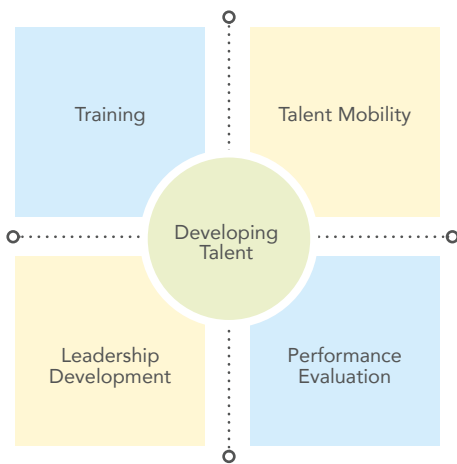
- Reimbursement of membership subscriptions for executive staff for their professional memberships

LONG TERM INVESTMENT INTO CAPACITY BUILDING

- Dedicated talent centre equipped with audio visual training equipment
- Talent Space, a cloud based virtual learning system

CAPACITY BUILDING FOR CONTINUITY AND SUCCESSION

- Structured career progression programmes for all levels of employees
- Management Trainees: Future Leaders
- Executives: LEAD
- Junior Executives: PILOT
- Mentoring Programme: RISE



Development Programmes was launched in April 2018 for top 100 senior managers while PILOT (Passion, Initiative, Learning, making use of Opportunities and Managing Time) was introduced during the year to support staff promoted to Junior Executive level. Apart from an induction programme, the initiative includes innovative modules such as "Winning Mind-set, Problem Solving and Decision Making and a specially customised module on transitioning to a leadership role titled "First Time Manager"

Performance Evaluation

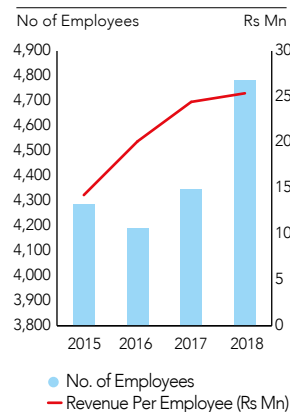
All employees are evaluated on an annual basis while the executive evaluations are conducted on bi annual basis. Since 2017, performance appraisal of executives is based on competency framework and KRA/KPI model instead of the previously used Balance Score Card system. The competency framework and KRA/ KPI model, developed in consultation with Society for Human Resource Management (SHRM) India maps key competencies required to achieve the banks 20-20 vision and links the Banks strategic goals to employee KPI's and KRA's. In line with our digitisation strategy, the new Human Resource Management System "Talent Edge" launched in January 2018, now includes a customised performance appraisal module, further improving the transparency and ease of the process.

Training by Employee Category and Gender		
Employee Category		
12	Corporate Management	26
42	Senior Management	90
734	Managers & Executives	1,599
694	Junior Executives	1,515
3,874	Bank Associates	2,106
358	Secretaries	21
0	Support Staff	158
588	Contract/Outsourced Staff/Interns	298

Promotions effected during the year

Senior Management to Corporate Management	5
Management to and within Senior Management	19
Managers & Executives	95
Executives	12
Bank Associates to Junior Executives (including allied grades)	154
Support Staff to Bank Associates	3

Employee Productivity

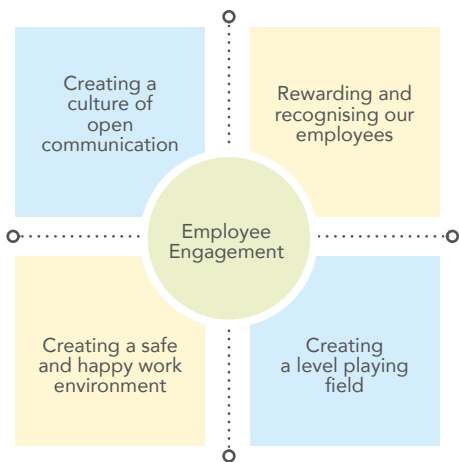


Talent Mobility

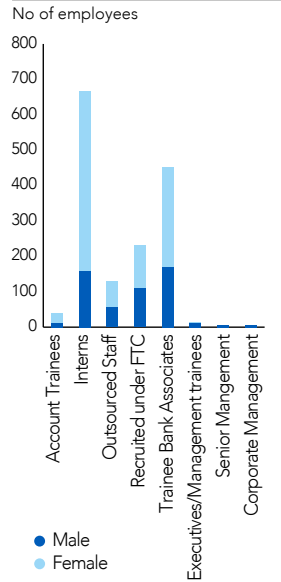
Talent mobility ensures that our employees are constantly upgrading their skills and competencies. The Talent Mobility Committee of the Human Capital Department tracks employees for transfers to ensure that employees are constantly provided opportunities for mobility. We also strive to ensure that wherever possible first preference is given to in-house talent when filling vacancies within the network. In order to attract talent, across the country we recruit candidates from different regions to fill the vacancies of the branch network that is spread around the country. Female candidates selected for employment are stationed in close proximity to the respective home towns as far as possible to make work life comfortable and safe. 1,118 talent mobility / transfers were effected during the year.

RETAINING TALENT

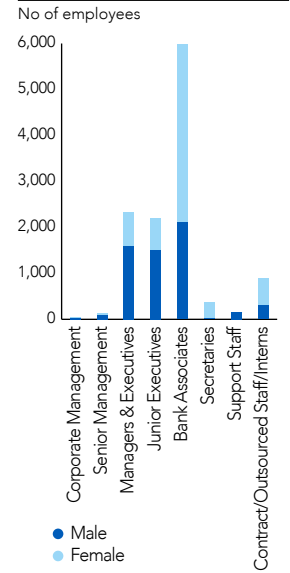
We believe the basis for talent retention is employee engagement as it creates an inclusive environment which respects diverse opinions, values unique strengths and recognises the varying contributions of employees.



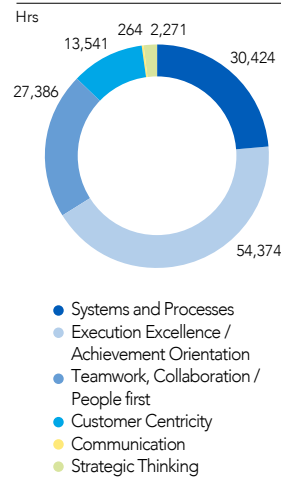
Recruitments during the year - Category/Gender



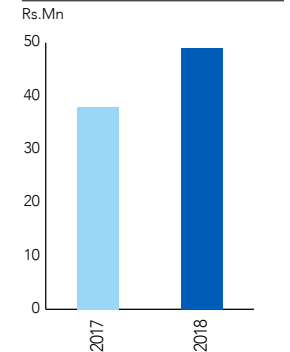
Total Learning Participants Employee Category and Gender



Training Hours by Competency



Training Investment (Excluding Admin & System Costs)



Rewarding star performers.



Staff Bakthi Gee 2018

Human Capital

A Culture of Open Communication

We firmly believe that a culture of open communication that respects and promotes diversity of opinion brings about not only greater buy-in for change but also creates a fertile ground for innovative thinking. We strive to communicate with our employees at every level and have multiple communication channels where employees are given the opportunity to be up-to-speed on all changes taking place in the bank, communicate their concerns and ideas and be true partners in the organisation's journey.

We are also in the process of digitising the communication process. In addition to increasingly using social media and other informal channels such as WhatsApp to disseminate information, we also launched an intranet portal where employees can now easily access information on ongoing lean initiatives, Lean Six Sigma training programs, case studies and articles of interest etc. "HNB Talent Edge" our new HRIS which was launched this year also includes a "Voice of Yours" widget providing yet another channel to contact the Human Capital Department.

"Voice of HNB" Employee Engagement Survey

During the year the bank conducted an Employee Engagement Survey, "Voice of HNB" with the aim of obtaining employee views on their experience of working at HNB. The survey was successfully concluded in June 2018 with a 72.4% participation rate.

Subsequent to the findings from the survey, the Core team together with 30+ change agents across branches conducted focus group discussions with self-nominated employees to deep dive into six dimensions of employee engagement and understand region specific priority areas. Accordingly, 22 focus groups discussions were carried out covering almost 300 employees across the 10 regions. These discussions have brought forth invaluable insight into the HNB employee experience and will be used towards further improving the employee experience as we undertake our transformational journey.

Freedom of Association & Collective Bargaining

As at end 2018, 72.2% of our people were members of the Ceylon Bank Employees Union (CBEU) and the HNB Officers Union. We engage in constructive dialogue with our trade unions to foster a culture of trust and transparency and to find mutually rewarding solutions through a collaborative process. There were

WE ENGAGE WITH OUR EMPLOYEES THROUGH:

- CEO's annual strategy presentation
- Quarterly strategic plan review meetings
- In-house magazine 'Hatna Mag'
- Monthly newsletter "From the CEO's Desk"
- Weekly email from the CEO
- Monthly corporate management meetings.
- Monthly / Quarterly Town Hall meetings.
- HR Service Days (Monthly / as required)
- Weekly divisional heads meetings.
- Weekly circulars
- HR roadshows
- Daily emails notifications
- One to one meetings
- Virtual – Voice of Yours
- Virtual – HNB Ideabox

no incidents of industrial action during the year in testimony to the high levels of engagement and proactive approach to resolution of issues.

Special Employee Focus Groups

Special Employee Focus groups chaired by the Chief Operating Officer, members of both trade unions, branch managers and management representatives have been formed and meet every two months to discuss and resolve matter related to the bank operations, product development, premises, staff, system issues to arrive at fruitful and effective outcomes.

Whistle Blowing

HNB has a whistle blowing policy with an independent director as the reporting authority which encourages employees to report irregularities without fear of reprisal or adverse consequences. We are also increasingly moving away from a punitive approach to "conduct-risk management" to a more self-regulatory approach where employees understand "what is right". A number of programmes including awareness programmes and "ethical behaviour" workshops are being conducted across



Women in Management Awards 2018



Sports fiesta 2018

the Bank to assist in this paradigm shift. The importance of professionalism and ethical behaviour is also communicated through employee communications such as the "HATNAMAG" with real incidents and case studies.

Grievance Handling Mechanisms

Proactively engaging with our employees and addressing weak links is critical. Multiple channels are in place for employees to highlight pain points and ensure that grievances are addressed fairly and independently.

REWARDING AND RECOGNISING OUR EMPLOYEES

Remuneration and Benefits

Remuneration of all permanent employees consist of fixed pay and variable pay component which is linked to the performance of the bank and individual performance. Junior executives and below grades remuneration structures are governed by Collective Agreement which are negotiated with respective unions once in every three years. Remuneration and benefits are revised periodically based on market surveys to ensure that they are on par with the competition.

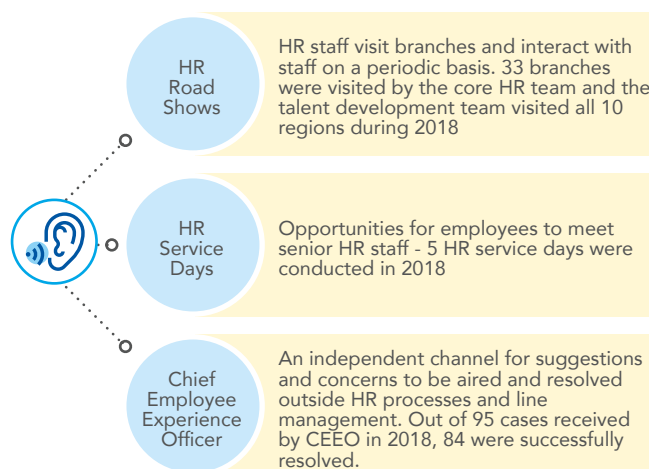
Recognising our employees

We promote a culture of appreciating one another by recognising high performers and employee contributions throughout the year. "Stars Night 2018", a glamorous awards ceremony was hosted to recognize exceptional performances by our retail and SME teams.

Creating a Safe and Happy Work Environment

We are committed to providing a safe, secure and healthy work environment for our employees and have a health and safety policy that goes well beyond the minimum health and safety regulations stipulated by law. In addition to taking every precaution to ensure that all our locations are accident free environments, we continue to conduct a range of health and wellness awareness programmes and promote a culture of work-life balance while offering our employees some of the best healthcare benefits in the industry.

As a Bank, the main threat to our staff arise from the risk of bank robberies. Consequently, physical safeguards have been implemented across all locations to secure cash with access controls. All locations are manned by trained security personnel outsourced from a third party to ensure the safety of our staff. Detailed service level agreements specify performance criteria to facilitate prompt action in case of emergency including contact with closest police station. Drills are conducted on a regular basis to ensure that staff are aware of the responses to security incidents.



CREATING A LEVEL PLAYING FIELD

As an equal opportunity employer, we strive to create a level playing field which provides every employee an equal opportunity to realize their personal and professional aspirations.

Women at Work Initiative

Our Women at Work Initiative which includes family friendly policies such as flexible mobility policies, personal coaching sessions for women, tailor-made leadership programmes etc. create an environment where women are supported and empowered to reach their full potential while fulfilling their multiple roles. In recognition of our efforts, the Bank was conferred a gold award for the 'best private sector organisation that promotes women in the workplace' at the annual Top 50 Professional and Career Women's Awards, held by Women in Management (WIM).

Supported by this conducive environment, our female colleagues continue to win recognition as trail-blazing business women. HNB's Board Director, Mrs Rose Cooray was awarded a Gold in the Judges category for her accomplished and long contribution to the banking industry, while Chief Financial Officer (CFO) Mrs Anusha Gallage received a Silver in the Banking, Finance and Insurance category at the WIM Top 50 Professional and Career Women's Awards.

Fair Work Practices

We are committed to ensuring that our business adheres to local and international labour regulations. Accordingly, our governance framework and work practices include a zero-tolerance policy on sexual harassment, child labour and forced labour and stringent policies with regards to safeguarding human rights. Ongoing training programmes are conducted to create awareness regarding fair work practices and human rights.

There were no reported Incidents of discrimination or human rights violations during the year.

Human Capital

FEMALE PARTICIPATION IN THE WORK FORCE

42%
of total work force

18%
of senior Management

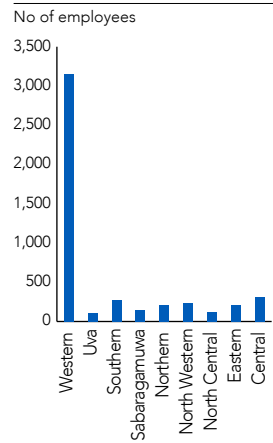
95.4%
of women returned to work after maternity leave

Wellness Initiative	Participants/ Beneficiaries
A special workshop on Cancer and its prevention	50
A programme on Mental Wellbeing titled "Your Mind & You"	60
Concessionary health check up packages for employees over the age of 40 / Special discounted rates for health services at leading hospital for all employees	525
A seminar on Competent Parenting	110
Fostering happiness in personal and family life	115

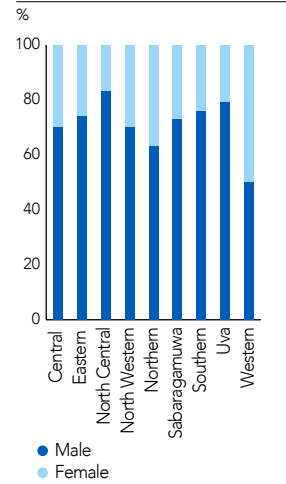
Inhouse Training programmes conducted on Human Rights

Programmes for	No. of Programmes	No. of Participants	Man Hours
Line Management	1	2	16
Executives	8	36	288
Total	9	38	304

Geographical Distribution of Employees



Geographical / Gender Diversity



HNB Walks the Talk event 2018



Rewarding employees completing 25 years of loyal service



Recognising sports achievers 2018



Sports Fiesta 2018

Social and Network Capital

Social and network capital comprises our relationships with customers, business partners, and community which are key to our growth. Like any capital, these key relationships have to be nurtured through appropriate engagement and integration of their needs and concerns in to strategy. As this capital comprises key external stakeholder relationships that impact our growth, sound corporate governance and principles of transparency are the bedrock for managing them to create sustainable long term value for all.

Our processes for managing these are set out on page 38 on Stakeholder Engagement and page 39 on Determining Our Material Issues. This segment of the report seeks to summarise the value derived from and value delivered to these key stakeholders.

DELIVERING VALUE TO CUSTOMERS

We create value to our customers by providing wealth creating opportunities through investment and financing options. Driving this value creation process is our customer value proposition which is based on the fundamentals of Product relevance, convenience and trust.

Delivering on this customer value proposition is a key component of the Bank's transformation programme, as we understand the role they play in our success.

Relevance

We seek to be relevant to the customer needs to ensure that we remain customer centric in our strategy and delivery of services, supported by a relevant product portfolio. Embedded in this value proposition is the promise that we will evolve with changing customer lifestyles with fit for purpose products that support customer aspirations.

Customer Focus

High levels of customer engagement ensures that we are able to stay relevant to their ever evolving needs and the Bank uses a number of tools to facilitate this. We recently conducted a customer survey to understand our Net Promotor Score (NPS) among different customer segments and gained valuable insight into areas we could potentially improve. HNB Connect, our recently opened Omni channel contact centre is also another avenue through which we engage with our customers to understand and address our customers' needs and pain points.

Relevant Products

In an increasingly homogenised banking sector, we strive to stand apart by understanding our client's requirements and offering innovative solutions to meet their complex financial needs. Our product portfolio was reviewed during the year and we introduced several new products including business card for SMEs and an ERP solution for SMEs.

VALUE ADDED

- 9.9 Bn distributed to suppliers
- 14.26 Mn distributed to Community
- Refer Value Created to Stakeholders Statement on page 312



Relevance	Convenience	Trust
<ul style="list-style-type: none"> • Customer Focus • Relevant Products 	<ul style="list-style-type: none"> • Accessibility • Superior Customer Service 	<ul style="list-style-type: none"> • Product Responsibility • Securing customer information

Social and Network Capital

Convenience

Customer convenience is a priority as it is key to higher levels of engagement, supporting our relevance to the customer. It is supported through increased investment in digitalisation and branch automation, expansion of customer touchpoints as well as an increased focus on customer service.

Accessibility

In addition to increasing the number of touch points, we also expanded the scope of many of these touch points. During the year, we added personal financial services to our Seven-day banking customer centres. We also expanded the services offered through our 684 self-service machines (SSM) which now provide a full range of services including cash withdrawal and deposits, real time fund transfers, credit card payments, utility payments, currency conversions, online cheque acceptance, card less transactions, topping up of HNB prepaid cards such as Smart pay and Wally E.

Superior Customer Service

Customer service is the bedrock of our customer relationships, and is an area that we have to excel in. It will differentiate and define us and is an integral part of our journey.

"HNB Connect", a fully integrated Omni-channel contact centre was introduced during the year with a view to further enhancing our customer experience. The new Omni Channel Contact Centre has been designed to address customer enquiries, requests and complaints through Voice Calls, Emails, Live Chats and Social media 24 hours a day, seven days a week and is accessible to customers of the bank world-wide. Meanwhile the Bank's wider strategy of centralising back-end processes through dedicated centres such as the HNB Centre of Aspiration and HNB Centre of Excellence enabled frontline staff to focus more on engaging with customers and improving service delivery through efficiency gains.

Trust

The strength of our customer relationships is based on the degree of trust and confidence our customers place on us. As custodians of their wealth and information, we are committed to securing both through sound systems and processes, carefully balancing the need for convenience, connectivity and costs.

Product Responsibility

Product responsibility revolves around ensuring that our product offerings conform to applicable laws and regulations and meets our ethical standards. It also involves ensuring that details regarding fees and charges, product features, terms and conditions etc. are clearly communicated to our customers. Details on products and their features are easily accessible through our corporate website and further information could be obtained through branch staff or through our new contact centre, "HNB Connect". We also promote financial literacy for targeted customer groups to ensure that they are able to manage their businesses and wealth through capacity building initiatives.



◦ **950** Correspondent Banks



◦ **90** Exchange Houses



◦ **15,000** Merchants

Securing customer information

Customer security and privacy are priorities for the Bank particularly as we move towards a more digitised banking solution.

There were no incidents of customer privacy or security breaches during the year.

VALUE TO BUSINESS PARTNERS

Our business partners are a vital link in our value creation process as they enable us to operate seamlessly. They provide supplies and services for our day to day operations while a growing network of corresponding banks, merchant and exchange houses provide our customers market access and opportunities in global markets. During the year, we made payments of Rs 9.9 Bn to our suppliers.

Procurement

A comprehensive procurement policy which adheres to the highest standards in procurement ensures a transparent and sustainable procurement process. A Board committee has oversight responsibility to ensure fair procurement practices and work together with the Procurement Division of the Bank to implement a transparent and effective system for procurement of goods and services of the right quality at the right price from reliable sources. Selection of suppliers is based on technical and cost specifications, timely delivery and compliance with the banks sustainability criteria on environmentally friendly, social and ethical practices. An E-Procurement system provides activity logs and audit trails facilitating efficient and effective procurement. All IT procurements go through a technical evaluation committee and if required vetted through multi-disciplinary teams including the risk departments.

Digitisation of procurement process

As part of our overall digitisation strategy, the bank introduced an E- procurement system for suppliers of goods and services during the year. Accordingly, tenders are called for electronically and suppliers can register and bid for these tenders online. The digitisation of the procurement not only has made the bidding process more convenient for our suppliers, it has also resulted in a more efficient, transparent, cost effective process for the Bank.

Supplier Engagement

Engagement with suppliers is an ongoing process which enables us to monitor supplier performance while providing guidance and support on growing their business and put in place sustainable business practices. Digitisation of the procurement process has further improved our ability to monitor our supply chain and actively engage with our business partners.

DELIVERING VALUE TO COMMUNITIES

We firmly believe that our long-term sustainability as a business depends on the positive impact we have on our community. As a Bank we contribute directly to the socio-economic development of communities by empowering our communities with access to finance, financial literacy and financial inclusivity. We also strive to act as a catalyst for positive change through our strategic philanthropy in healthcare, education, entrepreneurship and the environment.

Partner for Socioeconomic Progress

The table below sets out how we deliver value to the community through our normal banking operations. Value delivered has been mapped to the UN Sustainable Development Goals recognising the fact that our actions make a difference.



Partner for Socioeconomic Progress

As a Domestic Systemically Important Bank (DSIB) we are conscious of our responsibility to support the socioeconomic progress of the communities we operate in while remaining financially stable.



Strategic Philanthropy

As a large corporate in the country, we are conscious of the need to support those who are more vulnerable through strategic philanthropic initiatives which are carried out at both national and community level.



Introducing HNB ERP solutions for SME



Scholarships for children HNB Diridaru awards 2018











Supporting awareness of UNSDG among students.



Commemorating World AIDS Day 2018

Social and Network Capital

8 DECENT WORK AND ECONOMIC GROWTH 	Direct Employment	New Jobs created (Bank) 153 (permanent)
	4,781 Employees	30% decrease in paper disposed
	Material Footprint	31 ATMs per 1,000,000 adults
	Financial Services Access	11 Branches per 1,000,000 adults
Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all		
Financial Access	Zero Workplace injuries	72% of employees enrolled in unions
Zero Child Labour		
9 INDUSTRY, INNOVATION AND INFRASTRUCTURE 		
Build resilient infrastructure, promote inclusive and sustainable industrialisation and foster innovation		
Access to Finance SME & Microfinance Disbursements Rs 150 Bn		Co₂ Emissions Intensity 5,599.84 MT
10 REDUCED INEQUALITIES 		
Reduce inequality within and among countries		736 Awareness/Financial literacy programmes
Equal opportunity employer		
5 GENDER EQUALITY 		
Gender equality frameworks in place through HR policies		
Achieve gender equality and empower all women and girls		Proportion of Women in the work force 42%
4 QUALITY EDUCATION 		
Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all		Training Hrs Per Employee 40.1
In House & Virtual Training 186,009 Hrs		
Training Opportunities 12,115 Employees		Employee Coverage 94.5%
Rs 49.1 Mn (Excluding Admin & Systems Costs)		
7 AFFORDABLE AND CLEAN ENERGY 		
Ensure access to affordable, reliable, sustainable and modern energy for all		96 branches with solar panels
		Solar Power generation 17% of total energy consumption
		Solar Power generation 2.5 GWh
Emission		Per Employee 1.17
		Per MT sqft 0.004
11 SUSTAINABLE CITIES AND COMMUNITIES 		
Make cities and human settlements inclusive, safe, resilient and sustainable		Retail Lending Home Loans 22.7%
		Corporate Lending Construction Sector 10.3% Infrastructure 11.2% Transport and Storage 4.8%
12 RESPONSIBLE CONSUMPTION AND PRODUCTION 		
Ensure sustainable consumption and production patterns		Proponent of Sri Lanka Banks Association Sustainable Banking Initiative comprising 11 Environmental and Social Principles
		Hosting Training Workshops on SLBA Sustainable Banking Initiative
		Large project, SME & Corporate Loan facilities evaluated for environmental and social criteria in line with the Bank's ESMS policy

CSR (Strategic Philanthropy)

The Bank’s strategic philanthropy activities are carried out through the HNB sustainability foundation which was established in 2009 as an independent body to manage the sustainability initiative of the Bank. The foundation which consists of 8 trustees including the MD/ CEO meet periodically to strategise and review progress on sustainability issues. A comprehensive sustainability dash board which includes social, economic and environmental indicators track progress on key indicators.

CSR initiatives of the Bank revolve around four strategic areas; education, health, environment, empowering entrepreneurs. Details of CSR initiatives during the year are listed in the table below, mapped to the relevant Sustainable Development Goals.

Accolades for CSR
<p>Sri Lanka Sustainability Reporting Awards</p> <ul style="list-style-type: none"> Gold Award in the banking category and overall Runner Up at the 12th Annual ACCA Sri Lanka Sustainability Reporting Awards.
<p>LMD STING Corporate Accountability</p> <ul style="list-style-type: none"> Moved 3 places above to secure the 10th position in the LMD STING Corporate Accountability rating (only bank in the top 10).
<p>CSR Sri Lanka Leadership Award 2018</p> <ul style="list-style-type: none"> Best Leadership Award presented to Jonathan Alles – MD/CEO Best Corporate and Financial Reporting Best Use of CSR Practices in Banking & Finance Industry Best Workplace Practices
<p>Best Corporate Citizen Awards 2018</p> <ul style="list-style-type: none"> Declared First Runner Up – Best Corporate Citizen Sustainability Award Ranked among Top Ten Corporate Citizen in Sri Lanka Winners in the Finance Sector Sustainability Category Award Winner – Economic Contribution Triple Bottom Line Award Winner – Economic Sustainability (Profit) Consistent commitment and continuous improvement – Environment Beyond the Business Merit Certificate Winner – Best Projects Sustainability

Significant community investments during the year included the following

<p>3 GOOD HEALTH AND WELL-BEING</p> 	<p>Completion of the renovation of women’s ward at the National Institute of mental Health - Mullareiyawa</p> <p>Continued to sponsor HIV/AIDS awareness and rapid testing kits in partnership with the Ministry of Health - National STD/AIDS Control Programme</p> <p>Continued the financial support to cancer patients and provide counselling facilities</p> <p>Sponsored awareness programme for caring for terminally ill</p>
<p>Ensure healthy lives and promote well-being for all at all ages</p>	
<p>4 QUALITY EDUCATION</p> 	<p>Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all</p> <p>Continued to support schools in economically disadvantaged areas with renovations and book donations</p> <p>Working with the United Nations and Ministry of Education to create awareness of UNSDGs in 25 schools</p>
<p>Ensure availability and sustainable management of water and sanitation for all</p>	
<p>6 CLEAN WATER AND SANITATION</p> 	<p>Partnered with Habitat for Humanity Sri Lanka to provide water and sanitation facilities to disadvantaged community including a school</p> <p>Continued to sponsored setting up of rainwater harvesting systems with the Sri Lanka Water Partnership – 6 schools</p> <p>Installation and maintenance of RO water purification systems in schools with the University of Moratuwa AIESEC</p>
<p>Ensure availability and sustainable management of water and sanitation for all</p>	
<p>11 SUSTAINABLE CITIES AND COMMUNITIES</p> 	<p>Make cities and human settlements inclusive, safe, resilient and sustainable</p> <p>Warning boards at unprotected railway crossings</p>

Intellectual Capital

Our intellectual capital consisting of our brand equity, collective knowledge, robust systems and processes as well as our innovative spirit set us apart from the competition by enabling us to consistently anticipate our customers' needs in a rapidly evolving banking environment. Managing our intellectual capital is therefore of strategic importance as we set out to shape the future of banking industry in our country and position ourselves as the most future ready Bank in Sri Lanka.

A RESPECTED BRAND

Our Brand is a reflection of our relationships with our stakeholders. Over the years the HNB Brand has come to be associated with a level of trust and strength that continues to inspire confidence in all our stakeholders. The HNB brand was ranked among the top 10 most valuable brands in Sri Lanka for 2018 by Brand Finance for the 15th consecutive year. HNB brand value continued to grow during the year backed by our strong financial performance and focus on customer satisfaction. According to Brand Finance HNB's brand value rose 19.2% to Rs 22.2 Bn in 2018. Furthermore, HNB was recognised as one of 'Asia's 100 Greatest Brands 2018'. The award is procreated by AsiaOne and its process reviewed by PricewaterhouseCoopers, which celebrates and acknowledges the talented cohort of innovators, creators, and entrepreneurs who have been instrumental in boldly envisioning, realising and validating their aspirations to shape the future, and transform the world.



PERFORMANCE HIGHLIGHTS

- Ranked among top 10 Most Valuable Brands in Sri Lanka 2018- Brand Finance
- Brand Value of Rs 22.2 Bn an increase of 19% over the previous year
- No. 1 Bank in Sri Lanka 2018- Banker Magazine, UK
- Highest ranked bank in Sri Lanka by Business Today
- Recognised as one of 'Asia's 100 Greatest Brands 2018' by AsiaOne
- 54% of our staff have experience over 10 years

OUR COLLECTIVE KNOWLEDGE AND SKILLS

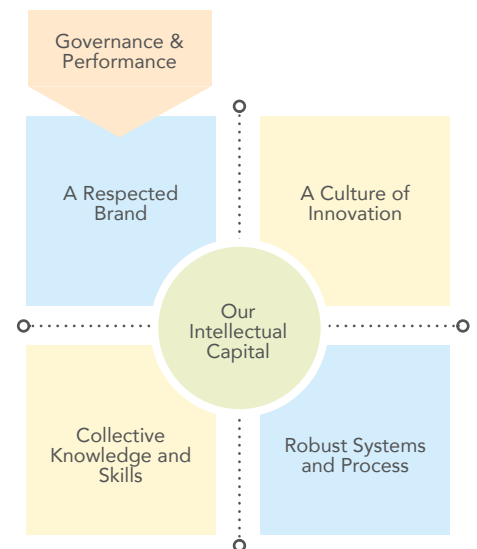
Our collective knowledge comprises of the tacit knowledge, skills and experience that our diverse employee base brings to the table. Our employees come from all across the island, span across 3 generations, and represent different ethnicities and backgrounds. We encourage employees to share their ideas, experience and knowledge through initiatives such as cross functional teams, focus groups and the idea-box initiative which is a platform to facilitate innovative ideas of our team. More details on employee engagement initiatives could be found on page 56 on our Human Capital Report.

Developing and retaining talent is a key aspect of managing our intellectual capital. We have consistently maintained a retention rate of 94% during the last five years while almost 54% of our employees have been with the Bank for over 10 years. This is ample evidence of our success of retaining talent within the Bank.

We encourage a culture of mentoring, which ensures that knowledge is passed down both formally and informally. Our structured mentoring program, RISE offers one to one mentoring for identified employees, while knowledge sharing is encouraged at every level across the Bank and built into our organisational culture.

A CULTURE OF INNOVATION

Staying relevant in a rapidly evolving environment requires that we are constantly thinking out of the box and pushing the boundaries of traditional banking. This innovative spirit is the driving force behind many of the pioneering efforts of the Bank. The year 2018 saw the successful implementation of a fully-



fledged Custodian Banking platform which is the first among local banks in Sri Lanka. As outlined under Social and Network Capital report, the Bank also launched new products to support the SME sector which included a business card, ERP system and an insurance product.

Robust Systems and Processes

Upgrading our systems and processes to better manage our risks, improve productivity and consistently exceed our client expectations is a key aspect of our Bank Transformation journey. One of the key process improvements during the year was the introduction of our omni channel contact centre aimed at improving service delivery and enhancing the customer experience. The Six Sigma lean initiative continued through the year with bank wide projects such as centralisation of the credit approval process and loan recovery process, streamlining of the mortgage bond cancellation process. These projects were complemented by smaller scale Six Sigma projects carried out branch level. Interest in the initiative was created among staff through Six Sigma training programs and the 'Inter Branch Lean Competition' which recognised successful lean initiatives at the annual Stars Night.

Awards

The awards and accolades we received during the year are a validation of our approach to building the HNB Brand in the minds of our stakeholders both locally and internationally.

1. Banker Magazine (UK) Number One bank in Sri Lanka 2018
2. Brand Finance Ranked among top 10 most Valuable Brands in Sri Lanka - 2018
3. Business Today TOP 30 2017 - 2018 Hatton National Bank - Ranked 02
4. Asian Banker International Excellence in Retail Financial Services Awards - Best Retail Bank in Sri Lanka - 2018
5. Asian Banker Transaction Awards 2018
Best Foreign Exchange Bank
Best Payment Bank

6. International Finance Magazine Awards (IFM) 2018 Singapore
Best Microfinance Bank in Sri Lanka
Best Retail Bank in Sri Lanka
7. Euromoney Cash Management Survey 2018
Market Leader Cash Management
Best Service Cash Management
8. Euromoney Trade Finance Survey 2019
Market Leader Trade Finance
Best Service Bank
9. Asiamoney Banking Awards 2018
Best SME Bank
Best Digital Bank
The Best Cash Management Bank
10. Annual Top 50 Professional and Career Women's Awards, organised by Women In Management.
Best private sector organisation that promotes women in the workplace - Gold
11. CMA Excellence in Integrated Reporting Awards 2018
Among top 10 Best Integrated Reports
Winner - Banking Sector
12. CA Sri Lanka Annual Reports Awards 2018
Silver Award - Banking Institutions Category
Silver Award - Corporate Governance Disclosure

The awards and accolades received in the areas of Islamic Banking and sustainability are detailed on pg 75 and pg 67 respectively.



Receiving the Business Today Award.

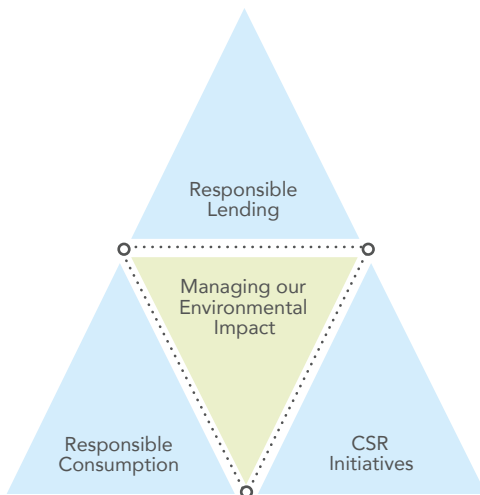


CA Sri Lanka Awards

Natural Capital

With impact of climate change increasingly being felt by national economies, financial institutions around the globe are pro-actively looking at addressing environmental impacts and risks as part of their overall strategy. In Sri Lanka, HNB has been in the forefront of adopting globally accepted sustainable banking principles, and is actively involved in setting the agenda for local peers to create industry level standards.

We take a multi-pronged approach to managing our impact on the environment.



RESPONSIBLE LENDING

Environmental Risk Management

Environmental and social considerations are integrated into lending decisions through a rigorous environmental and social management system (ESMS) which assesses the Environmental and Social risk involved with any given project. During the year, 76 projects were screened by the ESMS Unit while other relevant medium risk projects are screened by the respective credit officers. None of the projects were rejected due to non-compliance with E & S laws and regulations.

Environmental risk management does not end with the lending decision. We hold our customers responsible for strict adherence to E & S standards throughout the project life by incorporating rigorous loan covenants pertaining to E & S standards. Projects are also continuously monitored through periodic site visits to ensure E & S compliance and to assess risk levels.

Credit officers are provided training on ESMS on an ongoing basis. 170 officers were provided ESMS training during the year and 196 participated in virtual training.

We ensure that our operations are fully compliant with all environmental laws and regulations in the country. There were no instances of non-compliance with environmental laws and/or regulations during the year.

Promoting "green economy" growth

We promote projects and activities that contribute to a greener economy in Sri Lanka. The personal loan scheme for the installation of solar energy systems continued to gain traction with almost 86 loans being granted through the scheme upto end 2018. We also continue to be in the forefront of large scale renewable energy financing both locally and overseas.

RESPONSIBLE CONSUMPTION

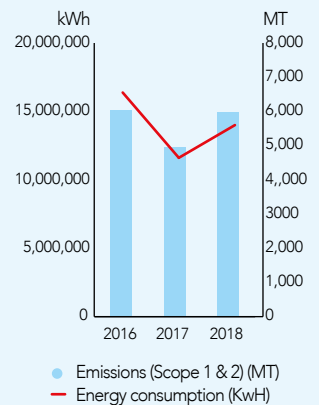
We strive to reduce our environmental footprint through responsible consumption of resources which involves careful management of our inputs and outputs.

Green Pledge

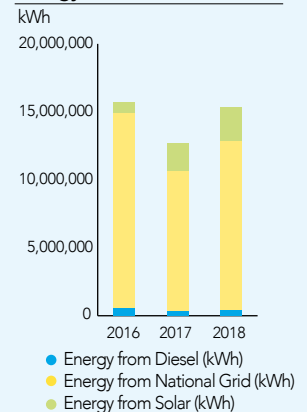
Our collective commitment to reducing our environmental footprint is put in to practice through our Green Pledge- a promise by every HNB employee to integrate environmentally friendly practices to daily operations. The initiative now in its 10th year promotes awareness and an eco-consciousness among employees and continues to be one of the driving forces behind the eco- friendly initiatives of the Bank. The HNB "Walk the Talk" initiative which commenced in August this year aims at promoting sustainable choices in our employees daily lives through innovative and easy to adopt practices such as choosing eco-friendlier commuting options for one day of the month.

PERFORMANCE

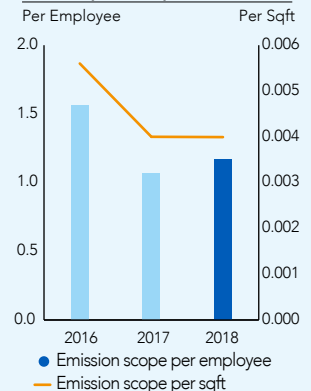
Carbon Footprint



Energy Mix



Emission Scope Per Employee/per sqft



Sustainability dash board

Measuring our impact is an important aspect of our sustainability journey. The CEO’s sustainability dashboard introduced in 2016 reports on key E & S indicators such as carbon footprint, material usage and disposal, supply chain assessments and risks etc. Progress is monitored on a quarterly basis.

MANAGING OUR INPUTS

We promote sustainable consumption of resources by reducing consumption and wastage.

Paper-less office initiative

Our Paper-less office initiative continued through the year with a number of new initiatives aimed at reducing paper usage and paper and printing costs;

- Commenced online tendering for suppliers as part of the e-procurement system introduced during the year. This has eliminated the requirement for paper-based tender documentation and contributed significantly to the reduction in paper consumption of the Bank.
- Hybrid customer vouchers which could be used both to obtain remittance claimants details as well as a cash withdrawal slip were introduced to the Branch Network eliminating the need for multiple vouchers
- Mandate Rationalisation: four application forms (Individual, Joint, Sole Proprietorship and Wally-E) were simplified using Lean principles resulting in reduction in paper usage
- Lean practices including six-sigma were implemented in 64 branches with the aim of reducing overall carbon footprint through sustainable process improvements. An ‘Inter Branch Lean Competition’ was conducted in August to create motivation for the initiative.
- All Bank Statements were digitised since October 2018.

Energy Efficiency

Increased digitisation and expansion of customer touch points entails a higher energy requirement. However, we continue to focus on finding the most energy efficient and environmentally friendly means to fulfil our increasing requirements.

Our solarising project continued during the year with 96 number of branches converted upto date and of which 69 were fully operational by end 2018. Energy generation from the solarised branches amounted to 2.5 GWh (nearly 17% of total energy consumption). Meanwhile we continued to invest in making our spaces more energy efficient with investments in conversion of magnetic ballast lights, signage boards etc to LED lighting.

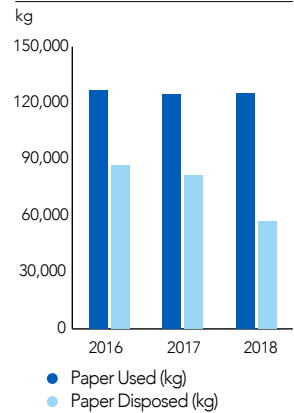
MANAGING OUR OUTPUTS

Emissions

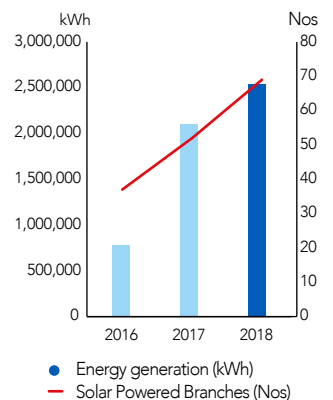
Scope 1 & 2 emissions generated by the bank are tracked and reported on a quarterly basis. The initiative to migrate to energy efficient inverter air-conditioning technology across branches continued during the year. We also introduced a number of improvements to our transportation system with the aim of reducing fuel costs and emissions.

Scope 1 and 2 emissions of the bank are derived mainly from the electricity consumption used by the head office and branches and is strongly correlated to the square area occupied. During 2018 the area occupied increased to support centralisation of specialised services and recruitment of 433 new employees. Accordingly, the Scope 1 and 2 carbon foot print of year 2018 shows an increase of 956 MT which is still lower than the carbon foot print of 2016. It is noteworthy that the energy intensity per square foot has decreased by 2.5% in 2018 reflecting numerous initiatives taken to reduce the carbon footprint. The energy intensity per employee increased by 10% during the year as floor space in use has provided for future expansion of our team.

Paper Usage and Disposed






Solarising Project



MAKING A POSITIVE IMPACT

Conserving the environment is one of the focus areas for the Bank’s CSR programme and a number of CSR initiatives were carried out during the year to create awareness and support bio-diversity.

<p>13 CLIMATE ACTION</p> 	<p>HNB partnered with the annual Sripada Cleanup project organized by the Leo Club of Colombo Knights and supported to clean the ancient heritage site of non-biodegradable waste such as polythene, bottles and plastic wrappings</p>
<p>15 LIFE ON LAND</p> 	<p>HNB continued to work with the Biodiversity Sri Lanka, Forest department, IUCN Sri Lanka and selected private sector partners to introduce a biodiversity credit accrual system for Sri Lanka</p> <p>Partnered with Biodiversity Sri Lanka to commemorate the ‘International Day for Biological Diversity’.</p>
<p>14 LIFE BELOW WATER</p> 	<p>Partnered with the Biodiversity Sri Lanka to protect the rare endemic fish species in the Thundola area</p>

Retail Banking

VALUE TO GROUP

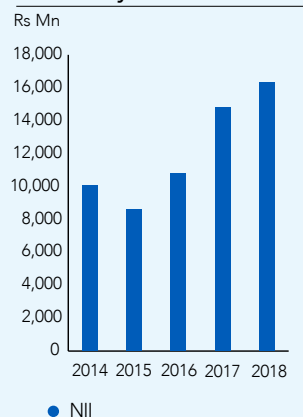
Relevance to Group

- 25% Operating Income
- 14% of Total Assets
- 42% of Liabilities

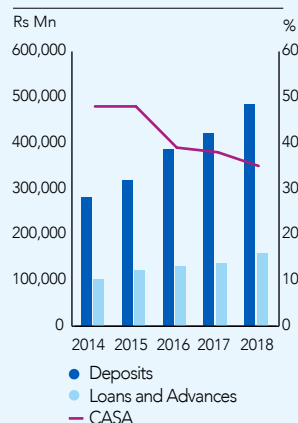
Relevance to Group

- Largest Leasing Portfolio Among Private Banks
- Market Leader in Merchant Acquiring
- Award winning Islamic Banking Unit

Profitability



Growth



Facilitating financial transactions, access to finance and wealth management for over 2.3 Mn customers, HNB Retail Banking plays a key role in supporting their socioeconomic aspirations. Future ready products, an island-wide branch and ATM network and electronic banking channels offer unparalleled customer convenience while a dedicated contact centre provides support to customers 24x7.

Retail Banking continues to focus on customer centricity with a strong relationship and service orientation. We aspire to shape the way Sri Lankans bank through innovation and supporting the migration of customers to digital banking channels in line with the country's agenda of becoming a cashless economy.

PERFORMANCE

Highlights (Rs Bn)	2017	2018	Change
NII	14.8	16.3	10%
Fee Based Income	2.2	2.4	10%
Deposits	422.2	484.5	15%
Advances	136.5	159.0	17%
NPA Ratio	2.3%	2.6%	

Increased NII of 10.3% was supported by portfolio growth and increasing interest rates in line with industry. Deposit growth was 14.8%, while fee based income also increased by 9.5%. Despite an increase in non-performing loans observed in the industry due to the distressed conditions, the Bank was successful in maintaining its retail NPAs at 2.6% which is mainly attributable to the focused engagement by the Centre of Aspiration.

Our market positioning also strengthened during the year. Nurturing the largest merchant network for cards with a 48% market share supports fee income and growth of our debit and credit card business. HNB Leasing has the largest market share for leasing among private banks in testimony to our agility and service excellence. Shanthi loans portfolio increased by 5.3% during the year as we disbursed nearly Rs 9.9 Bn working together with real estate developers and merchants to add value to our customers. Personal loans also grew by a significant 44.2% as we focused on offering convenience to professionals and retirees, connecting products to monthly incomes.

DRIVING GROWTH

Performance of retail banking was driven through a holistic strategy which focused on delivering value to our customers. A diverse product portfolio drives our growth, offering financial solutions for customers at every stage of their life.

BEST RETAIL BANK IN SRI LANKA

Asian Banker Magazine
International Finance Awards

Wealth Management	Supporting Growth	Convenience
<ul style="list-style-type: none"> Singithi Kiri Ketiyo, Lama and Surakum HNB Teen Account HNB You HNB Salary Smart HNB Fit HNB Sathkara Term Deposits Foreign Currency Accounts Islamic Banking Products 	<ul style="list-style-type: none"> Leasing Customised Personal Loans Shanthy Home Loans Islamic Banking Products 	<ul style="list-style-type: none"> 250 Branches islandwide 684 SSMs Dedicated Islamic Banking Centre Debit Cards Credit Cards HNB Momo 15,000 merchants Remittances Online Banking Mobile Banking

We continue to re-evaluate our portfolio to ensure that it is fit for the future and purpose, adapting to our customer lifestyles and new disruptive technology. Products such as HNB Fit App and WallyE launched in 2017 are good examples of how we continue to innovate, using technology to address key concerns and becoming more relevant to our customers.

Team Focus

Progress made during the year was driven by an inspired and motivated team who worked together to deliver on the department’s goals. In line with the Bank’s vision of a Happy and Bright team, we have increased the levels of employee engagement. We have trained our team to move to a relationship focus from a product specialisation to facilitate holistic solutions for customers. We are also restructuring our sales force comprising outsourced employees and fixed term employees in alignment with the Bank’s long term goals.

Efficient & Effective Processes

Streamlining internal processes and digitisation has already yielded results with improved user experience. With the upgrading and implementation of key systems we expect to deliver further enhancements in the years ahead. We also observe increased migration to e-statements and increased volumes of electronic transactions as customers adapt and adopt the smart solutions offered by the Bank. The appointment of 25 digital ambassadors in branches is supporting digital migration of customers.

REMITTANCES

Remittance volumes increased during the year as we signed up new remittance partners, opening new markets and enhancing access in others. On-boarding Western Union was a key achievement as we became the first bank to sign a non-exclusive agreement with this global leader in remittances. Re-entry into the Italian market with National Exchange Company supported volume growth in this key migrant market. Promising growth was witnessed in this short duration as we marketed remittances island-wide, reaching new customers. Existing channels also witnessed a growth, enabling HNB Remittance business to maintain momentum and stay in front. Improved performance supported the growth of Adhishtana, our remittance linked special account designed exclusively to cater to migrants and their families in Sri Lanka, as recipients were encouraged to save.

VALUE TO STAKEHOLDERS

Product-wise Disbursements

Product	Percentage (%)
Credit Cards	0.2
Development Loans	0.0
Home Loans	22.7
Leases	13.6
Other Term Loans	6.5
Overdrafts	7.0
Pawning	10.1
Personal Loans	10.1
Refinance Loans	11.3
Short Term Loans	0.5
Staff Loans	4.9
1.0	1.0

Interest Paid to Retail Customers

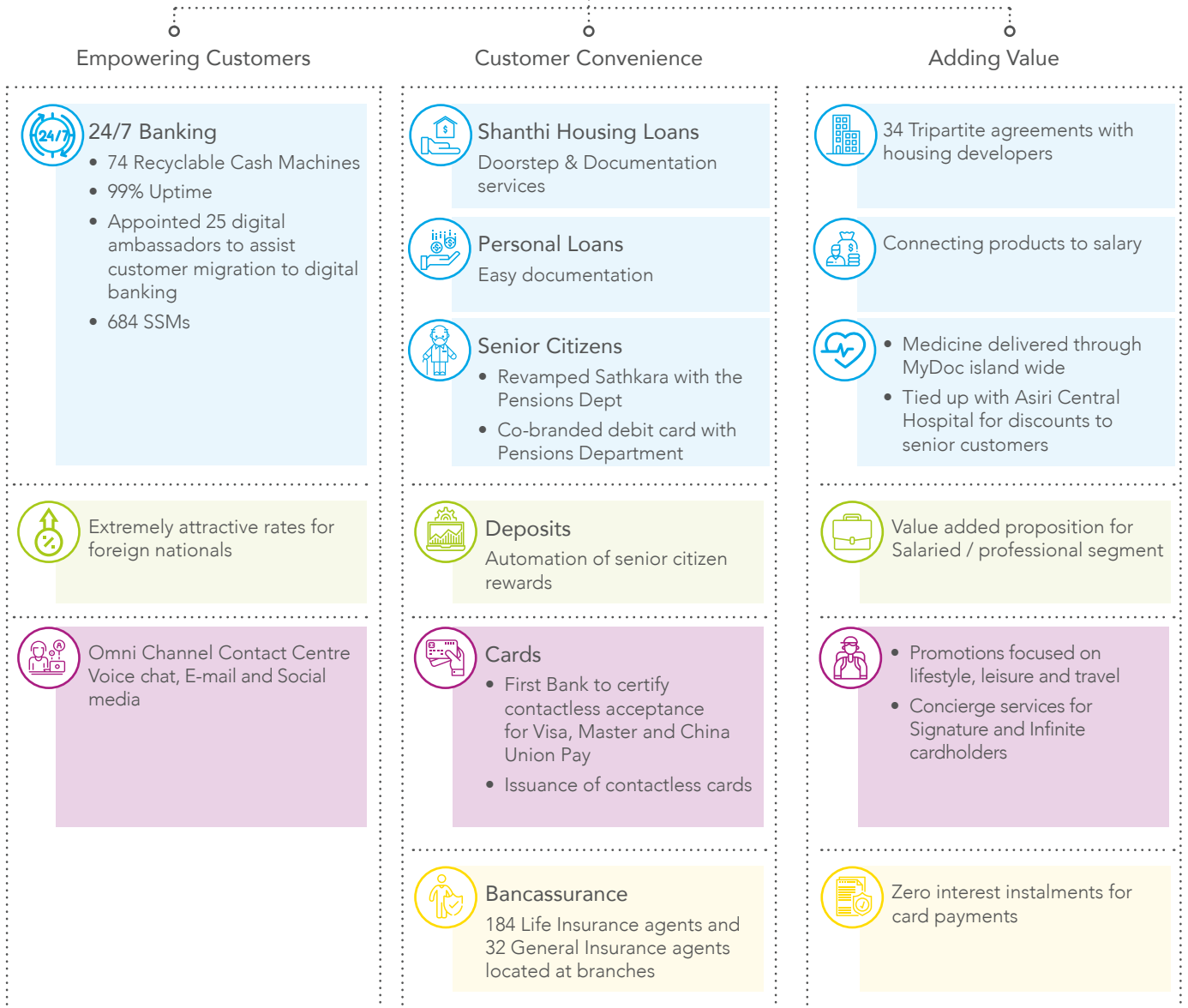
Year	Interest Paid (Rs Mn)
2014	16,000
2015	15,000
2016	22,000
2017	31,000
2018	35,000

Remittances Facilitated

Year	Commission received (Rs Mn)	No of payments
2014	145	700,000
2015	130	650,000
2016	140	680,000
2017	150	720,000
2018	190	850,000

Retail Banking

Value to Customers



Best Retail Banker Awards



Opening of the SSU at Gateway College

Rolling out Application Programming Interface for remittance partners continued during the year further improving turnaround times, team productivity and scalability in volumes. This key project will be completed in 2019 supporting growth and cost income ratios.

ISLAMIC BANKING

Managing the largest Islamic Banking portfolio among traditional banks operating Islamic Banking windows in the country, HNB Islamic Banking continues to gain recognition for its product innovation and Sharia compliance supporting growth in this highly specialised market. Deposits and Advances recorded strong growth at 46.1% and 9.8% taking the portfolios to Rs 12.1 Bn and Rs 14.5 Bn respectively. This was supported by numerous products and increased customer awareness activities in target markets. These activities contributed to a 21.4% increase in operating Income to Rs 784.4 Mn. It is noteworthy that NPAs were curtailed to 0.25% during the year despite higher NPAs observed throughout the industry.

Moving to a new location with sufficient space and opening of a new unit in Beruwala enhanced our presence, adding to the units in Kandy, Kalmunai and Pettah. Town storming, door to door campaigns and customer awareness programmes also contributed to drive growth. Our team expanded to drive our aspirations and we invested in providing them with the specialised knowledge required. These activities enabled HNB Islamic Banking to capture market share during the year, retaining its position as the fastest growing Islamic Banking portfolio.

FUTURE PLANS

Retail Banking will accelerate its growth trajectory supported by our strong domestic franchise, a fit for purpose product portfolio and future ready channels to empower customers. Empowering customers to manage their transactions will continue, supporting enhanced user experiences and growth in online transactions. Our efforts to promote remittances with virgin corridors will continue in to next year as well, supporting our aspirations.

We will continue to focus efforts on curtailing impaired assets within the Retail Banking portfolio through strong pre and post disbursement processes.

ACCOLADES FOR ISLAMIC BANKING

The Banker Magazine, UK

- Sharia compliant window of the year

Sri Lanka Islamic Banking and Finance Industry

- Gold award for Islamic Finance Entity of the Year
- Gold award for Islamic Finance Window/ Unit of the Year
- Silver award for Islamic Finance Deal of the Year

Islamic Finance Forum of South Asia

- Silver award for Islamic Finance Entity of the Year
- Silver award for Islamic Banking Window/ Unit of the Year
- Silver award for Islamic Finance Deal of the Year

NEW REMITTANCE PARTNERS

- Western Union
- National Exchange Company (NEC)
- Cross Links (Pvt) Ltd
- EzCash Ltd
- Max Money Sdn Bhd
- Asian Net Ltd
- Terraforma (Piplt) Ltd

SME

VALUE TO GROUP

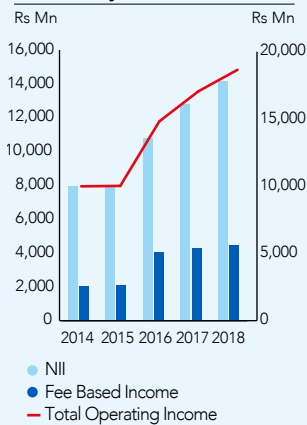
Group Perspectives

- 25% Operating Income
- 21% of Total Assets
- 14% of Liabilities

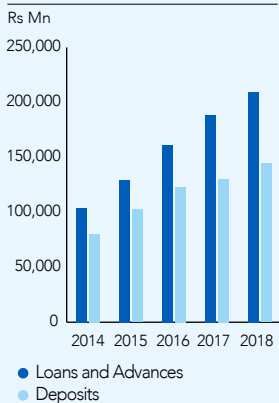
Key Facts

- Largest player in SME
- Rs 92 Bn of the portfolio is outside the Western Province

Profitability



Growth



Working with SME customers since inception gives us deep insights into this vital sector, enabling the formulation of unique products that cater to their needs. A committed team, dedicated SME cells covering all regions and high levels of digitisation complement our product portfolio making HNB SME one of the largest and most vibrant players in this segment.

HNB's approach to SME in 2018 was to build closer rapport with customers to understand the challenges faced by the sector in view of current economic conditions and climate change impacts on the agriculture sector. New products launched during the year addressed some of the issues facilitating access to markets, financial management and affordable safety nets, adding value to our clients and enabling their growth. We also increased our focus on the export sector through our Export Credit proposition in collaboration with the Export Development Board in line with Enterprise Sri Lanka strategy of the Government.

PERFORMANCE

Highlights (Rs Bn)	2017	2018	Change
NII	12.4	14.1	13%
Fee Based Income	4.7	4.5	(4%)
Deposits	141.2	153.8	9%
Loans & Advances	209.2	240.0	15%
NPA Ratio	4.2%	5.6%	

* Include middle market and SME facilities.

NII increased by 13.3% mainly due to portfolio growth of 15% during the year. Deposits growth was less satisfactory reflecting the climate change and monetary and fiscal conditions which combined to make 2018 one of the most difficult years for this business segment. Impairment charges increased as NPAs increased to 5.6% due to difficulties faced by this business segment. A proactive approach to resolving challenges supported the curtailment of NPAs to these levels along with the capacity building initiatives supporting growth of our valued customers.

Efficient & Effective Processes

We have also adopted a better model for the SME business with 10 SME cells covering all regions across the country. Relationship Managers driving the business, increased to 39 during the year, supporting the proactive model implemented during the year. This has led to faster turnaround times from application to approval and substantially improved the overall SME service delivery experience.

**BEST SME BANK
IN SRI LANKA 2018**

AsiaMoney

CHANNELLED

Rs 12 Bn
THROUGH PARTICIPATION
IN CREDIT LINES UNDER
ENTERPRISE SRI LANKA
TO SMES

DRIVING GROWTH

A passion for supporting SMEs coupled with extensive customer reach and over 130 years of working with them positions HNB as the bank for SMEs. We continue to enhance our SME value proposition in the firm belief that they form the backbone of our economy and implemented the following in 2018 to facilitate access to markets, access to capital and improved financial management.

Capacity Building

- Conducted 12 programmes covering all 10 regions with a structured programme conducted by HNB officials and external consultants on topics ranging from digital banking to export trade awareness.
- Awareness programmes on financial management and technical know-how in partnership with DEG and other multilateral funding agencies

Management Tools

- ERP Solution developed in partnership with Bileta (Pvt) Ltd to facilitate inventory and cashflow management

New Products

- Web X Pay e-commerce portal for SMEs
- SME Insurance solution developed in partnership with HNB Assurance PLC to combine all insurance needs into one affordable package with options for monthly payments
- SME Business Card to facilitate segregation of business activity and ease of doing business

Access to Markets

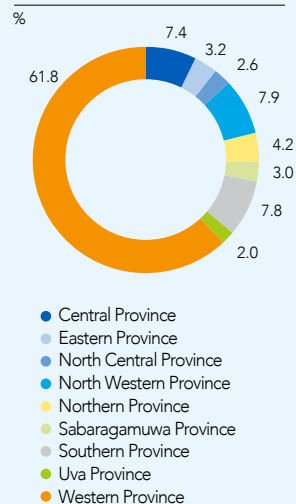
- Access to markets in EU in partnership with 27th Lane Business Hub including advise on certifications required and how to obtain them

FUTURE PLANS

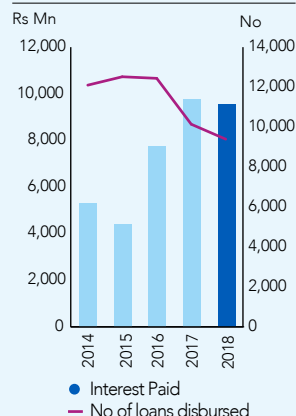
SME continues to be a key pillar of HNB’s growth strategy in alignment with the Country’s 2025 vision. Deep insights into challenges of the sector, a vision of how the SME sector can be developed and a commitment to the same drive us to find tailored solutions for this key business segment. We will continue to invest in this sector while enhancing our customer value proposition to write their growth story. Focus areas will include exports and ensuring that SMEs benefit from globalisation and digitisation. We will continue to work with partners in delivering these solutions enhancing our agility and serving as a catalyst for growth, a role HNB is familiar with. Curtailing NPAs will remain a key priority and we will continue with the rigour of our pre-evaluation processes and enhance the rigour of our post disbursement monitoring to manage our portfolio.

VALUE TO STAKEHOLDERS

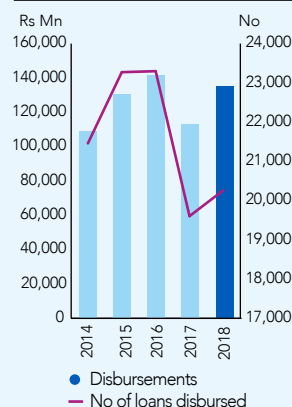
Province-wise Distribution of Loans



Interest paid to SME customers



Disbursements



Micro Finance

VALUE TO GROUP

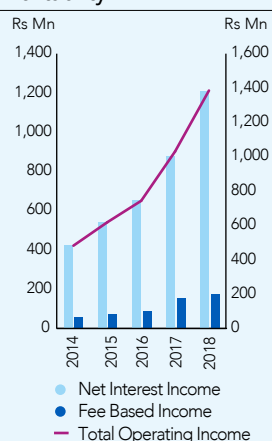
Group Perspectives

- 2% Operating Income
- 2% of Total Assets
- 1% of Liabilities

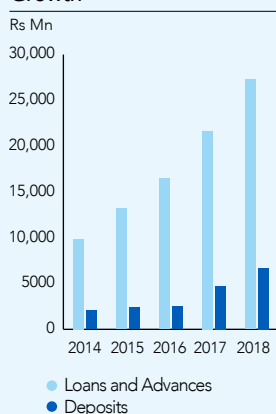
Key Facts

- Largest player in SME and Micro Finance segment
- Over 60% of the portfolio is outside the Western Province

Profitability



Growth



Our Micro Finance operations delivered through a field force of 140 staff, support growth of aspiring entrepreneurs with access to finance and financial literacy programmes. Adjudged the Best Microfinance Bank in Sri Lanka by the International Finance Magazine, HNB Micro Finance is a key growth area for the Bank with a vision of accelerating economic activity in the provinces and broad basing the country's growth.

HNB Micro Finance activities gathered momentum during the year as we focused on developing micro entrepreneurs outside the Western Province. Our programmes also focused on women and youth, developing their skills to support their growth. We also changed our operating model from an individual centric model to working with micro finance institutions and groups. We supported corporates who work with micro-entrepreneurs through value chain financing making it a win-win solution for both parties. Financial literacy remains a key challenge in supporting growth of this segment and we conducted 21 programmes with CBSL covering the island reaching around 2,000 participants.

BEST MICRO FINANCE BANK IN SRI LANKA

International Finance Magazine

PERFORMANCE

Highlights (Rs Bn)	2017	2018	Change
NII	0.9	1.2	41%
Fee Based Income	0.2	0.2	13%
Deposits	4.7	6.7	41%
Loans & Advances	21.7	27.3	26%
NPA Ratio	5.5%	5.6%	

Customer reach increased to over 54,256 through 153 units during the year, as testimony to our commitment to bank the unbanked through an inclusive approach that is part of our DNA. NII improved by 40.5% reflecting portfolio growth and increasing margins commensurate with the risk profile of the product. Total Operating Income also increased by 36.2% to Rs 1,385 Mn. Portfolio growth was healthy at 25.9% although it reflects the subdued economic activity stemming from climate change impacts on agriculture sector output and changes in fiscal policy. Deposit growth of 40.6% was robust, notwithstanding economic challenges. Inevitably, NPLs increased to 5.6% during 2018 which is being managed through increased monitoring to identify early warning signs and providing more flexible solutions to clients to optimise management of the micro finance portfolio.

DRIVING GROWTH

Over 3 decades of experience in taking banking to the doorstep of aspiring entrepreneurs have provided us with considerable insights in to the potential and challenges of this business segment. We have used these insights to build a multifaceted value proposition, supporting their growth as partners in progress with a comprehensive range of financial tools, advice and access to markets.

International Partnerships

- Partnered with USAID & ADB for Credit Guarantee and Risk Sharing schemes designed to uplift the rural economy, strengthening our risk profile while facilitating growth of micro finance activities

New Loan Schemes

- Participating in government sponsored loan schemes including Enterprise Sri Lanka
- Partnered with CBSL and International Fund for Agricultural Development to establish Smallholder Agribusiness Partnerships under the purview of the Project Management Unit of the Presidential Secretariat. IFAD will fund the financing of Public Private Producers Partnerships - Capital, Seasonal and Youth Loan Schemes

Group Lending

- Supporting entrepreneurs to form groups for lending purposes, building trust and support within themselves. It also enables us to approach more unbanked micro entrepreneurs.

Access to Markets

- Gami Pubuduwa Avurudu Pola was organised for second successive year during the April festive season. 100 free stalls were provided at the BMICH to micro entrepreneurs who sold their products and created market linkages. Over 40,000 people patronised the event with turnover exceeding Rs 20 Mn.
- Participation in trade fairs to encourage micro entrepreneurs

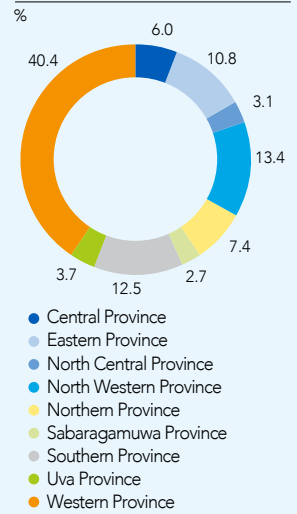
FUTURE PLANS

HNB will continue to play a significant and visible role in supporting micro entrepreneurs, in alignment with government plans. Digitisation of the products and supporting customers with information relevant to their business through deployment of appropriate technology will be key initiatives for 2019. These will support their progression to a digital era, facilitating financial inclusion and growth. We will continue to participate in refinance schemes of the government and multilateral funding agencies and increase focus on the Northern and Eastern provinces. The pace of growth is expected to accelerate as we sharpen our focus on women and youth with our award winning products.

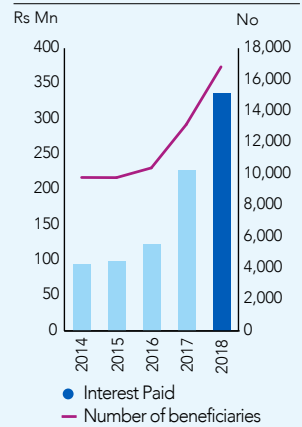
FINANCIAL LITERACY WORKSHOPS FOR >
2,000
MICRO ENTREPRENEURS

VALUE TO STAKEHOLDERS

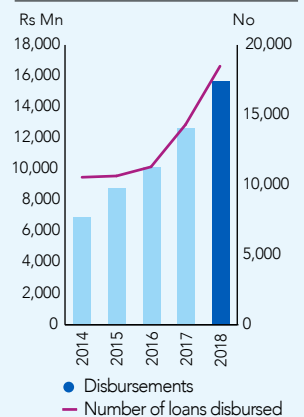
Province-wise Distribution of Loans



Interest Paid to Micro Customers



Disbursements



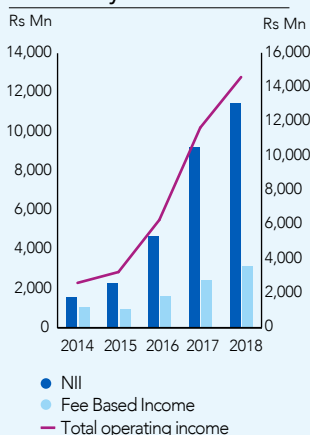
Corporate Banking

VALUE TO GROUP

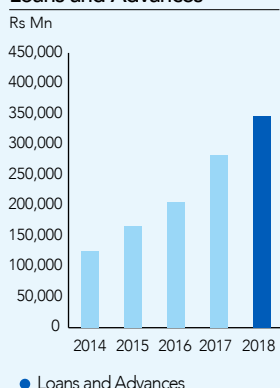
Relevance to Group

- 19% Operating Income
- 31% of Total Assets
- 12% of Liabilities

Profitability



Loans and Advances



We continue to own the largest Corporate Banking portfolio among private commercial Banks in the country with a track record of growth above industry benchmarks. Proactive relationship management drives our success, contributing to product innovation and excellence in service delivery, supporting mutual growth aspirations.

Corporate Banking focused on understanding the business needs of our customers in order to provide smart, customised business solutions that fit into their processes seamlessly, adding value and reducing effort. Relationship management by a motivated team, a portfolio of future ready products, an island-wide presence and a global correspondent banking network create a winning formula, driving our growth.

PERFORMANCE

Highlights (Rs Bn)	2017	2018	Change
NII	9.1	11.3	24%
Fee Based Income	2.5	3.1	21%
Deposits	116.0	133.5	15%
Loans & Advances	282.9	346.4	22%
NPA Ratio	1.2%	1.8%	

The Corporate Banking loan portfolio growth was 22.5%, exceeding industry benchmarks and targets. CASA also increased by 41% supporting cost effective funding of our growth. Predictably, NII increased supported by growth in both loans and advances and CASA and increasing interest rates in line with market movements. Fee income growth of 21.3% reflects higher utilisation of facilities as we focused on enhancing our share of exports. It is noteworthy that our Non-Performing assets are maintained at 1.8%, below Bank's risk thresholds and industry norms.

DRIVING GROWTH

Strong client relationships underpin our performance as we seek to understand their business to support their growth with appropriate solutions. We continue to maintain this client focus as it enables us to refine our customer service proposition leading to increased share of customer business and higher utilisation of facilities. Strong relationships also supported recoveries during a challenging year for customers, ensuring that we identified early warning signs and addressed them effectively.

Focus on China

Developing our capabilities to trade with and attracting investment from China is a key business imperative, given the increasing trade with this economic giant which accounted for 18.9% of imports and 2.2% of exports in 2017. We opened a Chinese desk to facilitate doing business with China for our customers which has been well received by them while giving us further insights into the related issues.

**BEST CASH
MANAGEMENT
BANK
IN SRI LANKA**

EuroMoney
Asian Banker
AsiaMoney

Cash Management

The excellence of our Cash Management products was affirmed by three awards received from Asia Money, Asian Banker and EuroMoney which are based on customer surveys. This has been a key factor, enabling us to become the preferred bank for a growing number of customers and winning the largest number of digital cash collection solutions supporting cash management of corporate customers. We also won the largest number of dividend mandates during the year, consolidating our position as the leading corporate banker.

Custody & Trustee Services

Custody & Trustee Services set up in 2016 has added another dimension to our portfolio supported by a state of the art system that has facilitated its growth. Assets under custody grew to Rs 70 Bn through 100+ local and foreign custody relationships while we became the market leader in trustee services for asset backed securitised transactions counting over 120 securitised transactions during the year. We provide fund accounting services for two fund management companies with nine unit trust funds under their management and look to grow this business in 2019.

Project Finance

The year under review was a historical year for Project Finance recording 40% profit growth supported by increased interest income, fee based income and improved CASA. Loan book grew by 123% with zero non-performing loans reflecting the quality of the portfolio. The Bank was Lead Arranger for two Syndicated Loan transactions in which we also participated with a significant amount. Our renewable energy portfolio also expanded by 13% contributing to the country's clean energy initiatives while the infrastructure portfolio grew by 7% to Rs 53 Bn, supporting the country's development goals. Despite macro-economic challenges Project Finance was successful in securing most of the related business opportunities in the market through team work as we worked together with specialised departments of the Bank to offer customised and superior solutions to the customer.

Team Focus

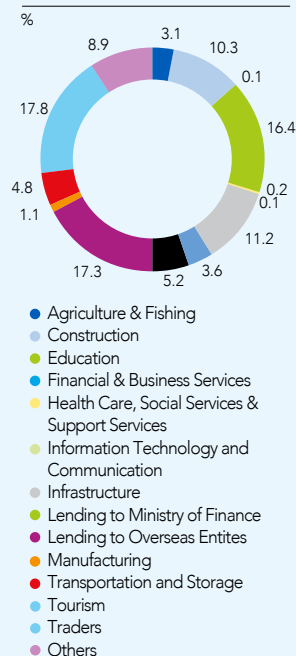
An inspired team drives our success and upskilling them to support excellence in relationship management is key to our strategy. Monthly staff engagement surveys improved during the year and are maintained at the 75th percentile during the latter part of the year reflecting high levels of engagement. We also conducted skip level meetings to understand pain points and address them.

FUTURE PLANS

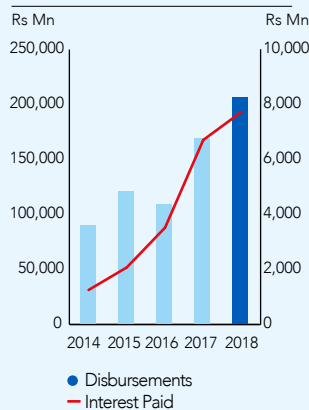
Implementing our transformation project will enhance our customer value proposition, enabling us to consolidate our success as the preferred corporate banking partner to local corporates. We will increase product depth and service offering as we roll out digital solutions. Development of our team to improve relationship management will continue, as this is a key differentiator. Finding win-win solutions to deliver long term value is what we do best and will be our mantra to drive growth in the coming year as well.

VALUE TO STAKEHOLDERS

Sector-wise Distribution of Loans



Disbursements



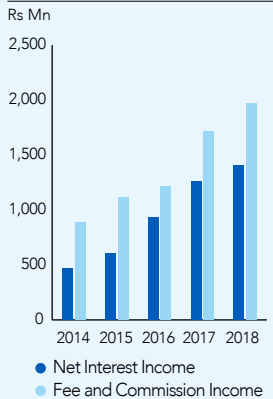
Trade Services

VALUE TO GROUP

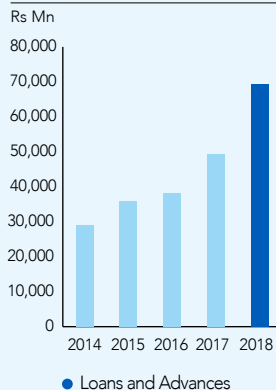
Significance to Group

- 5% Operating Income
- 6% of Total Assets

Profitability



Loans and Advances



Trade Services facilitates international trade through a global network of correspondent banks, connecting Sri Lankans to global opportunities. Specialist knowledge, streamlined processes and technology underpin our growth, enabling us to support growth of our customers.

Working together with the business verticals, Trade Services provides their clients specialised trade finance services, which include Documentary Credits and Collections, Entrepot Trade, International Guarantees and Open Account transactions. The Correspondent Banking network is managed by Financial Institutions who work together with Trade Services to deliver value in this vital operation.

PERFORMANCE

Highlights (Rs Bn)	2017	2018	Change
NII	1.3	1.4	11%
Fee Based Income	1.7	2.0	15%
Advances	49.4	69.4	41%

Growth of Sri Lanka's imports and exports was moderate during the year, recording 10.3% and 5.1% respectively as at end of November 2018. Moderation in imports was partly attributable to restrictions on imports of non-essential items and vehicles and the depreciation of the rupee. Export growth was impacted by slow pick up of volumes due to political uncertainty in key export markets.

The Bank was able to increase its import transaction volumes by more than 32% through targeted marketing to active sectors of the economy and its focus on service excellence. We also increased export volumes by 19%, capturing market share despite intensifying competition. The SME Expo Credit product launched in the fourth quarter of 2017 to support SME exporters was also promoted extensively with an encouraging number of customers on boarded, supporting export growth.

Additionally, we also provide performance guarantees for large scale infrastructure projects supporting the country's economic growth. Issuance of international guarantees increased exceptionally by 128% in value as we gained market share in this segment, leveraging a strong customer value proposition. Accordingly, the overall fee income from Trade products increased by 15%.

DRIVING GROWTH

Effective and Efficient Processes

Operational and service excellence was affirmed by the upgrading of our systems and processes to comply with ISO 9001:2015 standards, the global benchmark. This was facilitated by successful implementation of numerous initiatives to streamline processes while ensuring compliance with rigorous standards and regulations.

99%

CUSTOMER SATISFACTION

**BEST SERVICE AND
MARKET LEADER IN
TRADE FINANCE
IN SRI LANKA**

EuroMoney Trade Finance
Survey 2019

Nurturing Our Relationship Capital

We continue to enhance the reach of our correspondent banking network to more than 950 banks improving access to markets for our customers. This is a critical success factor supporting our growth as it reduces costs and transaction times for customers. Our correspondent banking network is given below.

Team Focus

Inspiring our team and enhancing their knowledge was a key focus area, facilitating high standards of compliance and service excellence. Driven by one of the largest teams of Certified Documentary Credit Specialist(CDCS) in the entire banking industry of the country, our transaction volume growth serves as testimony to value added by our team.

Customer Focus

Online and digital banking in trade through the trade internet banking portal was promoted to increase customer convenience and streamline processes. Accordingly, customers utilising this facility for trade transactions increased significantly indicating a positive customer experiences. These initiatives enabled us to deliver customer satisfaction levels of 99% which serves as testimony to the hard work of this specialist team.

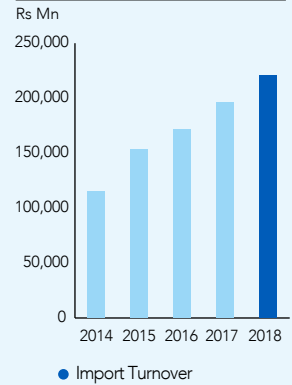
FUTURE PLANS

Slow economic growth in the domestic market and key export markets is likely to be a challenge in the year ahead together with increased regulations and intensifying competition from foreign banks. Initiatives to promote SME exports through our branch network and dedicated SME relationship managers are expected to gather momentum in 2019, driving export volumes. Trade services is well positioned for growth with world class systems, strong relationships with correspondents and customers who are supported by a highly motivated team.

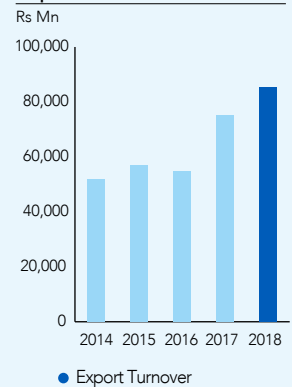
RECERTIFICATION UNDER THE NEW ISO STANDARD OF 9001:2015 INDICATING EXCEPTIONAL SERVICE STANDARDS AND INTERNAL PROCESSES

VALUE TO STAKEHOLDERS

Import Turnover



Export Turnover



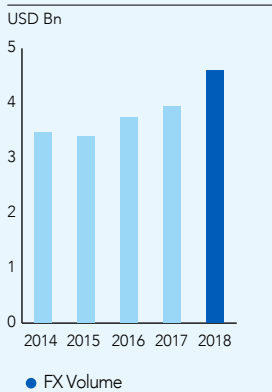
Treasury

VALUE TO GROUP

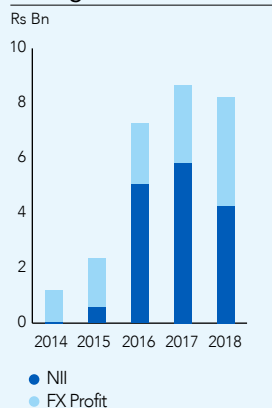
Relevance to Group

- 10% Operating Income
- 20% of Total Assets
- 7% of Liabilities

FX Volume



Earnings



Acknowledged as the Best Treasury in Sri Lanka by Asian Banker, HNB Treasury is one of the largest in the industry with significant impact on the country's benchmark interest rates and foreign exchange rates due to the large volumes handled. FX volumes grew by 16% in the year of 2018.

Treasury supports our customers' growth through innovative treasury products that facilitate their financial risk management, working together with our key business verticals. It also plays a key role in managing liquidity and profitability through its investment, funding and risk management activities. Consequently, Treasury is managed with professionalism and due care, in strict compliance with regulatory requirements and the Bank's prudential limits.

MARKET OVERVIEW

Positive impacts observed included the liberalisation of foreign exchange policy which supported increased volumes during the year. There was positive interest in the international bonds launched by the government and we observed a shift in interest from Rupee bonds to dollar denominated bonds which added to pressure on the exchange rate.

Strengthening of Advanced Economies, in particular the US economy, resulted in an increase in interest rates as regulators tighten monetary policy in response to improved financial stability in key advanced economies. Sri Lanka along with other emerging markets witnessed an outflow of foreign funds from the bills, bonds and stock markets as the US Dollar strengthened, increasing pressure on foreign exchange rates and interest rates. Rising oil prices due to impending sanctions on Iran by the US and forecast supply side issues exacerbated the pressure on foreign exchange. Political and policy instability contributed to the woes in the domestic economy making 2018 one of the most challenging years.

PERFORMANCE

Highlights (Rs Bn)	2017	2018	Change
NII	5.8	4.25	-27%
Forex Profit	2.8	4.0	41%
Investments in Govt. Securities	198.6	212.9	7%

Treasury FX income saw a mammoth growth of 41% compared to 2017 but the NII saw a drop of 27% amidst considerable market volatility. Foreign exchange income derived from customer transactions and from proprietary trading was supported by an increase in Net Open Positions of the banks in April 2018. This enabled the Treasury to increase trading portfolio activity, generating exchange income. However, Net Open Positions were reduced by CBSL by almost 80%, limiting treasury foreign exchange functions in the 4th quarter. Market volatility also supported growth in income from foreign exchange gains although this is likely to stabilise in the long term.

**BEST FOREIGN
EXCHANGE BANK
IN SRI LANKA**

The Asian Banker

Interest income targets proved more challenging as interest rates were hovering at very low levels and consequent curtailing of treasury portfolios below budgeted levels. Lack of liquidity to invest in fixed income securities at a time when deposit rates were very much higher also contributed to the NII being below target levels.

Higher levels of customer engagement together with Corporate and SME and the Branch network supported increased volumes of transactions together with innovative Treasury products. A highly motivated team of 45 members continues to drive our success as we invest in upskilling them to reach higher.

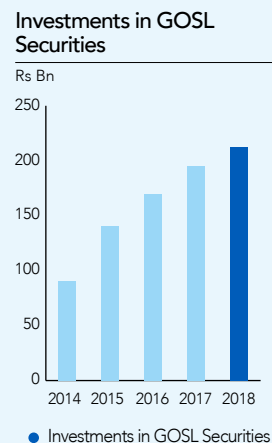
FUTURE PLANS

CBSL’s move to reduce statutory reserve requirement to 5% as a measure of easing monetary policy is expected to improve market liquidity and reduce pressure on interest rates. However, the government budget scheduled for early March, would be a key determinant of the interest rate movement in 2019.

Although the year 2018 saw, rupee depreciating significantly, on the back of capital outflows stemming from rising USD interest rates and political uncertainty in the country, rupee is expected to stabilise with the monetary policy tightening by the Federal Reserve coming to an end which may stimulate capital flows back into emerging markets.

ABILITY TO HANDLE LARGE TRANSACTIONS

VALUE TO STAKEHOLDERS



At the Asian Banker Transaction awards

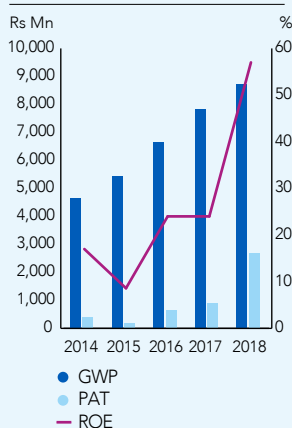
Insurance

VALUE TO GROUP

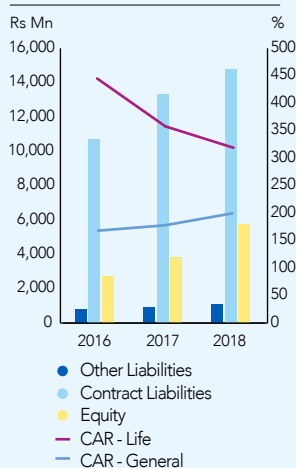
Relevance to Group

- 13% Operating Income
- 2% of Total Assets
- 2% of Liabilities

Gross Written Premiums



Capital Adequacy Ratios and Capital Structure



Maintaining its position as one of the fastest growing insurers in the country, HNB Assurance PLC and its subsidiary HNB General Insurance Ltd., offer a comprehensive portfolio of life and non-life insurance products. Rated A (Ika) by Fitch for National Insurer Financial Strength Rating, HNB Assurance, enables Sri Lankans to manage their risks by providing safety nets.

Despite the backdrop of increased taxation and high interest rates, we continued to deliver on our strategy of customer segmentation to create value, targeted marketing combined with risk selection and effective pricing of risk.

PERFORMANCE

Highlights	2017	2018	Change
GWP (Rs Mn)	7,821	8,725	12%
PAT (Rs Mn)	910	2,705	197%
Total Comprehensive Income (Rs Mn)	935	2,673	186%
Total Assets (Rs Mn)	18,649	22,279	19%
Insurance Contract Liabilities (Rs Mn)			
- Life	10,916	12,261	12%
- General	2,385	2,525	6%
Equity (Rs Mn)	3,796	5,744	51%
ROE	24%	57%	
CAR			
- Life	358%	319%	
- General	178%	200%	
No. of Policyholders			
- Life	143,933	147,234	2%
- General	146,138	148,177	1%
No. of Advisors	2,440	2,265	-7%

PAT growth of 197% was strongly supported by growth in gross written premiums of 12% and investment income of 13% and the change in Contract Liability including a transfer of one-off surplus as well as due to a recognition of a deferred tax asset. Premium ceded to reinsurers decreased marginally to Rs 1,059 Mn in line with the Group's risk appetite, supporting profitability.

LIFE INSURANCE

The resilience of HNBA is reflected in the strong financial performance delivered recording a profit of Rs 2,475 Mn which is an increase of 241% over the previous year. This included a one off surplus of Rs 381 Mn which was transferred as a restricted surplus as per the directions and approval of the insurance regulator as well as a deferred tax asset of Rs 1,177 Mn that was recognised.

A 12% growth in gross written premiums was achieved despite the extremely challenging economic conditions described above. HNBA Araksha, HNBA Hope Cancer Insurance Plan and Dengue cover were launched after careful analysis of customer needs and economic and market trends to fill perceived gaps in the market. The agency network and officers stationed within the HNB Bank branches facilitated personalised service and maximised group synergies. A decline in collections stemming from straitened

economic conditions is a key downside risk identified which will require careful management in the year ahead. The Claims Ratio of the Life Insurance business excluding maturity claims reduced to 8%, a 1% decrease compared to 2017 while the Expense Ratio was maintained at 49% on par with 2017 results.

GENERAL SECTOR

HNB General Insurance continued to accelerate its growth trajectory, delivering a Profit After Tax of Rs 230 Mn, an increase of 25% over 2017. A strong sales culture and the launch of a combined product catering to the needs of SME customers of the Bank supported growth and leveraged group synergies. Motor vehicle insurance continues to be the key market segment for HNBGI although initiatives to diversify are gaining ground. Increased cash margins and duties for vehicle imports together with a devalued rupee dampened growth in the 4th quarter. Focused marketing and diversification will be key to growth and success in this intensely competitive business. The Combined Ratio of the General Insurance business reduced by 1% to 102% due to the improved performance of the business line.

DRIVING GROWTH

Balance sheet growth of 19% reflects increased market share as we competed effectively in our chosen segments, enabling specialisation. Investment portfolio growth was 17% supporting profitability. Capital adequacy ratios of 319% and 200% for Life and General reflect a conservative risk appetite and strong equity growth.

A balanced approach to managing customer satisfaction, employee satisfaction and performance was key to creating long term value and differentiating HNBA from its competitors. We will continue to embed this inclusive approach, balancing long term and short-term value creation to deliver stability and growth in volatile times.

FUTURE PLANS

While market conditions are expected to remain challenging in 2019, we also see an opportunity as insurance market penetration remains low at 1.2%. HNBA is poised for growth with a strong domestic franchise and strong linkages to the largest financial services Group in the country. As the only insurance company in the country to be a subsidiary of a bank, we will continue to leverage group synergies to gain competitive advantage in delivering growth. Our strategy of driving growth in profitable market segments will continue in to the future to deliver sustainable growth to stakeholders.

VALUE TO STAKEHOLDER

LIFE INSURANCE

	Rs Mn
Maturity Claims	722
Surrenders	196
Death & Other Claims	135
Annuities	13
Total Net Claims & Benefits	1,066
Claims Ratio	25%
Claims Ratio excluding Maturities	8%
Bonus to Life Policy Holders	105
Dividend to Policy Holders	8.5%

GENERAL INSURANCE

	Rs Mn
Claims	2,171
Claims Ratio	66%

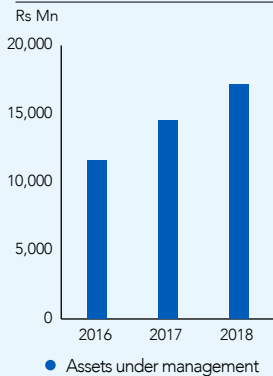
Investment Banking

VALUE TO GROUP

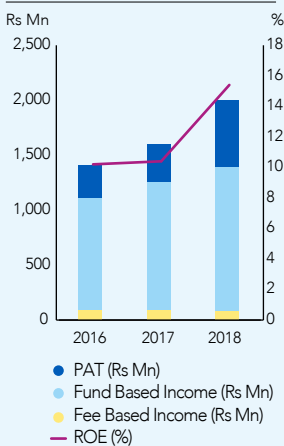
Relevance to Group

- 1% Operating Income
- 1% of Total Assets
- 1% of Liabilities

Assets Under Management



Earnings and Profitability



Acuity Partners is a leading investment bank with significant market share across a comprehensive product portfolio, supporting access to capital markets and opportunities for wealth management. A knowledgeable and determined team drives our performance with foresight and smart strategy.

Our strategy in 2018 was to further consolidate our position in Sri Lanka for our core investment banking services supporting market share and returns. All business segments maintained market share in an intensely competitive landscape, leveraging our expertise and acumen.

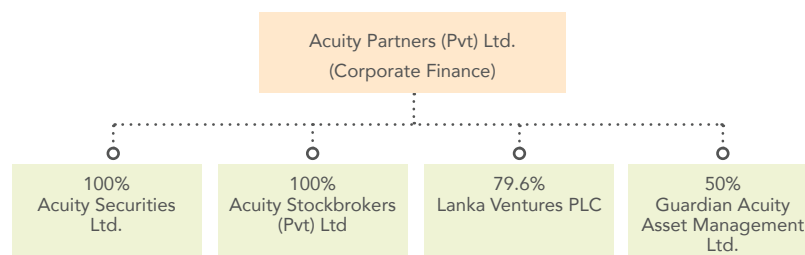
PERFORMANCE

Highlights (Rs Mn)	2017	2018	Change
Fund Based Income	1,162	1,305	12%
Fee Based Income	90	81	-10%
Profit Attributable to Shareholders	351	610	74%
Total Comprehensive Income	303	746	146%
Assets Under Management	14,526	17,140	18%

Despite volatility in the operating environment, Acuity Corporate Finance, Acuity Securities, Guardian Acuity Asset Management and Lanka Ventures were able to grow their bottom lines in the reporting year, supporting an increase in PAT of 73.6% to Rs 610 Mn. The growth in PAT also reflects a deferred tax asset of Rs 356 Mn that was recognised during the year. Political uncertainty and moderating economic growth dampened capital market activity which was exacerbated by foreign fund outflows in response to a stronger US dollar, making 2018 an exceptionally challenging year. ASPI moved from 6,369.3 to 6,052.4 during the year, reflecting market woes and the S&P 20 moved from 3,671.7 to 3135.2.

Corporate finance increased its market share of debenture issuances and equity placements in a highly unfavourable climate, raising Rs 17.5 Bn for clients.

Acuity Stockbrokers maintained its market share in the stockbroking space in an intensely competitive and challenging environment although it made a loss in line with most players in the industry, given adverse market conditions.



Lanka Ventures, following on from the successful IPO of LVL Energy Fund last year maintains its position as the largest listed portfolio of energy sector investments with a pipeline of upcoming projects in Sri Lanka, Nepal and Bangladesh.

The high level of political instability in 4Q 2018 had an extremely adverse impact on our business, particularly on stock brokering and corporate finance with several mandated assignments being postponed to 2019 pending an improvement in the domestic political situation and market sentiment.

DRIVING GROWTH

Landmark transactions during the year included Rs 7.5 Bn 10-year debenture issue by Sri Lanka Telecom PLC (“SLT”) which was the largest issuance of 10 year debentures by a non-banking institution. We were pleased to be involved in this large scale capital raising for one of the few public companies in the technology, media, telecom space as the sector will make increasingly higher contributions to the country's growth going forward, to enable the pivotal transition to a digital economy.

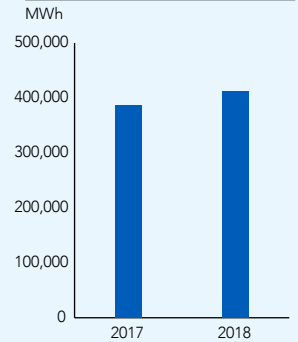
FUTURE PLANS

The outlook for capital markets is uncertain, given the current political scenario and macroeconomic conditions. Nevertheless we will continue to review our strategy to remain profitable while retaining market share, supporting corporates to access capital markets and investors to find opportunities for wealth management.

VALUE TO STAKEHOLDER

LVL Energy Fund has grown its portfolio and generated consistent investment returns for its stakeholders.

Energy Generation (MWh) by LVL



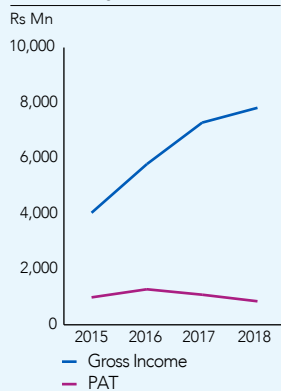
● Energy Generation (MWh) by LVL

VALUE TO GROUP

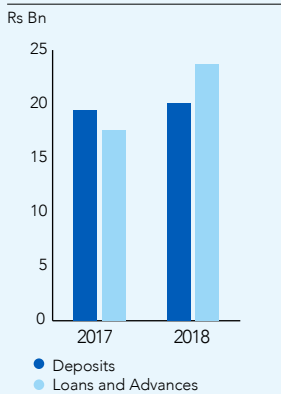
Relevance to Group

- 7% Operating Income
- 3% of Total Assets
- 3% of Liabilities

Profitability



Growth



HNB Finance Ltd., was repositioned as a fully-fledged finance company during 2018 and continues to promote financial inclusion through a hybrid microfinance model focusing on empowering women. Evolving with our mandate, we are transforming our business model to broad-base growth and improve profitability.

Using an integrated approach, we provide flexible financing coupled with free financial consultancy services and skill development to support development of communities. Our goal is to support entrepreneurial development through responsible financing.

PERFORMANCE

Highlights	2017	2018	Change
No. of Loan Customers	236,671	242,450	2%
No. of Savings Customers	405,000	622,000	54%
Deposits (Rs Mn)	19,499	20,170	3%
Loans & Advances (Rs Mn)	17,607	23,667	34%
Income (Rs Mn)	7,295	7,826	7%
NII (Rs Mn)	4,198	4,364	4%
PBT (Rs Mn)	1,881	2,009	7%
PAT (Rs Mn)	1,085	848	-22%
Equity (Rs Mn)	4,274	4,323	1%
ROE	28.55%	19.72%	
Impairment Charge (Rs Mn)	883	490	-44%

Challenging economic conditions, higher taxation and climate change dampened activities in microfinance as disposal income moderated. Consequently, deposits increased by 3.4% and loans and advances increased by 34.4% whilst micro entrepreneurs in agricultural areas and agri related businesses opted to wait for rains and easing of economic conditions.

In line with our commitment to responsible financing and in line with the guidelines issued by the Government, we reduced interest rates on 46% of our portfolio comprising microfinance loans to ease the burden of our customers. However, SME and small scale enterprises were more resilient, enabling growth in these segments. Our portfolio is one of the most diversified across the provinces in the country with 66% comprising loans and advances outside the Western Province.

Predictably, non-performing loans increased during the year. This was exacerbated by the government's decision to write off loans below Rs 100,000 in default without a clear implementation plan, leading to default by those with sufficient capacity to repay. We strengthened our credit processes in response to the operating environment and are taking proactive measures to align repayment plans to current cash flows.

Profitability declined by 22% to Rs 848 Mn, impacted by reducing interest margins, lacklustre growth, increased Impairment charges

OUR NETWORK

48
BRANCHES

21
SUB OFFICES

10,500
MEETING CENTRES

and higher taxes. Capital to Deposits ratio declined marginally due to the increase in deposits and reduced profitability which are expected to improve in 2019.

DRIVING GROWTH

Repositioning our company as a fully fledged finance Company is a key milestone in our journey and enables us to broad-base our business, diversifying a portfolio heavily weighted to microfinance.

Our team increased by 197 to 1,899 and high levels of engagement were affirmed by Great Place to Work @ as we were ranked among the Top 25 workplaces in Sri Lanka for the 2nd consecutive year.

Strengthening corporate governance and risk management was a key priority during the year and there is better alignment with the Bank’s culture as a result. These will remain as priorities moving forward as we evolve to become a public listed company.

FUTURE PLANS

The mandatory listing of the company planned for 2019 will be another key milestone for HNB Finance. We are planning to expand our presence in the SME and Small Scale Enterprise segments and will also launch Pawning and Islamic Finance products supporting access to finance for all ethnic groups in the country.

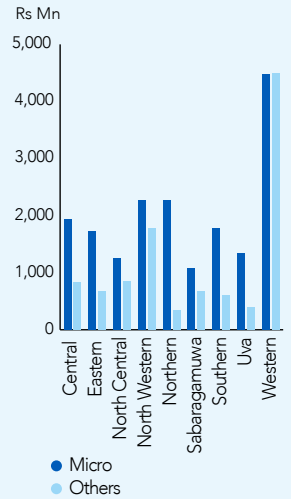
Improved weather patterns led to an uptick in the agriculture sector performance in the latter half of the year which will support demand for credit outside the Western Province. While downside risks weigh on forecasts for the country’s economic growth, our new mandate supports a more broad-based strategy to deliver growth.

HNB FINANCE HAS SIGNED AN MOU WITH THE GOVERNMENT TO WRITE-OFF LOANS FOR "DEBT RELIEF FOR MICRO FINANCE LOANS TO WOMEN IN DROUGHT AFFECTED AREAS"

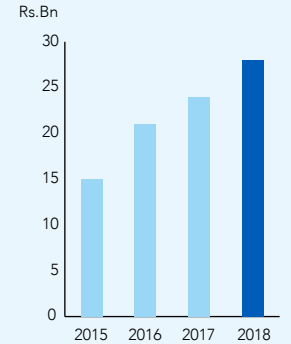
RS 155 MN

VALUE TO STAKEHOLDER

Supporting Economic Growth in Provinces



Lending



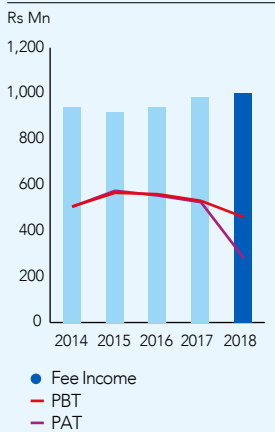
Real Estate

VALUE TO GROUP

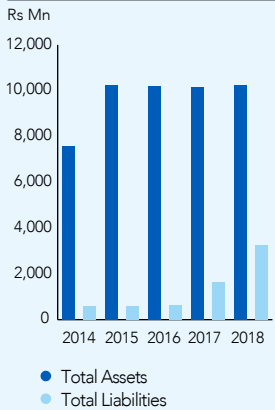
Relevance to Group

- 1% Operating Income
- 1% of Total Assets
- 1% of Liabilities

Income and Profitability



Assets and Liabilities



Sithma Development (Pvt) Ltd., owns and manages the iconic building that houses the Bank’s Head Office.

With a track record of delivering future ready premises, Sithma has the necessary expertise to ensure that our branches are future ready as well. Addressing our energy and information requirements, Sithma continues to deliver environmentally friendly solutions that enable us to operate as a technology driven bank. A key milestone was the amalgamation of the Engineering Department of the Bank with Sithma to realise group synergies in managing the Group’s real estate, ensuring that they are future ready premises.

PERFORMANCE

Highlights (Rs Mn)	2017	2018	Change
Fee Income	986	1,001	2%
PBT	532	460	-14%
PAT	526	281	-47%

Income increased by 2% over the previous year, while costs increased during the year due to the increased finance costs. Predictably, profit before tax declined by 14% to Rs 460 Mn. The end of the tax holiday in 2017 resulted in a taxation charge of Rs 179 Mn which had an adverse impact on Profit After Tax which declined by 47% to Rs 281 Mn.

DRIVING GROWTH

A clear mandate to upgrade branch premises to support the Bank’s strategy as the leading digital bank and reduce the Bank’s carbon footprint served as the foundation for Sithma’s strategy.

On solar power generation, the Bank has now reached saturation point as all premises owned by the Bank have been converted to solar power where it is technically feasible. Other plans to reduce our carbon footprint are underway to further reduce our energy intensity ratio, the main KPI for measuring success and migration from fluorescent tubes to LED lighting also continues.

FUTURE PLANS

Energy costs are forecast to increase as fuel prices increase in global markets and the rupee comes under pressure. Our investments in solar energy are expected to provide a significant cushion against this, reducing payback periods and enhancing profitability.

VALUE TO STAKEHOLDER

Reducing Our Carbon Footprint

- 96 branches with solar power
- Installed solar capacity

Corporate Governance: Annual Report of the Board of Directors on the Affairs of the Company

CHANGES IN BOARD 2018

Retirement / Resignation of Directors

- Mr Rienzi Arsecularatne (Chairman) retired on 25th May 2018
- Miss Sanjivani Jayawardena (Director) resigned on 28th June 2018

Appointment of Directors

- Mr Damien Fernando and Mr Madu Ratnayake were appointed during the year to fill the casual vacancies created by the resignation of Miss Sanjivani Jayawardena and the retirement of Mr Rienzi Arsecularatne respectively. Both Mr Fernando and Mr Ratnayake will offer themselves for re-election at the AGM to be held on 29th March 2019.

Retirement by rotation / reappointment of Directors

- Directors Dr Rohan Karunaratne, Mr Rusi S Captain and Mr Nilanth de Silva who account for 1/3rd of the NED, will retire and being eligible, offer themselves for re-election, as required by the Articles of Association.

The Board of Directors of Hatton National Bank PLC (the 'Bank' or the 'Company') takes pleasure in presenting its Annual Report to the shareholders for the financial year ended 31st December 2018, 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, 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.

The Annual Report of the Board of Directors on the Affairs of the Company has been expanded to enlarge disclosures on the Bank's Corporate Governance practices. A more detailed report on Corporate Governance forms part of the suite of reports produced by the Bank and is included as a supplement to the Annual Report.

Hatton National Bank PLC 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. The Bank has been assigned a National Long-Term Rating of AA- (lka) with a Stable Outlook by Fitch Ratings Lanka Ltd and a foreign currency issuer rating of B2 by Moody's Investors Service, which is on par with the sovereign rating. HNB is the first Sri Lankan Bank to obtain an international rating.

The registered office and Head Office of the Bank is located at No 479, T B Jayah Mawatha, Colombo 10, Sri Lanka.

The financial statements were reviewed and approved by the Board of Directors on 20th February 2019.

CORPORATE GOVERNANCE HIGHLIGHTS

The stewardship exercised by the Board on behalf of the Bank's shareholders and other stakeholders, necessitates upholding high standards of Corporate Governance and ensuring accountability, fairness, and transparency throughout the Bank. The Board ensures that the Bank's Corporate Governance framework remains robust and relevant in a highly regulated industry and challenging business environment. Industry regulations and internal policies, underpin the governance framework, which is regularly reviewed to adapt to internal developments and benchmarked against international best practice.

The Board

The Board is made up of experienced professionals from diverse backgrounds, experience, expertise and age, contributing varied perspectives to boardroom deliberations and constructively challenging management on matters concerning the operations of the Bank. Directors are appointed through a formal and transparent process, assessed for their independence and approved by the Central Bank of Sri Lanka. New Board members are inducted thoroughly aimed at providing them with the information and support needed to be effective. Directors continue to keep abreast of changes in regulations and the business environment by attending seminars, workshops, conferences and formal training programmes to build their capability to guide the Bank through key challenges.

Corporate Governance: Annual Report of the Board of Directors on the Affairs of the Company

Board Meetings

Details of Directors' meetings are given below.

Board Member	Date of Appointment to the Board	Board	Board Audit Committee	HR & Remuneration Committee	Nomination Committee	Board Integrated Risk Management Committee	Related Party Transactions Review Committee	Strategy & Investment Review Committee	Procurement and Assets Disposal Committee ***	Board Credit Committee
Total Meetings Held		15	8	7	8	9	4	8	12	7
Mr Dinesh Weerakkody (Chairman - Appointed w.e.f. 26th May 2018)	29th June 2017	■ 15/15		■ 5/6	■ 4/4					2/3
Mr Rienzie Arseculeratne, (Chairman - Resigned w.e.f. 25th May 2018)	30th April 2015	8/8		4/4	4/4					
Mr Jonathan Alles (MD/CEO)	01st May 2013	14/15	*7	*5	*2	6/9	2/4	*4		*5
Ms Rose Cooray	15th February 2010	15/15	*7	*2	8/8	■ 9/9	2/2	8/8	2/3	
Dr Rohan Karunaratne	06th October 2011	14/15	3/4	2/3			1/2		■ 10/12	7/7
Mr Sujeewa Mudalige	02nd April 2012	13/15	■ 8/8	7/7		*7		7/8		
Ms Sanjivani Jayawardena (Resigned w.e.f. 28th June 2018)	02nd April 2012	8/8				4/5			6/6	
Mr Rusi Captain	02nd April 2012	**14/15	**4/4	4/4	**8/8					
Mr Amal Cabraal	01st April 2014	**14/15	8/8	7/7				■ 8/8		3/3
Mr Palitha Pelpola	30th April 2015	**15/15			**8/8		**4/4			6/7
Mr Duliksha Soosaipillai	30th April 2015	15/15	*1 4/4	*1		9/9		8/8	12/12	
Mr Nilanth de Silva	30th April 2015	15/15	8/8				■ 4/4			■ 7/7
Mr Madu Ratnayake	25th October 2018	**2/2				0/1			1/2	
Mr Damien Fernando	25th October 2018	2/2	0/2					1/1		

* Meetings attended by invitation

** Includes meetings attended by an alternative Director

*** The papers to the Procurement and Assets Disposal Committee are submitted via circular resolutions and physical meetings are held only on need basis.

■ Chairman.

The meeting agenda and papers are made available to the Directors at least seven days before the meeting and minutes of the preceding meeting circulated two weeks before the subsequent Board Meeting, allowing members sufficient time to review them, make their observations and be prepared for the forthcoming meeting. The Chairman sets the Board agenda, assisted by the Company Secretary. Care is taken to ensure that the Board spends sufficient time considering matters critical to the Bank's success, as well as compliance, risk and administrative matters.

Leadership

The Board collectively sets the risk appetite of the Bank, leads in formulating the Bank's strategy and monitors the achievement of goals and objectives set. The roles and responsibilities of the Chairman and Chief Executive Officer have been clearly separated and no one Director has unfettered power and

authority on the Board. The Board has delegated specific oversight responsibilities that warrant greater attention, to Eight (08) Board Sub-Committees. Of these, five are mandated and are compliant with the regulations. These Committee reports are given on page 102 to 115 in IR. Committee mandates are reviewed regularly.

Remuneration

The HNB remuneration policy supports the motivation and reward of performance of employees while meeting regulatory requirements and stakeholder expectations. Remuneration consists of two components - fixed remuneration and variable remuneration including that of an annual performance bonus. Details of Directors' emoluments and other benefits paid in respect of the Group and the Bank during the financial year ended 31st December 2018 are given in Note 18 to the financial statements in IR page 201.

Board Evaluation

A performance evaluation designed to improve the Board's effectiveness and that of its Committees, is conducted annually in line with good Corporate Governance practices. Each member of the Board carries out a self-assessment of his/her effectiveness as an individual as well as the effectiveness of the Board as a team.

Directors Interests and Related Party Transactions

The Board is committed to the highest standards of professional and ethical conduct. Directors declare their outside business interests on appointment and quarterly thereafter details of which are recorded in the Directors' Interests Register, and available for inspection in terms of the Companies Act. The Directors have no direct or indirect interest in a contract or a proposed contract with the Bank other than those disclosed on page 119 to 122 in IR.

The Related Party Transactions Review Committee considers all transactions that require approval, in line with the Bank's Related Party Transactions Policy and compliance with regulations. Related party transactions are disclosed in Note 60 to the financial statements in IR page 294.

Independence

The independence of Non-Executive Directors is reviewed on an annual basis as part of the Directors' evaluation process. When the Board considers any matters in which a conflict is manifestly evident, Directors withdraw from participating in the meeting and recuse themselves from the particular deliberation and decision.

Compliance

The Board complies with all applicable laws and regulations including the Listing Rules of the CSE, and the directions issued by the Central Bank. The Board is also guided by the Bank's policies, its values, standards and its Code of Conduct & Ethics. The Compliance Officer who reports to Board Integrated Risk Management Committee, tables a report on compliance at the quarterly meetings of the Committee and where necessary such non-compliant issues are escalated to the Board for necessary action.

Group Corporate Governance

The Bank's Board is responsible for Corporate Governance across the Group, ensuring the consistent application of sound policies and procedures aligning the structure, business and risks of the Group to that of each entity.

Statutory Disclosures

Section 168 of the Companies Act No 7 of 2007, requires the following information to be published in the Annual Report prepared for the year under review.

No.	Disclosure requirements	Reference to the Companies Act No 7 of 2007	Disclosure reference for compliance	Page
1	The nature of the business of the Bank and the Group	Section 168 (1) (a)	About Us	IR 6
2	Financial statements for the accounting period completed and signed in accordance with Section 152	Section 168 (1) (b)	The financial statements of the Group and the Bank for the year ended December 31, 2018	IR 136-304 Signed on page IR 138
3	Auditor's report on the financial statements of the Bank and the Group	Section 168 (1) (c)	Independent Auditors' Report	IR 133
4	Any change in accounting policies made during the accounting period	Section 168 (1) (d)	Note 2.2 to the financial statements - Changes in Accounting Policies and Disclosures	IR 146
5	Particulars of entries in the interests register made during the accounting period	Section 168 (1) (e)	Directors' Interest in Contracts with the Bank Corporate Governance report - Conflicts of interests and other Commitments / Related Party Transactions, provides details of management of Directors' Interests	IR 119 - 122 CG&RR 13
6	Remuneration and other benefits of Directors during the accounting period	Section 168 (1) (f)	Note 18 to the financial statements - Other Expenses Corporate Governance report - Directors' and Executive remuneration, provides details of the remuneration framework	IR 201 CG&RR 16

Corporate Governance: Annual Report of the Board of Directors on the Affairs of the Company

No.	Disclosure requirements	Reference to the Companies Act No 7 of 2007	Disclosure reference for compliance	Page
7	Total amount of donations made by the Company during the accounting period	Section 168 (1) (g)	Note 18 to the financial statements - Other Expenses	IR 201
8	Names of the persons holding office as Directors of the Company as at the end of the accounting period and the names of any persons who ceased to hold office as Directors of the Company during the accounting period	Section 168 (1) (h)	Board Profiles	IR 20 - 25
9	Amounts payable by the Company to the person or firm holding office as auditor of the Company as audit fees and as a separate item, fees payable by the Company for other services provided by that person or firm	Section 168 (1) (i)	Note 18 to the financial statements – Other Expenses	IR 201
10	Particulars of any relationship (other than that of auditor) which the auditor has with or any interests which the auditor has in, the Company or any of its subsidiaries	Section 168 (1) (j)	<p>The Bank's auditors during the period under review were Messrs. Ernst & Young, Chartered Accountants.</p> <p>Corporate Governance Report - External Auditor, provides details of the Policy for the Engagement of the External Auditor for Audit and Non-Audit services.</p> <p>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 judgement, 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.</p> <p>A resolution appointing Messrs Ernst & Young as Auditors and authorising the Directors to fix their remuneration will be proposed at the Annual General Meeting.</p>	CG&RR 19
11	Signed on behalf of the Board by two Directors and the Company Secretary	Section 168 (1) (k)	Complied with as stipulated below	IR 138

Additional Disclosures

The following information is additionally disclosed. The details are provided within notes to the Annual Report, which form an integral part of the Annual Report of the Board of Directors.

No.	Disclosure	Note Reference	Page
1	Vision, Mission and Corporate Conduct	Our Strategy - Vision and Mission The Bank is committed to upholding high standards of business conduct and ethics in the work place at all times, paramount in retaining the trust of our stakeholders. All employees of the Bank abide by the Bank's Code of Conduct and Ethics, which has been communicated via electronic and visual mediums and been made available in three languages. The Code of Conduct and Ethics for Directors is embodied in the Board Charter.	IR 3
2	Principal Activities	About us	IR 6
3	Changes to the Group Structure	There were no changes to Group structure during the year	-
4	List of Directors of Subsidiaries and Joint Ventures of the Bank as at 31st December 2018	<p>Subsidiaries</p> <p>HNB Assurance PLC</p> <p>Ms Rose Cooray - Chairperson Mr D P Lokuarachchi - MD/CEO Mr S C Ratwatte Mr Dilshan Rodrigo Ms S N Wickramasinghe Dr S Selliah Mr J A P M Jayasekera Mr Rajive Dissanayake Mr D Ravindra Abey Suriya</p> <p>HNB Finance Ltd</p> <p>Mr Jonathan Alles - Chairman Mr B M D C Prabath - MD/CEO Mr B Premalal Ms Rose Cooray Ms L L C C Thambiah Mr A S Wijesinha Mr S U H Fernando Mr P A H D Wijesundara Mr Rajive Dissanayake Mr Mahinda Perera</p> <p>Joint Ventures</p> <p>Acuity Partners (Pvt) Ltd</p> <p>Mr Jonathan Alles - Chairman Mr M R Abeywardena - MD Mr T W de Silva Mr L H A L Silva Mr Rajive Dissanayake Mr Damith Pallewatte Mr N H T I Perera</p>	-

Corporate Governance: Annual Report of the Board of Directors on the Affairs of the Company

No.	Disclosure	Note Reference	Page
		Other Group Companies	
		<i>HNB General Insurance Ltd</i>	<i>Lanka Ventures PLC</i>
		Ms Rose Cooray - Chairperson	Mr L H A L Silva – Chairman
		Mr D P Lokuarachchi - MD/CEO	Mr Jonathan Alles
		Ms M Tharmaratnam	Mr M R Abeywardena
		Mr M O F Salieh	Mr A R Munasinghe
		Mr Dilshan Rodrigo	Mr T W de Silva
		Mr Rajive Dissanayake	Mr Rajive Dissanayake
			Mr J D N Kekulawala
		<i>Acuity Securities Ltd</i>	<i>Acuity Stockbrokers Ltd</i>
		Mr M R Abeywardena - Chairman	Mr M R Abeywardena - Chairman
		Mr I A S P Fernando - MD/CEO	Mr P P S Fernando - CEO
		Mr Rajive Dissanayake	Mr R D Manatunga
		Mr Damith Pallewatte	Mr N H T I Perera
		Mr T W De Silva	Mr Rajive Dissanayake
		Mr Ashok Goonesekere	Mr Ashok Goonesekere
		<i>LVL Energy Fund Ltd</i> <i>(Subsidiary of Lanka Ventures PLC)</i>	
		Mr L H A L Silva - Chairman	
		Mr D S Arangala - Director/CEO	
		Mr Jonathan Alles	
		Mr T W De Silva	
		Mr A R Munasinghe	
		Mr M R Abeywardena	
		Mr M A Wijetunge	
		Mr M M Wijetunge	
		Mr J D N Kekulawala	
		Mr K C S Dharmawardana	
5	Review of Operations	Chairman's Message Managing Director's Message Managing Our Capitals and Impacts Business Line Review	IR 10 - 13 IR 14 - 19 IR 15 - 71 IR 72 - 92
6	Future Developments	Chairman's Message Managing Director's Message Managing Our Capitals and Impacts Business Line Review	IR 10 - 13 IR 14 - 19 IR 45 - 71 IR 72 - 92
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 Group and the Bank for the year ended December 31, 2018	IR 136 - 304
8	Directors' Responsibility for Financial Reporting	Directors' Responsibility for Financial Reporting	IR 132
9	Auditors' Report	Independent Auditors' Report	IR 133
10	Significant Accounting Policies	Note 2 to the financial statements - Basis of Preparation and Other Significant Accounting Policies	IR 145
11	Going Concern	Note 2.3.1 to the financial statements – Going Concern	IR 147

No.	Disclosure	Note Reference	Page
12	Income	Note 8 to the financial statements – Gross Income	IR 190
13	Financial Results and Appropriations	Statement of Profit or Loss Statement of Comprehensive Income Statement of Changes in Equity	IR 136 IR 137 IR 139 - 142
14	Reserves	Statement of Changes in Equity	IR 139 - 142
15	Corporate Donations	Note 18 to the financial statements - Other Expenses The Bank did not make any donations to Government approved charities	IR 201
16	Taxation	Note 21 to the financial statements - Taxation	IR 203
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	Note 23 to the financial statements - Dividends Paid and Proposed	IR 207
19 (i)	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 1,936,507,000/- and Rs 2,205,288,000/- respectively (2017 Bank: Rs 1,996,829,000/- and Group: Rs 2,296,235,000/-). Details are given in Note 37, 38 and 39 to the financial statements. 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 -Capital Commitments	IR 250 - 269 IR 293
(ii)	Capital commitments	The bank has a Capital commitment totalling approximately Rs 2.6 billion over the next 24 months consisting principally of an upgrade to the Banks Core Banking system, a Digital Layer to it and a Payments & Cash Management system	
20	Property, Plant and Equipment	Note 38 to the financial statements - Property, Plant and Equipment	IR 256
21	Net Book Value of Freehold Properties	Note 38 to the financial statements - Property, Plant and Equipment.	IR 256
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, will not have a material impact on the financial position of the Bank or its future operations. Notes 59 (d) to the financial statements - Litigation against the Bank	IR 294
23	Events after the Reporting Date	Note 64 to the financial statements - Events Occurring After the Reporting Period	IR 304
24	Stated Capital and Debentures	Notes 54 and 47 to the financial statements – Stated Capital and Subordinated Term Debts, respectively	IR 286 & 274
25	Share Information	Investor Relations	IR 315-323
26	Shareholdings	Investor Relations	IR 315 - 323
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	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.	-

Corporate Governance: Annual Report of the Board of Directors on the Affairs of the Company

No.	Disclosure	Note Reference			Page
29	Directors' Interests in the Ordinary Shares (Voting and Non-Voting)	Name	As at 31st December 2018 No of Shares	As at 31st December 2017 No of Shares	-
		Mr Dinesh Weerakkody	2,050	2,031	
		Mr Jonathan Alles	123,504	122,542	
		Ms Rose Cooray	7,068	7,003	
		Dr Rohan Karunaratne	1,055	1048	
		Mr Sujeewa Mudalige	-	-	
		Mr Rusi Captain	7,271	7,218	
		Mr Amal Cabraal	-	-	
		Mr Palitha Pelpola	-	-	
		Mr Duliksha Soosaipillai	-	-	
		Mr A N de Silva	101	101	
		Mr Damien Fernando	615	-	
		Mr Madu Ratnayake	-	-	
		Mr Rienzie Arseculeratne*	11,913	11,825	
		Ms Sanjivani Jayawardena**	517	514	
Mr P R Saldin (Alternate Director to Mr Rusi Captain)	-	-			
	*Retired w.e.f. 25th May 2018				
	**Resigned w.e.f. 28th June 2018				
30	Directors' Interest in Debentures	Name	As at 31st December 2018 No of Debentures	As at 31st December 2017 No of Debentures	-
		Mr Amal Cabraal	100,000	100,000	
31	Directors' Remuneration	Note 18 to the financial statements - Other Expenses			IR 201
32	Human Resources	Human Capital			IR 56 - 62
33	Employee Share Option Plan	Note 54 to the financial statements - Stated Capital			IR 286
34	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 found in the Managing Our Capital and Impacts Report.			IR 45 - 71
35	Risk Management and Internal Control	Corporate Governance Report - Risk Management and Internal Control			CG&RR 16
36	Directors' Statement on Internal Control	Directors' Statement on Internal Control Over Financial Reporting			IR 116 - 117
37	Corporate Governance	Corporate Governance Report			CG&RR 1 - 36
38	Insurance and Indemnity	Pursuant to a decision of the Board, the Bank obtained an Insurance Policy to cover Directors' and Officers' liability			-
39	Material Foreseeable Risk Factors (As per Rule No 7.6 (VI) of the Listing Rules of the Colombo Stock Exchange)	Risk Management Review			CG&RR 37 - 73

No.	Disclosure	Note Reference	Page
40	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)	No material issues occurred during the year	-
41	Operational Excellence	Performance Highlights	IR 8 - 9
42	Shareholder Litigation	<p>Pursuant to an action filed by Stassen Exports (Private) Limited (Case No CHC/59/2016/CO) - a shareholder of the Bank, interim orders were issued on 20th October 2016 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 a 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.</p> <p>However, the said petitioner- Stassen Exports (Private) Limited and the 18 respondents thereafter reached a settlement in the contested matter and the settlement terms were entered by the parties on 31st July 2018 under the said Case No. CHC/59/2016/CO. Consequently the cases filed by HNB PLC and the Managing Director/CEO in the Supreme Court of Sri Lanka (SC/HA/LA/64/2017 and SC/HA/LA/65/2017) were also withdrawn on 14th September 2018. Accordingly, the private placement of shares above said will not take place.</p>	-

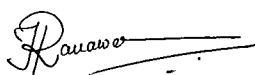
Notice of Annual General Meeting

The 50th Annual General Meeting of the Bank is convened on 29th March 2019, at 11.00 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 50th Annual General Meeting is enclosed.


Acknowledgement of the Contents of the Report

As required by Section 168 (1) (k) of the Companies Act No 7 of 2007, the Board of Directors hereby acknowledges the contents of this Annual Report.

For and on behalf of the Board of Directors,



K A L Thushari Ranaweera
Deputy General Manager (Legal) / Company Secretary



Jonathan Alles
Managing Director / Chief Executive Officer



Dinesh Weerakkody
Chairman

Colombo, Sri Lanka.
20th February 2019

HR and Remuneration Committee Report



KEY INITIATIVES IMPLEMENTED IN 2018:

- Reviewed and recommended arrangements for the Executive Directors and the Executives reporting to the CEO, including contract terms, annual remuneration and participation in the Bank's short and long-term incentive plans.
- Reviewed the major changes and developments in the Bank's recruitment, retention and development policies and procedures for Senior Management and Human Resource practices and employee relations strategies.
- The Bank concluded the Collective Agreements with the Ceylon Banks' Employees Union and the HNB Officers' Union.
- With Deloitte the Bank is on a HR transformation journey to future proof the work force

The Human Resources & Remuneration Committee ('the Committee'), operates within agreed terms of reference and is committed to the principles of accountability, transparency and ensuring that remuneration structures are equitable and aligned with the performance of the Bank, the long-term interests of the Bank and its shareholders.

The Committee believes that recruitment, motivation and retention of outstanding senior leadership are crucial to promoting a sustainable future for the Bank. Therefore, the Committee has adopted a detailed process to ensure that the Board selects, motives, and retains the right personnel for senior leadership positions.

COMPOSITION

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 members of the Committee have wide experience and knowledge of Finance, HR, Marketing and the Financial Industry. The following Directors serve / served on the HR & Remuneration Committee:

Mr Rienze Arseculeratne (IND/NED) – Chairman (up to his retirement on 25th May 2018)

Mr Dinesh Weerakkody (IND/NED) – (Member w.e.f. 20th February 2018, Chairman w.e.f. 1st June 2018)

Mr Sujeewa Mudalige (IND/NED)

Mr Rusi Captain (NIND/NED) (up to 1st July 2018)

Mr Amal Cabraal (NIND/NED)

Dr Rohan Karunaratne (IND/NED) (w.e.f. 2nd July 2018)

Mr Madu Ratnayake (IND/NED) (w.e.f. 25th October 2018 up to 29th November 2018)

(IND - Independent Director, NIND Non-Independent Director and NED - Non Executive Director)

Brief profiles of the Directors are given on page 20 to 25 in IR.

MEETINGS

The Committee met seven (7) times during 2018.

Attendance at the meetings is also given in the table in IR page 94.

	Eligible to attend	Attended
Mr Rienze Arseculeratne	04	04
Mr Dinesh Weerakkody	06	02 (As a member) 03 (As Chairman)
Mr Sujeewa Mudalige	07	07
Mr Amal Cabraal	07	07
Mr Rusi Captain	04	04
Mr Rohan Karunaratne	03	02
Mr Madu Ratnayake	01	-

Meetings of the HR & Remuneration Committee shall be held as necessary but at least twice a year and at such other times as the Chairman of the Committee shall deem necessary. The proceedings of the Committee meetings were regularly reported to the Board of Directors.

REGULAR ATTENDEES BY INVITATION

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 does not take part in the Committee deliberations when his performance and remuneration is discussed.

SECRETARY TO THE COMMITTEE:

The Chief Human Resource Officer (CHRO/DGM-HR) functioned as the Secretary to the Committee until 1st July 2018. With effect from 2nd July 2018, the Board Secretary was appointed as the Secretary to the Committee.

POLICY

The Bank's HR Remuneration Policy aims to attract, motivate and retain employees with the appropriate professional, managerial and operational expertise, necessary to achieve the objectives of the Bank in a competitive environment.

The focus of the Committee is to oversee and provide guidance for the implementation of strategic human resource objectives of the Bank in keeping with the following Terms of Reference (TOR).

“The Committee shall consider/evaluate the performance of the MD/CEO and KMPs periodically against the targets and goals set by it and determine the basis for revising the remuneration, increments, bonuses and other performance based incentives of the MD/CEO and KMPs. The Committee shall consult MD/CEO and take into account his/her recommendations when determining the performance of the KMPs, increments, bonuses and other performance based incentives payable to such KMPs.”

SCOPE

The Committee is vested with the power to examine, evaluate and recommend to the Board of Directors on any matter that may affect the Human Resources of the Bank and any other matter referred to it by the Board or any other Sub-Committee. In discharging its responsibilities, the Committee must have regard to the following policy objectives:

- to attract, retain and develop skilled Executives;
- to structure short and long-term incentives that are challenging and linked to the creation of sustainable performance and shareholder returns.

To achieve these goals;

- a) The Committee sets targets and goals to the Directors, MD/CEO and the KMPs annually.
- b) It reviews the Human Resource policies and initiatives, salary structures, terms and conditions relating to the staff at Senior Management level. In this process, necessary information and recommendations are obtained from the MD/CEO and the CHRO/DGM-HR. The Committee deliberates and recommends to the Board of Directors the remuneration packages, annual increments and bonuses of the MD/CEO, Chief Operating Officer (COO), members of the Corporate Management and Senior Management staff, having evaluated their performance.
- c) The organisational structure is 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.
- d) Recruitment and promotions of staff at management level are also considered and approved by the Committee based on proposals submitted by the MD/CEO and CHRO/DGM-HR following a formal process of evaluation.
- e) In respect of diversity, to review and recommend to the Board in relation to:
 - the Bank's diversity policy;
 - establishment of measurable objectives for achieving diversity across the Group, and the annual assessment of both the objectives and progress in achieving them; and
 - development and maintenance of strategies and initiatives to promote diversity.
 - annually, to review and report on the relative proportion of women and men in the workforce at all levels and review remuneration by gender and consider whether any pay gap

exists as a result of gender difference and where relevant, provide recommendations to the Board.

EMPLOYMENT REPORT

The success and growth of the Bank is dependent on the knowledge and collective skills of its employees. The Bank recognises its responsibilities towards employees and is committed to facilitating learning and development to form a skilled and motivated future ready workforce, thereby reaching a higher level of performance year on year.

The table below reflects the employment report of the Company as at 31st December 2018.

Levels	Total
Top Management	19
Senior Management	50
Mid Management [Executive Officers I to III, Management, Management Trainee, Probationary Executives]	822
Junior Management, Supervisors and Clerical Staff [Junior Executives, Clerical]	3,222
Secretaries	231
Workers [Electricians, Technical Assistants, Drivers, Labourers, Peons]	172
Total Permanent	4,516
Employees on Contract	265
Total	4,781

PROFESSIONAL ADVICE

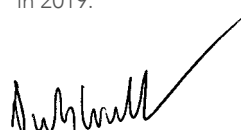
The Committee is authorized to seek external professional advice on matters within its purview.

COMMITTEE EVALUATION

To ensure that the Committee's performance is optimal, a self-evaluation of the Committee members was also carried out and circulated amongst the members of the Committee for necessary action.

CONCLUSION

The Bank will continue to focus on introducing and strengthening HR policies, practices & systems in the area of performance management, employee recognition and employee engagement in 2019.



Dinesh Weerakkody
Chairman

Human Resources & Remuneration Committee

Colombo, Sri Lanka
20th February 2019

Nomination Committee Report



KEY INITIATIVES IMPLEMENTED IN 2018:

- Setting up of a Non- Executive Directors' Governance Committee
- Formulation of a comprehensive induction programme for the new Directors
- Formulation of a Policy for Directors' Continuing Professional Development

ACTIVITIES IN 2018

In discharging its duties during the year 2018 the Committee mainly focused on reviewing Bank's corporate governance policies guidelines and principles and identifying the additional/critical skills required at Board and Key Management level with a view to successfully implement the Bank's Transformation initiatives and the 2020 Strategic Plan. The succession planning efforts at the level of Key Management Personnel (KMPs) were continuously reviewed by the Committee. The effectiveness and robustness of the process envisaged in the Articles of Association of the Bank on Directors' Retirement by Rotation was reconsidered at length by the Committee and an amendment to the Articles of Association was proposed. In addition to the above, the fit and propriety of the Directors and the new KMPs were examined during the year as and when it was required to ensure compliance with the statutory requirements.

SUMMARY OF NOMINATION COMMITTEE CHARTER

Terms of Reference (TOR) covers the main responsibilities entrusted to the Nomination Committee under Corporate Governance regulations promulgated by the Central Bank under Direction No 11 of 2007 and also the Code of Best Practice on Corporate Governance - 2017 published by the Institute of Chartered Accountants of Sri Lanka. The TOR also spells out the constitution and the composition of the Committee; that the Chairman should be an Independent Director; at least once in every quarter the Committee should meet and it has direct access to the required data and information in order to discharge its duties and when in doubt the Committee has the right to obtain appropriate opinions.

COMPOSITION & MEETINGS

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 Dinesh Weerakkody (IND/NED) – Chairman
(Appointed w.e.f. 1st June 2018)
- Ms Rose Cooray (NIND/NED)
- Mr Rusi Captain (NIND/NED)
- Mr Palitha Pelpola (IND/NED)
- Mr Rienzie Arseculeratne (IND/NED) (Retired on 25th May 2018)
(IND - Independent Director, NIND-Non Independent Director and NED - Non Executive Director)

Brief profiles of the members of the Committee are given on page 20 to 25 in IR.

Committee Meetings and how it discharged its duties

The Nomination Committee met Eight (08) times during the year under review. Attendance by the Committee members at the meetings is also given in the table on page 94 of IR.

Board Member	Eligible to attend	Attended
Mr Dinesh Weerakkody *	04	04
Ms Rose Cooray	08	08
Mr Rusi Captain	08	08 (6 Mtgs through Alt Director)
Mr Palitha Pelpola	08	08 (1 Mtg through Alt Director)
Mr Rienzie Arseculeratne **	04	04

* Appointed w.e.f. 1st June 2018

** Retired on 25th May 2018

Regular Attendees by Invitation:

The Chief Executive Officer also attended two (02) meetings by invitation.

Secretary to the Committee:

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 (KMPs) 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 2018 as per the Code of Best Practice on Corporate Governance - 2017 published by The Institute of Chartered Accountants of Sri Lanka.

DETAILS OF THE DUTIES ATTENDED TO BY THE COMMITTEE

Board Composition

The Committee

- Proposed the setting up of a Non-Executive Directors' Governance Committee
- Reformulated the Directors' Induction Programme
- Introduced a formal Policy on Continuing Professional Development for Directors
- Identified skill gaps and vacancies created at Board level and made recommendations for certain appointments to be made;
- Evaluated the constitution of the Board statutory and non-statutory Sub-Committees 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 appointment of two Directors to fill casual vacancies created by the resignation of two other Directors and further recommended that the Directors so appointed be formally appointed by the shareholders at the 50th Annual General Meeting to be held on 29th March

2019 in terms of Article 36 of the Articles of Association of the Bank.

- Continuously engaged with regulatory bodies to further streamline good governance practices

Succession Planning

The Committee:

- 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

The Committee:

- 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;
- Evaluated and assessed the process Involved in re-appointment of Directors by rotation.
- Evaluated the Director Rotation Policy and proposed amendments to Article 34 of the Articles of Association
- 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 KMPs;

Group Governance/ Management Principles

- Having promulgated a Group Governance Code in 2016, the Committee, on 16th November 2018 assessed the level of compliance by the Group Companies of the requirements envisaged in the Group Governance Code, for the year 2018, 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.

Nomination Committee Report

Re-election / Re-appointment of Directors at the 50th Annual General Meeting

- Three Directors namely Dr Rohan Karunaratne, Mr Rusi S Captain and Mr Nilanth de Silva representing 1/3rd of the Board, are to retire by rotation and are eligible to be re-elected/re-appointed at the 50th Annual General Meeting to be held on 29th March 2019. 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 20th February 2019, decided that Dr Rohan Karunaratne, Mr Rusi S Captain and Mr Nilanth de Silva, should be re-elected / re-appointed at the next Annual General Meeting.
- Directors - Mr Damien Fernando and Mr Madu Ratnayake who were appointed to fill a casual vacancies have offered themselves for formal appointment under Article 36 of the Articles of Association. The re-appointment of Mr Damien Fernando and Mr Madu Ratnayake were recommended by the Committee and approved by the Board.

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 2018, which was conducted by the Chairman and Committee Members and the review concluded that the Committee continues to operate effectively.



Dinesh Weerakkody
Chairman

Nomination Committee

Colombo, Sri Lanka
20th February 2019

Board Integrated Risk Management Committee Report



“Our focus is to make risk management function more dynamic to manage emerging risks in digital and cyber space, whilst preserving the rigour of traditional risk management practices to act as an enabler for business decisions.”

Rose Cooray

MAJOR INITIATIVES FLOATED BY RISK MANAGEMENT UNIT DURING 2018 WERE:

- Commencement of a project on next generation Loan Origination System (LOS)
- Commencement of risk model development project to be in line with SLFRS 9, Basel III and validation of internal risk ratings
- Internal risk rating system recalibration and development of new rating models to suit target customer segments.
- Project initiated to implement Data Loss Prevention (DLP) tool and Digital Right Management (DRM) solution

ACTIVITIES IN 2018

- The Bank has commenced a project to implement a next generation Loan Originating System (LOS). This project is expected to bring significant efficiencies and value additions to promote paperless office, route all types of credit requests to be facilitated through LOS, avoid duplication of information/re-work within a credit proposal, improved customer experience/convenience, inculcate a compliance driven culture/discipline, facilitate capturing of total customer exposure – 360° view, expedite the process in preparation of security documentation etc...
- Introduced credit analytics through improved portfolio slide decks for personal loans, housing loans, credit cards, pawning and leasing are prepared and presented to the management on monthly basis.
- Maintained a robust tracking and monitoring process to measure and manage risk-reward within bank's risk appetite. This was further augmented through focus on special attention to forecast "Likely to fall NPA's" which were promptly escalated for corrective action
- Dynamically evaluated elevated country risks and industry risks based on market trigger events as deemed necessary, which facilitated management of risks on offshore exposures and risks associated with specific industry segments.
- Reputation Risk Task Force (RRTF) refined the reputation risk scorecard and incorporated information and cyber security in to risk governance scorecard of the bank.
- Risk model development project was initiated to develop capabilities in risk management function to align itself to regulatory requirements and risk management best practices in moving in to Expected Credit Loss (ECL) based SLFRS 9 framework and Basel advanced approaches
- A project was kicked-off to recalibrate and upgrade existing internal risk rating models and upgrade the existing RAM (the rating software platform) to its latest version incorporating up-to-date features.

COMPOSITION & MEETINGS

During the year 2018, the Board Integrated Risk Management Committee (BIRMC) comprised six (06) members, where three (03) members were Non-Executive Directors.

MEMBERS

Ms Rose Cooray (NIND / NED) - Chairperson - On completion of 09 years of service on the Board, Chairperson retired on 15th February 2019.

Ms Sanjivani Jayawardena (NIND / NED) Resigned on 28th June 2018

Mr Duliksha Soosaipillai (IND / NED) Appointed as a new Chairman w.e.f. 25th January 2019

Mr Madu Ratnayake (IND/NED) appointed w.e.f. 25th October 2018

Mr Jonathan Alles (MD / CEO)

Mr Damith Pallewatte Chief Risk Officer / DGM-Risk / Chief Information Security Officer

Ms Mohini Seneviratne Head of Compliance

Brief profiles of the directors representing the committee are given on pages 20 to 25 in IR.

(IND - Independent Director, NIND - Non Independent Director, NED - Non Executive Director, MD - Managing Director and CEO - Chief Executive Officer)

MEETINGS

Nine (09) meetings were held and at least one in each quarter. Attendances at the meetings are also given in table on page 94 in IR.

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.

Board Integrated Risk Management Committee Report

- Strengthened the Loan Review Mechanism (LRM) function and expanded the coverage to all segments of the loan book of the Bank.
- Upgraded Finacle treasury system was implemented and this upgrade brought in host of new features to the treasury risk management with enhanced limit management, improved online real time monitoring, and better automation in controls enabling speedy processing of deals.
- Awareness creation programs aimed at risk culture transformation and promotion of ownership conducted parallel to Risk and Control Self-Assessment (RCSA) rollout.
- Root cause analysis (RCA) of operational loss events and incidents including near misses in a streamlined manner under the operational risk management function and findings used for control optimization
- Fully fledged Business Continuity Management (BCM) function was established under operational risk vertical and the Bank is in the process of improving the comprehensiveness of Business Impact Assessment (BIA) process and establishing measurable time scale associated with different functions as Recovery Time Objectives (RTO) and Recovery Point Objectives (RPO)
- The Bank progressively enhanced the effectiveness of information and cyber risk management strategy and following are few key initiatives floated during the year
 - Engagement of a cyber and security expert to strengthen the data management in the Bank
 - Establishment of an Information Security Steering Committee (ISSC)
 - Establishment of an information classification policy and rollout of a software tool to facilitate classification of information
 - Project initiated to implement DLP tool and DRM system
 - Floated a request for proposal to procure an Identity and Access Management System
 - The Bank has upgraded its firewalls
 - Implementation of two factor authentication capability for internet banking application
- Established a Risk Intelligence Unit which acts as an information hub with different information sources in the nature of delinquency, customer and portfolio level credit assessments, elevated risks industries, expected and incurred loss assessments, impaired customers and their cash flow behaviours, impact on individual and credit portfolios on external and macro-economic scenarios etc..
- Project initiated to develop risk based models for ECL estimations under SLFRS 9
- Staff development through training and knowledge transfer on ECL and SLFRS 9 assessments

Board Member	Eligible to attend	Attended
Ms Rose Cooray	9	9
Ms Sanjivani Jayawardena <i>Resigned on 28th June 2018</i>	5	4
Mr Duliksha Soosaipillai	9	9
Mr Jonathan Alles (MD / CEO)	9	6
Mr. Sujeewa Mudalige	9	7
Mr. Madu Ratnayake (New Director) <i>Joined on 25th October 2018</i>	1	0

Regular Attendees from the Management by Invitation:

Mr Dilshan Rodrigo - Chief Operating Officer

Mr Niroshana Seneviratne

- Chief Internal Auditor / DGM - Internal Audit

Ms Anusha Gallage - Chief Financial Officer

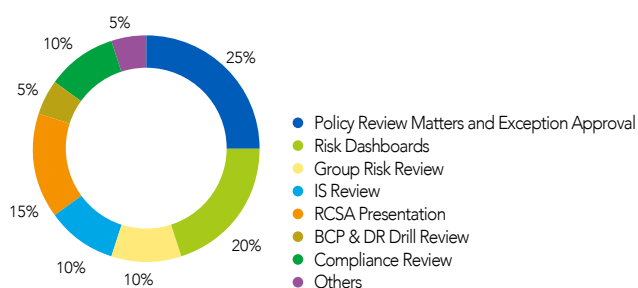
Mr Ruwan Bakmedeniya

- Chief Information Officer

Other invitees from Board

Mr Sujeewa Mudalige (IND/NED)

Key Areas and Time Allocated



SECRETARY TO THE COMMITTEE:

Mr Damith Pallewatte - Chief Risk Officer / DGM-Risk / Chief Information Security Officer.

SUMMARY OF BIRMC CHARTER

Establishing a risk management framework that proactively support the risk assessment, evaluation, monitoring and management whilst creating a strong risk culture, promoting the Bank's strategic objectives. Decisions are made in compliance with the Bank's internal risk policy guidelines and regulatory supervisory requirements and corrective actions are taken to mitigate risks taken beyond the risk tolerance set by the committee.

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 (CBSL) Banking Act Direction No 7 of 2011. Further, BIRMC has adopted Basel III guideline issued under the Banking Act No 01 of 2016 as well and continue to improve the Bank's adherence.

THE PRIMARY RESPONSIBILITIES OF THE COMMITTEE

The terms of reference sets 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 /information and cyber security risk 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, based on 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 and risk goals set for the Bank
- Review issues raised by internal audit that impact upon the risk management framework and refer in writing to the Board Audit Committee (BAC) any matters that have come to the attention of the committee that are relevant to the BAC.
- To review compliance on the Basel III guidelines and provide risk insights on SLFRS 9 implementations.
- Examine any other matters referred to it by the Board.

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 of the Bank. The committee also reviews and monitors the Bank's compliance report on money laundering and action taken in relation to report.

Review and refer back for action to the any subcommittee of the Board any matters that are either specifically referred to the attention of the committee or that come to the attention of the committee from Board filings, that impact systemic risks to the Bank, with a clear objective of eliminating repeat findings.

LOOKING AHEAD

Credit Risk

- Rollout of credit risk scorecards for approval of credit cards, personal loans, housing loans, leasing and micro finance.
- Implementation of a state-of-the-art LOS
- Enhance the scope and coverage to intensify the LRM assessments.
- Use LRM learning to influence credit policy revisions.

Integrated and Portfolio Risk Management

- Implementation of revised/ recalibrated internal risk rating system
- Implementation of revised and improved ICAAP for the Bank.
- Improve the stress-testing framework.
- Introduction of model risk management framework.
- Rollout conduct risk management initiatives.
- Strengthen portfolio based risk return management.

Operational Risk Management

- Strengthen the fraud risk management framework
- Improve RCSA process in terms of comprehensiveness and coverage together with establishment of clear framework for timely review.
- Strengthen the BCM plan across the Bank and establish oversight responsibilities under operational risk.
- Moving into an operational risk management solution.

Market Risk

- Improve market risk management limit structure to have a better control over losses; i.e. introduction of take – profit limits.

Information & Cyber Security Risk

- Completion of rollout of data classification tool.
- Implement DLP and DRM tool, to ensure minimal data losses.
- Strengthen security management framework through ISSC

Board Integrated Risk Management Committee Report

- Partner with industry experts to garner knowledge and experience in managing system related vulnerabilities by subscribing to security as a management service.
- Introduce a cyber-crisis management plan.
- Introduce IT-GRCM (Governance Risk Compliance Management) framework.
- Introduce governance framework to implement industry standard such as Payment Card Industry Data Security Standard (PCIDSS), ISO 27001, General Data Protection Regulation (GDPR) etc.

PROFESSIONAL ADVICE

The BIRMC is authorized to obtain legal or other professional advice internally and / or from outside as and when it considers necessary, at the Bank's expense.

The committee may also seek the views of other board sub committees as and when required and may inform them of any relevant procurements that maybe of relevance to their mandates

COMMITTEE EVALUATION

The committee completed the evaluation process with self-assessment in December 2018 with the result "satisfactory".



Rose Cooray
Chairperson

Board Integrated Risk Management Committee - 2018

Colombo, Sri Lanka
14th February 2019

Board Audit Committee Report



“In a rapidly evolving and increasingly challenging environment, the Committee continued to provide independent oversight and input into the Bank’s financial reporting and internal control process.”

Sujeewa Mudalige

SIGNIFICANT ACCOUNTING JUDGEMENTS CONSIDERED DURING 2018

Reviewed key assumptions and judgements including following areas:

- Actuarial valuation of Pension liability
- Tax Provisions
- Implementation of SLFRS 9
- Going Concern
- Loan impairment, allowances and charges
- Carrying value of investments in group companies
- Valuation of financial instruments.

CHARTER OF THE COMMITTEE

Board Audit Committee (BAC) assists the Board in the discharge of its responsibilities by exercising structured, systematic oversight over the Bank's financial reporting, internal audit, internal controls and external audit practices. The BAC Charter clearly defines the Terms of Reference (TOR) of the Committee and regulates the composition, role and responsibilities of the BAC. Approved by the Board, the Charter was last reviewed and updated in November 2018.

KEY RESPONSIBILITIES OF THE AUDIT COMMITTEE

Key responsibilities include;

- Monitor and review adequacy and effectiveness of accounting policies, financial and other internal control systems and financial reporting processes.
- Exercise independent oversight of the Bank's assurance functions, including external, and internal audit and ensure the independence and effectiveness of both the external and internal audit functions.
- Review Bank's compliance with relevant legal, regulatory and accounting standards in the preparation and presentation of financial statements external reports, providing independent oversight of the integrity thereof.

AUTHORITY OF THE AUDIT COMMITTEE

The BAC has investigative authority conferred upon it under the TOR. Members have unrestricted access to records, data, and reports and to management and staff, to obtain the relevant information considered necessary in the discharge of duties and responsibilities. The BAC may also engage independent counsel and/or other advisors deemed necessary.

COMPOSITION & MEETINGS

Membership	Attendance and eligibility
Sujeewa Mudalige (IND/NED) - Chairman	08 / 08
Dr Rohan Karunaratne (IND/NED) (Resigned - 1st July 2018)	03 / 04
Rusi Captain (NIND/NED) (Appointed - 2nd July 2018)	04 /04*
Amal Cabraal (NIND/NED)	08 /08
A N de Silva (IND/NED)	08 /08
Mr Duliksha Soosaipillai (IND/NED) (Appointed - 2nd July 2018)	04 /04
Damien Fernando (NIND/NED) (Appointed – 25th October 2018)	00 /02

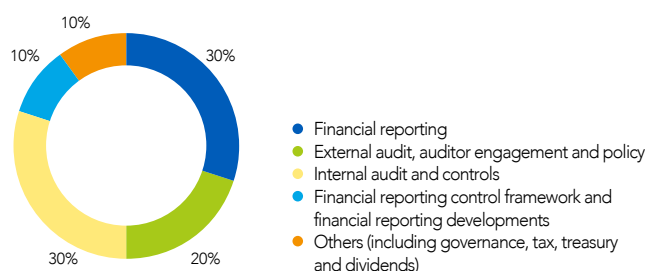
*through Alternate Director, P.R.Saldin.

(IND - Independent Director, NIND - Non Independent Director, NED - Non Executive Director)

REGULAR ATTENDEES BY INVITATION:

- Ms Rose Cooray – NED (As the Chairperson of BIRMC)
- Mr Jonathan Alles – Managing Director / Chief Executive Officer
- Mr Dilshan Rodrigo - Chief Operating Officer
- Ms Anusha Gallage - Chief Financial Officer
- Mr Niroshana Seneviratne - Chief Internal Auditor / DGM (Internal Audit)
- Mr Damith Pallewatte - Chief Risk Officer / DGM (Risk) / Chief Information Security Officer
- Ms Mohini Seneviratne - Head of Compliance
- Ms Thushari Ranaweera, Board Secretary, functioned as the Secretary until 1st July 2018. Chief Internal Auditor, Mr Niroshana Seneviratne was appointed as Secretary, thereafter.

Key Areas and Time Allocated



Board Audit Committee Report

MEETINGS

BAC met eight (8) times during the year. On invitation, the Engagement Partner of the Bank's external audit, Messrs Ernst & Young attended five (5) Committee meetings during the year. The Committee also invited members of the Senior Management team to participate in meetings, on a need basis. Proceedings of BAC meetings are regularly reported to the Board.

ACTIVITIES IN 2018

In discharging responsibilities as set out in the BAC Charter, the following were some of the key focus areas for the year under review:

Financial Reporting

Oversaw the Bank's financial reporting process on behalf of the Board ensuring financial statements are prepared in accordance with the Bank's accounting records, in compliance with regulatory provisions including the Sri Lanka Accounting Standards, Companies Act No 7 of 2007 and Banking Act No 30 of 1988 and amendments thereto and reflect a true and fair view on the financial position and performance of the Bank.

- BAC satisfied itself that accounting policies and practices are appropriate and adequate internal controls and procedures are in place to provide reasonable assurance that the financial reporting system is effective and well managed to provide reliable and timely information.
- Reviewed the impact of adopting new accounting standards, the accounting treatment of significant risks and uncertainties and key estimates and judgements material to the Bank's financial reporting and whether disclosures made in the published financial statements were adequate, appropriate and fair.
- Reviewed and recommended to the Board for approval, the annual and the quarterly financial statements, prior to their release.

Risks and Internal Controls

- Continued to assess the adequacy and effectiveness of the Bank's internal control system. Satisfied itself that adequate controls and procedures are in place to provide reasonable assurance to the effect that the Bank's assets are safeguarded.
- Assessed effectiveness of the Bank's internal control over financial reporting as of 31st December 2018, 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).
- BAC is satisfied as to the reliability of the system as disclosed on page 116 and 117 in IR, 'Directors' Statement on Internal Control Over Financial Reporting'. External auditor has issued an Assurance Report on Directors' Statement on Internal Control Over Financial Reporting. BAC confirm

Implementation of SLFRS 9 - Financial Instruments, continued to receive focus throughout 2018, as the Bank strove to improve the processes, procedures and models used in estimating loan provisions. 2018 interim financial statements were prepared by continuing the application of LKAS 39 with disclosures on impact to the Statement of Comprehensive Income and the Capital Adequacy Ratio, following the alternative methodology offered by the Institute of Chartered Accountants of Sri Lanka. However, the financial statements for year ended 31st December 2018, presented in this report have been prepared by applying SLFRS 9. The cumulative impact as at 1st January 2018 has been adjusted as the "Day 1" impact in the Statement of Changes in Equity.

that the report given in IR page 118 does not suggest any fundamental concerns over the control framework or procedures.

- Reviewed the processes for identification, recording, evaluation and management of all significant risks throughout the Bank. BAC receives regular reports from the Chief Internal Auditor on appraisal of systems of internal controls across these risk types and areas of operation of the Bank and setting out the internal audit function's view of the control environment. Reports also include summary highlights of the most significant matters being highlighted by the Internal Audit Department

Internal Audit

- Reviewed the independence, objectivity and performance of the internal audit function, the findings of the internal audits completed and their evaluation of the Bank's internal control system
- Reviewed the annual audit plan for the year, prepared on risk based planning methodology. Evaluated the adequacy and frequency of coverage.
- Assessed the Internal Audit Department's resource requirements including succession planning.
- Reviewed the performance appraisal of the Chief Internal Auditor and other senior staff members of Internal Audit Department.
- Conducted two (2) independent discussions with the Chief Internal Auditor in the absence of the management team to ensure independence of the Internal Audit Department's operations.

WHISTLE-BLOWING

Reviewed issues relating to breach of ethics if any and arrangements by which staff of the Bank may in confidence raise concerns about possible improprieties. The Committee ensures procedures for the independent investigations of such matters are appropriate and are in place.

EXTERNAL AUDIT

- Assisted the Board in engaging External Auditors for audit services, in compliance with regulatory provisions.
- Monitored and assessed the independence, objectivity and effectiveness of the external auditor during the year 2018. Recommended their re-appointment and remuneration for the year 2019, for shareholder approval at the Bank's next AGM in March 2019. The Engagement Partner was rotated during the year 2018.
- Discussed the audit plan, scope and the methodology proposed to be adopted in conducting the audit with the Auditors prior to commencement of the annual audit.
- Discussed all relevant matters arising from the interim and final audits together with the Management Letter and management responses thereto. Met the external auditors twice (2) during the year in the absence of Key Management Personnel 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. The Committee concluded that there was no cause for concern.
- Reviewed non-audit services provided by the Auditors, ensuring such functions do not fall within the restricted services and provision of such services will not impair the External Auditors' independence and objectivity.

TRAINING AND DEVELOPMENT OF COMMITTEE MEMBERS

Training and continuous professional development undertaken by BAC includes attending seminars, conferences, workshops, presentations done by tax consultants and external auditor on areas such as new accounting standards, tax, basel regulations and directions issued by the Central Bank of Sri Lanka.

COMMITTEE EVALUATION

The annual evaluation of the Committee was conducted by the Independent Non-Executive Chairman, with contributions from the individual assessments by the members of the Audit Committee, Managing Director / CEO, Chief Operating Officer, Chief Financial Officer and Chief Internal Auditor in accordance with international best practices and was deemed to be satisfactory.



Sujeewa Mudalige
Chairman

Board Audit Committee

Colombo, Sri Lanka
20th February 2019

Related Party Transactions Review Committee Report



KEY INITIATIVES IMPLEMENTED IN 2018 WERE:

- Expanded training and awareness on Related Party Transactions (RPT) guidelines by conducting training programmes for branch personnel.
- Refined RPT approval matrix.
- Revised Related Party Transactions Policy Document by incorporating changes occurred, since previous revision.
- Developed a comprehensive Report to extract RPTs.

COMPOSITION & MEETINGS

The Bank's Related Party Transactions Review Committee (the "Committee") was established as a Board Sub Committee with effect from 1st January 2016. Its scope is to conform to 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 present Committee is as follows:

Mr A N de Silva - (IND/NED) – Chairman

Ms Rose Cooray - (NIND/NED)

Mr Palitha Pelpola - (IND/NED)

Mr Jonathan Alles - (MD/CEO)

(IND - Independent Director, NIND - Non Independent Director, NED - Non Executive Director, MD/CEO - Managing Director and Chief Executive Officer)

Brief profiles of the Directors representing the Committee are given in pages 20 to 25 in IR.

Regular attendees by invitation:

The Committee is assisted by the following Management Officers of the Bank who attended sittings on a regular basis.

Mr Dilshan Rodrigo – Chief Operating Officer

Ms K A L Thushari Ranaweera – DGM - (Legal) / Board Secretary

Ms Anusha Gallage – Chief Financial Officer / Secretary to the Committee

Ms Mohini Seneviratne – Compliance Officer

Ms Angelina Dharmaraj – Senior Manager (Credit Admin)

In addition, the Committee summoned other relevant officials of the Bank to participate in the Committee proceedings on a need basis.

Meetings are held mandatorily, at least once a Quarter. During 2018, four (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 Related Parties that were more favourable or preferential during the period under review and the Bank had been compliant with the Code.

Membership attendance details at Meetings were as follows:-

	Eligible to attend	Attended
Mr A N de Silva	4	4
Ms Rose Cooray *	2	2
Mr Palitha Pelpola	4	4 (one through Alt Director)
Mr Jonathan Alles	4	4 (two meetings through Alt Representative)
Dr Rohan Karunaratne **	2	1

* Appointed w.e.f. 2nd July 2018

** Member up to 1st July 2018

Secretary to the Committee:

The Bank's Chief Financial Officer functions as the Secretary to the Related Party Transactions Review Committee.

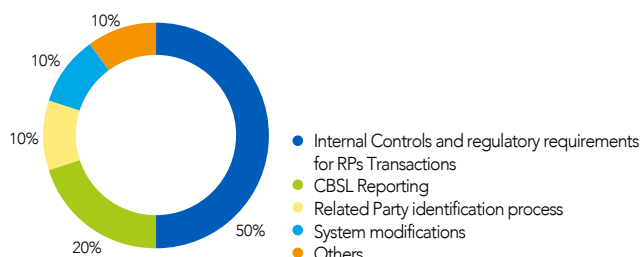
Summary of the 'Terms of Reference' (TOR) of the Related Party Transactions Review Committee

The Related Party Transactions Review Committee is governed by 'Terms of Reference' approved by the Bank's Board of Directors. The Statutory and Fiduciary responsibilities of such Committee are those as envisaged in the Code of Best Practices on Related Party Transactions published by the Securities and Exchange Commission of Sri Lanka (the "Code") and regulations promulgated by the Colombo Stock Exchange ("The CSE Rules"), Financial Reporting under LKAS 24, Banking Act Direction No: 11 of 2007 on Corporate Governance of Licenced Commercial Banks in Sri Lanka and Code of Best Practices on Corporate Governance 2017 issued by the Institute of Chartered Accountants of Sri Lanka.

The TOR also spells out the constitution and the composition of the Committee; that the Chairman should be a Non - Executive Independent Director, and the Committee should meet at least once in every Quarter. It also sets out the guidelines on Related Party Transactions and its reporting. As per the TOR, the Committee has direct access to the required data and information in order to discharge its duties and responsibilities and when in doubt, the Committee has the right to obtain appropriate opinions from external Specialists.

The TOR is subject to periodic review based on regulatory as well as operational requirements. During the year, the TOR was amended to accommodate desired changes.

Key Areas and Time Allocated



SCOPE OF OPERATIONS

The principal functions of the Committee are the verification and scrutiny of all Related Party Transactions with Directors, Key Management Personnel (KMPs), Substantial Shareholders, Subsidiaries and Associated 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 the following:-

- A comprehensive list of Related Parties based on latest available declarations, signed off by the responsible Directors/ KMPs.
- Related Party Transactions confirmed by the Business Heads to the Committee.
- The quarterly CBSL Reports on Related Party Transactions reported under the responsibility of Chief Risk Officer, which in turn is further reviewed by the Chief Financial Officer who is the ultimate reporting authority to the Committee and its Secretary. This review is carried out by comparing Related Party Transactions with benchmarked criteria applicable for comparable Non Related Party Transactions, to verify and determine that Related Parties have not received more favourable nor preferential consideration, based on the Reports submitted by the Business Heads to the Committee.

The Bank’s Internal Audit Division is also mandated to periodically verify the integrity of reported data, to ensure greater transparency.

As stated previously, wherever necessary, the Committee has the authority to obtain independent legal, financial & technical advice from competent authorities in such fields, to review transactions. Further the Committee has the right and power to access as well as call for clarifications and explanations from

the Management & Auditors (External & Internal) on any allied matter.

In addition, the Committee shares information with the Board Audit Committee whenever necessary and appropriate to facilitate the Board Audit Committee to conduct its Statutory & Regulatory responsibilities with regard to Related Party Transactions.

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 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.

A N de Silva
Chairman

Related Party Transactions Review Committee

Colombo, Sri Lanka
20th February 2019

Directors' Statement On Internal Control Over Financial Reporting

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 eliminating 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 robust 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 Bank's declared 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 Board Audit Committee and the findings of the audits are submitted to the Board Audit Committee for review at their periodic meetings.
- The Board Audit Committee of the Bank approves the annual audit plan, 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 same. The minutes of the Board Audit Committee meetings are tabled for the information of the Board on a periodic basis. Further details of the activities undertaken by the Board Audit Committee of the Bank are set out in the Board Audit Committee Report on page 111 to 113 in IR.
- 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 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, 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. This assessment did not include Subsidiaries of the Bank.

The Bank adopted SLFRS 9 – "Financial Instruments", which became applicable for financial reporting periods beginning on or after 1st January 2018. SLFRS 9 poses a significant impact on impairment assessment of financial assets where by the impairment assessment approach shifted from an "incurred credit loss model" applied based on LKAS 39 – "Financial Instruments – Recognition and Measurement" to an "expected credit loss

model". Further this standard creates a significant impact on the processes adopted for classification of financial instruments which is now driven by the "business model" based on which the financial instruments are held and the contractual cash flow characteristics of the instrument. Giving due regards to the complexities involved with the implementation of this standard the Bank began the implementation journey in 2017 with the assistance of a Consultant. During the year Bank continued to refine the statistical models used in the computations and the procedures used for data extraction which is essential for the successful implementation of the standard. Despite SLFRS 9 becoming applicable from 1st January 2018 Bank continued to report its interim financial statements based on LKAS 39, based on the option granted by the Institute of Chartered Accountants of Sri Lanka to prepare the interim financial statements continuing the application of LKAS 39 – "Financial Instruments: Recognition & Measurement". However, the financial statements for the year ended 31st December 2018 are being presented in line with SLFRS 9.

Adequate training and awareness sessions have been conducted for the Board and the Senior Management with regard to this new standard. Further, the Board ensures that processes and controls are put in place for use of management information systems and validation of information extracted to comply with SLFRS 9.

Since adoption of this standard, progressive improvements on processes to comply with new requirements of classification, estimation of expected credit losses and disclosure were made whilst, further strengthening of processes will take place pertaining to expected credit loss estimation and financial statement disclosures.

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 those.

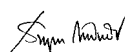
CONFIRMATION

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 Over Financial Reporting for the year ended 31st December 2018 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 in IR page 118.

By order of the Board



Sujeewa Mudalige
Chairman
Board Audit Committee



Jonathan Alles
Managing Director / Chief Executive Officer



Dinesh Weerakkody
Chairman

Colombo, Sri Lanka
20th February 2019

Independent Assurance Report



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Chartered Accountants
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TO THE BOARD OF DIRECTORS OF HATTON NATIONAL BANK PLC

Report on the Directors' Statement on Internal Control

We were engaged by the Board of Directors of Hatton National Bank PLC ("Bank") to provide assurance on the Directors' Statement on Internal Control over Financial Reporting ("Statement") included in the annual report for the year ended 31 December 2018.

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 Independence and Quality Control

We have complied with the independence and other ethical requirement of the Code of Ethics for Professional Accountants issued by the Institute of Chartered Accountants of Sri Lanka, which is founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behaviour.

The firm applies Sri Lanka Standard on Quality Control 1 and accordingly maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

Our responsibilities and compliance with SLSAE 3050 (Revised)

Our responsibility is to assess whether the Statement is both supported by the documentation prepared by or for directors and appropriately reflects the process the directors have adopted in reviewing the design and effectiveness of the internal control of the Bank.

We conducted our engagement in accordance with Sri Lanka Standard on Assurance Engagements (SLSAE) 3050 (Revised), Assurance Report for Banks on Directors' Statement on Internal Control, issued by the Institute of Chartered Accountants of Sri Lanka.

This Standard required that we plan and perform procedures to obtain limited assurance about whether Management has prepared, in all material respects, the Statement on Internal Control.

For purpose of this engagement, we are not responsible for updating or reissuing any reports, nor have we, in the course of this engagement, performed an audit or review of the financial information.

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 (Revised) 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 (Revised) 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.

The procedures selected depend on our judgement, having regard to our understanding of the nature of the Bank, the event or transaction in respect of which the Statement has been prepared.

We believe that the evidence we have obtained is sufficient and appropriate to provide a basis for our conclusion.

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.

Colombo, Sri Lanka
20th February 2019

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 Ms. P V K N Sajeewani 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

Directors' Interest in Contracts with the Bank

Related party transactions as required by LKAS 24 "Related Party Disclosures", are detailed in Note 60 to the financial statements. In addition, the Bank carries out transactions in the ordinary course of its business at commercial rates with entities in which a Key Management Personnel (KMP) of the Bank is the Chairman or a Director of such entities, the details of which are given below.

Also 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	Relationship	Nature of Transaction	Aggregate Amount of Accommodation				Security
			As at 31st December 2018		As at 31st December 2017		
			Limit	Outstanding	Limit	Outstanding	
			Rs Mn	Rs Mn	Rs Mn	Rs Mn	
A	Mr Amal Cabraal						
John Keells Holdings PLC	Director	Overdraft	200.00	-	200.00	-	Commercial paper agreement Clean
		Commercial paper	*(200.00)	-	*(200.00)	-	
		Overdraft	*(200.00)	-	*(200.00)	-	
		Short term loan	*(200.00)	-	*(200.00)	-	
		Total	200.00	-	200.00	-	
Ceylon Beverage Holding PLC	Director	Term loan 1	18.60	18.60	118.20	118.20	Board Resolution
		Term loan 2	92.50	92.50	122.50	122.50	
		Total	111.10	111.10	240.70	240.70	
Lion Brewery (Ceylon) PLC	Director	Overdraft	100.00	-	100.00	-	Board Resolution, Demand promissory notes, LG Indemnity, documents of title
		Letter of guarantee	20.00	-	20.00	-	
		Money market loan	5,000.00	-	5,000.00	2,000.00	
		Term Loan 1	(1,622.00)	1,622.00	(5,000.00)	-	
		Term Loan 2	(388.40)	388.40	(722.00)	722.00	
		Letter of credit	50.00	-	50.00	-	
		Import loan	(50.00)	-	(50.00)	-	
		Overdraft 2	(400.00)	-	-	-	
Total	5,170.00	2,010.40	5,170.00	2,722.00			
Sunshine Holdings PLC	Director	Overdraft	50.00	19.72	-	-	Clean
		Total	50.00	19.72	-	-	
Sunshine Healthcare Lanka Ltd	Director	L/C	1,200.00	254.98	1,000.00	709.80	Docs of title, Duly accepted usance drafts, letter of indemnity Overdraft agreement Concurrent mortgage bond over stock, import loan agreement. forward exchange agreement, Absolute ownership of vehicle/ leased assets
		Overdraft	200.00	198.39	(200.00)	134.70	
		Letter of guarantee	(100.00)	-	(100.00)	-	
		Import loan	(500.00)	110.57	(500.00)	-	
		Forex forward contracts	(270.00)	-	(270.00)	-	
		Block lease facility	2.76	2.76	4.80	4.80	
		Shipping guarantee	(400.00)	114.05	(400.00)	143.40	
		Unadvised L/C	-	-	400.00	-	
		Total	1,402.76	680.75	1,404.80	992.70	
Healthguard Pharmacy Ltd	Director	Short term loan 1	20.00	-	20.00	-	Mortgage over stock LG indemnity Docs of title. duly accepted usance drafts Import loan agreement
		LG	25.00	-	25.00	-	
		Overdraft 1	(5.00)	-	(5.00)	-	
		Overdraft 2	50.00	24.41	50.00	52.87	
		letter of credit	100.00	12.71	100.00	17.40	
		import loan	(100.00)	-	(100.00)	-	
		Short term loan 2	5.00	-	5.00	-	
Total	200.00	37.12	200.00	70.27			
Watawala Tea Ceylon Ltd	Director	Overdraft	275.00	2.05	200.00	167.50	Overdraft agreement LG indemnity
		TOD	-	-	75.00	-	
		LG	15.00	1.26	15.00	-	
		Total	290.00	3.31	290.00	167.50	

Directors' Interest in Contracts with the Bank

Director/Company	Relationship	Nature of Transaction	Aggregate Amount of Accommodation				Security
			As at 31st December 2018		As at 31st December 2017		
			Limit	Outstanding	Limit	Outstanding	
			Rs Mn	Rs Mn	Rs Mn	Rs Mn	
B Mr Sujeewa Mudalige							
Price Water House Coopers	Director	Overdraft	7.80	6.31	7.80	1.88	Cash Deposit
C Mr Nilanth de Silva							
Malwatte Valley Plantations PLC	Director	Overdraft	254.00	186.67	254.00	58.69	Stock & book debts/property mortgage
		Commercial paper	-	-	40.00	-	Commercial paper agreement
		Money market Loan	40.00	40.00	-	-	Clean
		Packing credit loan	400.00	115.28	400.00	101.58	Simple receipt/Dollar bond for \$695,000/- over property
		Export bill	(400.00)	205.00	(400.00)	201.85	Letters of Hypothecation
		Lease	64.00	64.00	61.61	61.61	Vehicles/equipment
		Total	758.00	610.95	755.61	423.73	
D Ms M A R C Cooray							
Ceylon Guardian Investment Trust/Ceylon Investment PLC	Director	Overdraft/Term loan	300.00	-	300.00	-	Clean
		Overdraft/Term loan	(300.00)	-	(300.00)	-	
		Total	300.00	-	300.00	-	
Sithma Development Pvt Ltd	Director	Overdraft	50.00	-	50.00	-	Commercial Property
		Term Loan	645.14	645.14	1,000.00	1,000.00	
		Total	645.14	645.14	1,000.00	1,000.00	
E Mr D S Weerakkody							
Hemas Holdings (Group) PLC	Director	Overdraft	210.00	-	210.00	-	DPN/Clean
		Letter Of Guarantee	50.00	27.45	50.00	-	Counter Indemnity
		Total	260.00	27.45	260.00	-	
Access Engineering PLC	Director	Letter of guarantee	7,000.00	3,240.62	7,000.00	2,363.66	LG Indemnity
		Letter of Credit	500.00	110.15	500.00	52.48	Documents of title/ Duly Accepted
		Total	7,500.00	3,350.77	7,500.00	2,416.14	usage drafts
Lanka Aluminium Industries PLC	Director	Letter of credit/ Import Loan 1-2	490.00	168.97	490.00	283.71	Documents of title/ Duly accepted
		Overdraft	(65.00)	55.46	(65.00)	65.56	usage drafts.
		Short term loan	(275.00)	252.92	(170.00)	134.18	Clean
		Term loan 1-5	112.82	112.82	105.64	105.64	
		Total	602.82	590.17	595.64	589.09	
F Dr L R Karunarathna							
AKK Engineers	Director	Overdraft	31.00	21.57	27.45	18.72	Overdraft agreement
		Letter of guarantee	161.30	68.45	60.80**	64.20	Mortgage over property
		Letter of guarantee	(10.00)	-	(10.00)	-	Against fixed deposits
		One off LC	-	-	11.18	4.02	personal guarantee
		One off Bridging finance facility	-	-	(11.18)	-	mortgage over property
		Total	202.30	90.02	99.43	86.94	
Arpico Finance PLC	Director	Term Loan	179.45	179.45	267.80	267.80	Lease Portfolio
		Total	179.45	179.45	267.80	267.80	
Pinthaliya Resort	Proprietor	Overdraft	1.80	0.4850	1.8	0.8694	Cash deposit

Director/Company	Relationship	Nature of Transaction	Aggregate Amount of Accommodation				Security
			As at 31st December 2018		As at 31st December 2017		
			Limit	Outstanding	Limit	Outstanding	
			Rs Mn	Rs Mn	Rs Mn	Rs Mn	
G	Mr A J Alles						
Acuity Partners Pvt Ltd	Director	Letter of guarantee	1.15	1.15	-	-	Cash
		Overdraft	150.00	-	150.00	-	Board Resolution
		Term loan	107.81	107.81	150.00	126.56	
		Total	258.96	108.96	276.56	126.56	
HNB Finance Ltd	Director	Term loan 1-4	1,186.24	1,186.24	424.90	424.90	Absolute ownership of vehicles over movable & immovable assets
		Lease	2.77	2.77	9.48	9.48	
		Money M/Loan	1,000.00	1,000.00	-	-	Negative pledge
		Overdraft	500.00	202.39	-	-	DPN/MOU
		Credit Card	0.15	0.06	-	-	
		Total	2,689.16	2,391.46	434.38	434.38	
LVL Energy Fund	Director	Term loan	93.75	93.75	168.75	168.75	Clean
Lanka Venture PLC	Director	Term loan	45.00	45.00	-	-	Clean
H	Mr R S Captain / Mr Prawira Rimoe Saldin (Alternate Director)						
Paints & General Industries Ltd	Director	Overdraft/Money	560.31	300.12	904.61	820.83	shares in the CDS
		Letter of credit	(100.00)	-	(100.00)	-	Board resolution
		Total	560.31	300.13	904.61	820.83	Power of attorney Docs of title and duly accepted usance drafts.
I	Mr E D P Soosaipillai						
Commercial Credit & Finance PLC	Director	Overdraft	12.00	-	12.00	-	Property
		Securitisation Loan	666.80	666.80	1,322.98	1,322.98	Mortgage over securitisation of lease/higher purchase
		Term Loan	156.77	156.77	121.88	121.88	Fixed deposit
		Short T/ Loan	1,500.00	1,500.00	-	-	DPN
		LG	2,104.00	2,104.00	2,128.19	2,128.19	Indemnity/Cash buildup/ Cash Margin/special power of attorney in favour of Bank
		Total	4,439.57	4,277.57	3,585.05	3,573.05	

* Figures in brackets indicate sub limits granted to respective entities.

** Approval was obtained for the excess.

Directors' Interest in Contracts with the Bank

2. OTHER BUSINESS TRANSACTIONS WITH THE BANK

Company/Director	Name of the Director / Relationship	Nature of Transaction	Amount (RsMn)		
			2018	2017	
A	Mr Jonathan Alles				
	Lanka Financial services Bureau	Director	Repo (outstanding as at year end) Interest on repurchase agreements	- 0.22	17.32 1.12
	Acuity Partners (Pvt) Ltd	Director	Interest on repurchase agreements	-	0.02
B	Mr Amal Cabraal				
	John keels Holdings PLC	Director	Interest on repurchase agreements	-	154.70
	Lion Brewery Ceylon PLC	Director	Quoted Debentures	477.87	477.87
	Access Engineering PLC	Director	Quoted Debentures	1,518.95	1,518.95
	Watawala Tea Ceylon Ltd	Director	Merchant Commission	0.04	-
	Healthguard Pharmacy Ltd	Director	Merchant Commission	2.62	-
C	Ms M A R C Cooray				
	HNB Assurance PLC Life Fund	Director	Merchant Commission	1.60	6.71
	HNB General Assurance Ltd	Director	Merchant Commission	14.13	1.08
	Sithma Development Pvt Ltd	Director	Interest on repurchase agreements	-	7.53
D	Dr L R Karunaratna				
	Pinthaliya Resort	Director	Merchant Commission	0.25	0.24
E	Mr R S Captain				
	CIC Holdings PLC	Director	Quoted Shares (Fair value)	22.03	34.50
F	Mr D S Weerakkody				
	Access Engineering PLC	Director	Quoted Debentures	1,518.95	1,518.53

Collateral details of facilities for each company are grouped together without identifying collateral, facility-wise.

The above disclosure only pertains to the transactions carried out with directors who are holding office as at 31/12/2018.

The above entities also held customer deposits with the Bank totalling to 19,095.49 Mn. and interest paid was 1,353.52 Mn

Interest income earned from loans and advances amounted to 1667.90 Mn. for the year ended 31/12/2018.

Risk Review

Our strategy is supported by a comprehensive risk management framework which carefully balances profitability and financial stability with due consideration of regulatory requirements and developments in the macro operating environment.



Refer the governance and risk report, staying ahead for a more detailed review of how we manage risk and capital.

The Board bears ultimate responsibility for managing risks and is assisted by BIRMC who has oversight responsibility for detailed review of matters pertaining to risk and capital management and reporting to Board. A dedicated risk management unit reporting directly to BIRMC supports this key function of the Board under the purview of the Chief Risk Officer. Executive committees comprising of the CEO, CRO and other key management personnel facilitate monitoring and continuous improvement of the Bank's risk management framework, fostering high levels of risk awareness. The Bank's risk management framework comprises a suite of risk management policies and the risk appetite statement complemented by an organization structure based on the three lines of defence model.

RISK CULTURE

High levels of risk awareness in the Bank and Group is necessary to drive competitive advantage and manage risks as risks and opportunities are two sides of the same coin. Accordingly, significant resources are devoted to

train employees in risk awareness throughout the Group while those in specialized roles are required to gain the skills and experience to accept and manage risks related to their roles. The risk management department serves as the 2nd line of defence by constructively challenging risk assessments submitted by business units and monitor compliance with regulatory and other prudential requirements. The 3rd line of defence comprising internal and external audit provide assurance on the effective functioning of internal controls set in place on a regular basis.

RISK APPETITE STATEMENT

This key document defines the parameters for managing risk as we balance conflicting priorities to realise our strategic goals. It is reviewed and revised annually taking into account regulatory requirements and other prudential factors. It is also clearly aligned and linked to performance management systems shaping the risk culture of the Bank and encouraging employees to adopt appropriate risk behaviours.

Summary of Risk Appetite Statement

Risk Parameter	Appetite	Tolerance	Capacity	Compliance
NPL (Gross)	<2.0%	4.00%	6.00%	✓
Capital Adequacy	>15.0%	14.50%	14%	✓
RoA	1.50%	1.40%	1.25%	✓
Earning Volatility	-5%>X <20%	-10%>X <25%	-20%>X <33%	✓
RoE	16%	15%	12.50%	✓
Leverage (No of times over Core Capital)	15	20	25	✓
On B/S	25	30	33	✓
Off B/S				
Long Term National Credit Rating	AA-			✓
Economic Capital Utilization	70%	65%	50%	✓



RISK MANAGEMENT POLICIES

- Overall Risk Management Policy
- Credit Risk Management Policy
- Treasury Management Policy
- Stress Testing Policy
- Cyber Security Management Policy
- Operational Risk Management Policy
- Environmental Risk Management Policy
- Information Classification Policy
- Liquidity Risk Management Policy
- Foreign Exchange Risk Management Policy

Risk Review

AN EVOLVING FUNCTION

Risk management has evolved at a rapid pace to ensure that it is geared to manage emerging risks stemming from a dynamic operating environment, an agile and transforming banking business. The adjacent column highlights the key initiatives implemented during the year to ensure that we are sufficiently equipped to identify, measure, manage and monitor risk.

RISK LANDSCAPE

The Banking industry is transforming to embrace an increasingly digitised future transcending country borders as regulators across territories strive to overcome disruptions through cybercrime and providing sufficient safeguards to its citizens will be a key priority. Increased regulation on data protection and customer privacy will be another key focus area for evolving regulations. Anti-money laundering is also an important key area of focus as emerging nations look to manage capital flows which impact the country's competitiveness and financial stability. EU's revised Directive on Payment Services (PSD2) which came in to

effect in January 2018 is expected to level the playing field between banks and other payment solution providers while advancements in technology and Artificial Intelligence (AI) enable integration of fraud-prevention systems that are preventive and adaptive to effectively counter threats.

Climate change is rated as a top risk across many observers as the cost of natural disasters weaken vulnerable countries and increase inequalities in emerging economies leading to increased crime and instability.

Moderating economic growth and political uncertainty brings its own issues for the financial services industry as increasing interest rates, inflation, exchange rates and taxation stress the business models and wealth management strategies of customers. 2018 witnessed declining asset quality, tightening liquidity and a decline in NIM and profitability across the industry necessitating a cautious approach to growth and a review of pricing models to ensure they reflect risks assumed.

Licensed Commercial Banks Industry Indicators	2014	2015	2016	2017	Q3 2018
Core Capital (Tier 1 Capital) Adequacy Ratio	14.1	12.8	12.5	12.3	12.4
Total Capital Adequacy Ratio	17.0	15.3	15.6	15.2	15.7
Gross Non-performing Advances Ratio	3.6	2.9	2.4	2.3	3.5
Return on Equity (ROE)	16.8	15.7	17.2	17.5	14.5
Efficiency Ratio	51.6	51.1	48.9	45.2	47.7
Interest Margin	3.6	3.5	3.6	3.5	3.7
Liquid Assets Ratio	33.2	28.7	25.4	27.2	25.7
Credit to Deposit Ratio	86.9	91.8	91.9	90.1	92.0

2018 HIGHLIGHTS

Project/Key Initiatives

Risk Governance

- Reviewed and Update of Risk Management Policies
- Establishment of Risk Intelligence Unit

Credit Risk

- Implementation of state-of-the-art Loan Origination System
- Strengthened Portfolio Risk Management
- Project Initiated in Developing and Improving Risk Models including SLFRS 9 /ICAAP, Internal Risk Rating Model Validation
- Recalibration and enhancements to Internal Risk Rating Models

Market Risk

- Upgraded the Treasury Systems

Operational Risk

- Strengthened the Risk & Control Self-Assessment Process
- Streamlined Root Cause Analysis of Operational Loss event including near misses
- Reviewed and Improved Business Continuity Management of the Bank
- Strengthened Monitoring of Outsourced Activities

Information & Cyber Risk

- Strengthened Data /Information Management
- Improved Firewalls
- Adopted International best practices in mitigating Cyber and Information Security Risk

KEY RISK SUMMARY

Key risk indicators remain within the Bank’s risk appetite. The credit rating affirmed by Fitch Ratings Lanka Ltd., as AA-(lka) Stable also indicates a stable risk profile despite challenging environment. It is noteworthy that the rating is also influenced by the outlook of the Sri Lankan banking sector and the sovereign risk rating.

Loan book growth remained steady at 19% as the Bank adopted a cautious approach in response to key drivers of the operating environment. Impairment charges increased by 206% predominantly attributable to the impact of SLFRS 9 and weaker economic performance.

Deposit growth of 14% reflects the strength of the domestic franchise and supported funding of the loan portfolio. Deposits of Rs 800 bn account for 82% of Total Liabilities.

Bank’s capital ratios declined marginally in line with industry as depicted in the capital ratio graph. The total capital ratio remains within regulatory requirements and the Bank’s risk appetite.

CREDIT EXPOSURE

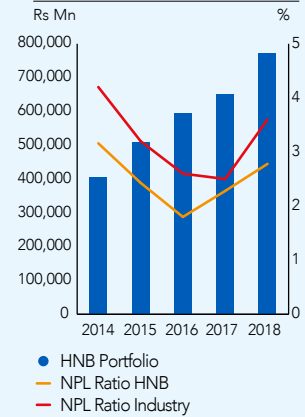
Despite challenges in the business environment and industry wide deterioration of asset quality, persistent and focussed efforts by the Bank enabled it to maintain NPAs at a level much below industry average

CREDIT QUALITY

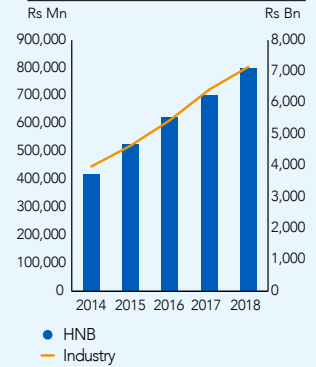
Credit quality has been under stress given the deterioration of macro economic conditions. Such circumstances lead in sizable number of SMEs and large corporate facing cash flow constraints which resulted comparatively higher past due loans. However, possession of sufficient collateral and identified cash flows towards HNB liabilities resulted them not attracting an impairment.

Further, change in impairment assessment methodology from an incurred loss model to forward looking ECL model also had a notable impact on identifying loans qualifying for impairment

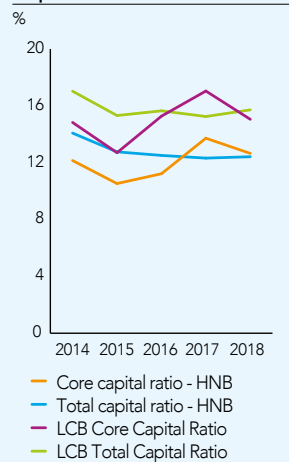
Asset Quality



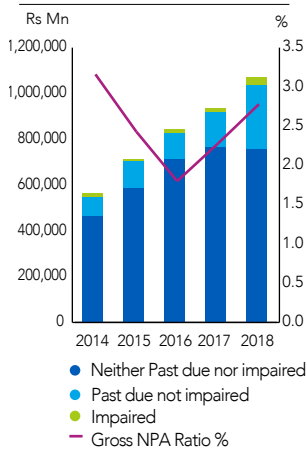
Deposit Growth



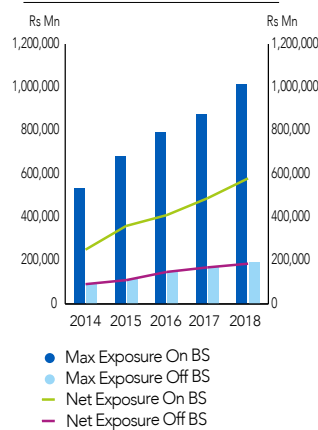
Capital Ratios



Credit Quality



Credit Exposure



Risk Review

Key risks impacting our operations are summarised below as viewed through a prudent lens:

Risk	Assessment	Trend	Rationale/Description
External			
Economic growth and trade cycles	High	↗	Economic growth while forecast to gather momentum may suffer setbacks due to political uncertainty and other economic headwinds
Fiscal and monetary policy	Moderate	↗	Fiscal and monetary policy is expected to enhance the stability of the financial markets in line with stated government policy
Regulation	Moderate	↗	Regulation for LCBs is expected to maintain pace in line with stated policy
Cyber threats	High	↗	Cyber threats remain a key risk with artificial intelligence applications becoming more prevalent in the industry. HNB continues to monitor developments in the field and invest in enhancing cyber security.
Internal			
Credit Risk	Moderate	↗	Measures implemented during the year are expected to result in improved credit risk indicators in 2019
People & Operational Risk	Moderate	→	Operational risk event trends have been maintained within the Bank's risk appetite. A focus on risk culture, continuous training and improvement in effectiveness of internal controls are key mitigants.
Liquidity Risk	Moderate	↗	Liquidity indicators maintained at satisfactory level against the regulatory requirements and the Bank's risk appetite.

Initiatives implemented during the year including a reorganisation of the risk management department have strengthened the risk management capability of the Bank significantly to meet the unfolding risk landscape. plans for 2019 also include further initiatives to strengthen the risk management function. Experienced professionals, sound corporate governance, a comprehensive suite of risk management policies, appropriate tools and methodologies and a conducive risk culture support the Bank's growth aspirations in a heightened risk landscape.

COMPLIANCE REVIEW

The compliance department of the Bank ensures that HNB conducts its business in conformity with laws, regulations and rules issued by the regulator, which are aligned and integrated into the Bank's policies, systems and processes. Regular dialogue and partnerships with the business further ensure transparency and continuous improvement to the compliance framework.

The Bank's independent compliance function is headed by the Compliance Officer and reports directly to the BIRMC with an indirect line of reporting on administrative areas to the Bank's Chief Operating Officer. The compliance division staffed with specialists, supports the Compliance Officer in implementing the Bank's compliance programme, thereby ensuring the business and industry specific standards are met.

The compliance division contributes towards knowledge enhancement and awareness on statutory regulations, internal policies and best practices in the industry by integrating these into the training programmes held at the Bank's head office and regional centres situated across the country. The purpose of these training sessions is to ensure that employees do not overstep boundaries as a result of ignorance or uncertainty. New recruits and promoted employees receive a compliance training tailored to meet the demands of their new role and function. An e-learning AML module further supports knowledge enhancement on Anti Money Laundering areas.

The Bank's policies are updated regularly, incorporating any change in the economic and regulatory landscape, internal business processes and technological advances. All policies are reviewed and approved by HNB's Board of Directors or the relevant Board Sub Committee.

Key Priorities in 2018

Outsourced Service Providers
Contract management system set up to maintain MIS on outsourced service providers as per CBSL regulations.
Regular Reporting to Board
Continuous Board reporting on compliance areas, AML/CFT matters and regulatory audit reports.
Anti-Money Laundering
AML process improved through online real time sanction screening of SWIFT messages, Bank ML/FT risk assessment and AML process manual.
Enhanced awareness of Foreign Exchange Act Requirements
Foreign Exchange training programme introduced through the Bank's talent development portal to improve staff knowledge on the Foreign Exchange Act no. 12 of 2017.
Compliance with US Foreign Account Tax Compliance Act
Ensured compliance with requirements of the US Foreign Account Tax Compliance Act (FATCA) for 2018.
Enhanced Compliance
Strengthened compliance checks at branches to improve staff awareness on regulatory requirements.

**And so, we say
simply**

thank you

FINANCIAL CALENDAR - 2018

49th Annual General Meeting held on	28th March 2018
Rs. 2/00 per share Final Dividend for 2017 paid on	28th March 2018
Rs. 1/50 per share Interim Dividend for 2018 paid on	19th December 2018
Audited Financial Statements signed on	20th February 2019
50th Annual General Meeting to be held on	29th March 2019
Rs. 7/00 per share Final Dividend for 2018 payable in (Cash Dividend Rs. 3/50 per share and Scrip Dividend Rs.3/50 per share)*	April 2019
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	14th May 2018
2nd Quarter Interim Results released on	15th August 2018
3rd Quarter Interim Results released on	14th November 2018

FINANCIAL CALENDAR - 2019

Interim Dividend for 2019 to be payable in **	December 2019
51st Annual General Meeting to be held in	March 2020
Final Dividend for 2019 payable in ***	April 2020
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 to be released in	May 2019
2nd Quarter Interim Results to be released in	August 2019
3rd Quarter Interim Results to be released in	November 2019

* 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 2018 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 Board 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 2018, as required by the Banking Act Direction No 11 of 2007, result of

which is given on page 116 to 117 in IR, the 'Directors' Statement on Internal Control Over Financial Reporting'. External auditor's Assurance Report on the 'Directors' Statement on Internal Control Over Financial Reporting' is given in IR page 118.

The financial statements of the Group for the year 2018 were audited by Messrs Ernst & Young, Chartered Accountants, the independent external auditors. Their report is given in IR page 133 to 135.

The Board 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 Board Audit Committee to discuss any matter of substance. Details of which are given in the 'Board Audit Committee Report' on page 111 to 113 in IR.

The Board 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
Chief Financial Officer

Colombo, Sri Lanka
20th February 2019

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 in IR page 133 to 135.

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 of the Statement of Financial Position as at 31st December 2018, 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 2018; 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. judgements 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 Sri Lanka Accounting Standards (SLFRS) which came in to effect from January 01, 2012 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 2018 are given on page 116 to 117 in IR, Directors' Statement on Internal Control Over Financial Reporting. External Auditor's Assurance Report on the Directors' Statement on Internal Control is given in IR page 118.

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 page 111 to 113 in IR. 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 Integrated 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.

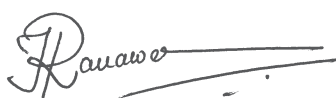
The financial statements of the Bank and the Group have been certified by the Chief Financial Officer of the Bank, the officer responsible for their preparation, as required by Sections 150 (1) (b) and 152 (1) (b) of the Companies Act. Also the financial statements of the Bank and the Group have been signed by two Directors and the Company Secretary of the Bank on February 20th, 2019 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 (in the form of Rs 3.50 cash and Rs. 3.50 script) for the year 2018.

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
20th February 2019

Independent Auditor's Report



Ernst & Young
Chartered Accountants
201 De Saram Place
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TO THE SHAREHOLDERS OF HATTON NATIONAL BANK PLC

Report on the audit of the consolidated financial statements

Opinion

We have audited the 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 31st December 2018, and the statement of profit or loss, the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements of the Bank and the Group give a true and fair view of the financial position of the Bank and the Group as at 31st December 2018, and of their financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

Basis for opinion

We conducted our audit in accordance with Sri Lanka Auditing Standards ("SLAuSs"). Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report. We are independent

of the Group in accordance with the Code of Ethics issued by CA Sri Lanka ("Code of Ethics") and we have fulfilled our other ethical responsibilities in accordance with the Code of Ethics. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the Auditor's responsibilities for the audit of the financial statements section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying financial statements.

Key audit matter	How our audit addressed the key audit matter
<p>Impairment allowance for loans and advances including Group's transition to SLFRS 9:</p> <p>We considered the Impairment allowance for loans and advances as a key audit matter. Significant judgments and assumptions were used by the management to determine the impairment allowance and complex manual calculations were involved in its estimation. The higher level of estimation uncertainty involved, materiality of the amounts reported in the Group's financial statements, and impact of transition to Sri Lanka Financial Reporting Standard 9: Financial Instruments (SLFRS 9) underpinned our basis for considering it as a Key Audit Matter.</p> <p>As at 31st December 2018 loans and advances, net of impairment amounted to Rs 770.26 Bn. These collectively contributed 67% to the Group's total assets.</p>	<p>We designed our audit procedures to obtain sufficient appropriate audit evidence on the reasonableness of the impairment allowance; that included the following procedures</p> <ul style="list-style-type: none"> • Focusing on the oversight, review and approval of impairment policies by the board audit committee and management, we evaluated the design, implementation and operating effectiveness of controls over measurement of loans and advances and impairment allowance for loans and advances there of, in the light of the requirements in SLFRS 9. • We test – checked the underlying calculations and data used in such calculations of impairment allowances. • For impairment allowance for loans and advances individually assessed for impairment: <ul style="list-style-type: none"> - where impairment indicators existed, we evaluated the reasonableness of management's estimated future recoveries including the expected future cash flows, discount rates and the valuation of collateral held. We also compared the actual recoveries against previously estimated amounts of future recoveries. - where impairment allowance for loans and advances which were granted to customers with high risk of credit loss, we assessed the main criteria used by the management for determining whether an impairment event had occurred and reasonableness of management estimation of such additional impairment.

Independent Auditor's Report



Key audit matter

How our audit addressed the key audit matter

The Note 31 of the financial statements describes the basis of impairment allowance for loans and advances and significant judgements and assumptions used by the management in its calculation. The impact on transition to SLFRS 9 on the Group's Financial Statements has been quantified and presented in Note 7 of the financial statements.

- For impairment allowance for loans and advances collectively assessed for impairment:
 - we assessed the completeness and relevance of the underlying information in loans and advances used in the impairment calculations by agreeing details to the Group's source documents and information in IT systems.
 - we also considered reasonableness of macro-economic and other factors used by management in their judgemental overlays for various types of loan portfolios, by comparing them with publicly available data and information sources.
- We assessed the adequacy of the related financial statement disclosures as set out in Note 31 to the financial statements.
- We also assessed the adequacy of the Group's disclosure on the impact of the initial adoption of SLFRS 9 as set out in Note 7 to the financial statements. This included testing the quantitative impact of the transition.

Bank's financial reporting process and related IT systems and controls:

As the Bank uses multiple and complex IT systems, the process of preparation of financial statements and key disclosures are heavily dependent on the output of such systems. In that process, the Bank uses automated, IT dependent and manual accounting procedures and controls.

Accordingly, we considered preparation of financial statements and key disclosures together with manual, automated and IT dependent manual controls over the said process as a Key Audit Matter.

Our audit procedures included the following, amongst others:

- We involved our internal specialized resources in understanding and evaluation of design and operating effectiveness of key manual, automated and IT dependent manual controls implemented by management over generation of financial statements and key disclosures.
- Test-checking;
 - the reports used to generate significant disclosures for accuracy and completeness;
 - source data with those of the related systems;
 - calculations made by management;
 - reasonableness of categorizations made by management;
- Where we considered necessary, performing additional substantive audit procedures on selected account reconciliations on which the significant financial statement disclosures are based.
- Where we considered necessary, we also performed other procedures which included understanding and evaluation of specific procedures carried out by personnel involved in the information security function that supported management's assertion of integrity of systems.
- Assessing if the significant disclosures were made in line with the applicable accounting standards.

Other information included in the Group's 2018 Annual Report

Other information consists of the information included in the Annual Report, other than the financial statements and our auditor's report thereon. Management is responsible for the other information.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material

misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of management and those charged with governance for the financial statements

Management is responsible for the preparation of financial statements that give a true and fair view in accordance with Sri Lanka Accounting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management



either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Bank's and Group's financial reporting process.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with SLAuSs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with SLAuSs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 internal controls of the Bank and the Group.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report.

However, future events or conditions may cause the Group to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with ethical requirements in accordance with the Code of Ethics regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on Other Legal and Regulatory Requirements

As required by section 163 (2) of the Companies Act No. 07 of 2007, 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.

CA Sri Lanka membership number of the engagement partner responsible for signing this independent auditor's report is 2199.

20th February 2019
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 Ms. P V K N Sajewani 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	
		2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Gross income	8	121,356,089	106,295,194	138,250,551	119,759,106
Interest income		108,104,923	96,175,453	116,488,588	103,908,195
Less : Interest expenses		60,525,342	56,526,138	62,852,424	58,446,928
Net interest income	9	47,579,581	39,649,315	53,636,164	45,461,267
Fee and commission income		9,540,862	8,415,579	10,382,030	9,227,529
Less: Fee and commission expenses		141,592	105,482	284,080	213,143
Net fee and commission income	10	9,399,270	8,310,097	10,097,950	9,014,386
Net interest, fee and commission income		56,978,851	47,959,412	63,734,114	54,475,653
Net loss from trading	11	(356,594)	(3,711,203)	(396,918)	(3,695,658)
Net gain from financial assets	12	215,551	212,129	217,896	247,166
Net insurance premium income	13	-	-	7,431,823	6,326,292
Net gains on derecognition of financial assets		-	-	72,150	-
Net other operating income	14	3,851,347	5,203,236	4,054,982	3,745,582
Total operating income		60,689,155	49,663,574	75,114,047	61,099,035
Less: Impairment charge for loans and other losses	15	9,292,421	3,035,468	9,784,052	3,926,149
Net operating income		51,396,734	46,628,106	65,329,995	57,172,886
Less : Operating expenses					
Personnel expenses	16	10,000,083	8,866,642	12,290,751	10,916,284
Benefits, claims and underwriting expenditure	17	-	-	5,679,269	5,485,864
Other expenses	18	12,075,883	10,689,807	14,353,950	12,407,714
Total operating expenses		22,075,966	19,556,449	32,323,970	28,809,862
Operating profit before Value Added Tax (VAT), Nation Building Tax (NBT) and Debt Recovery Levy (DRL) on financial services		29,320,768	27,071,657	33,006,025	28,363,024
Less: Value Added Tax (VAT) , Nation Building Tax (NBT) and Debt Recovery Levy (DRL) on financial services	19	6,369,268	5,021,446	6,842,813	5,435,628
Operating profit after Value Added Tax (VAT), Nation Building Tax (NBT) and Debt Recovery Levy (DRL) on financial services		22,951,500	22,050,211	26,163,212	22,927,396
Share of profit of joint venture (net of income tax)	20	-	-	303,092	175,616
PROFIT BEFORE INCOME TAX		22,951,500	22,050,211	26,466,304	23,103,012
Less: Income tax expense	21	7,433,297	5,583,421	7,316,842	6,361,616
PROFIT FOR THE YEAR		15,518,203	16,466,790	19,149,462	16,741,396
Profit attributable to:					
Equity holders of the Bank		15,518,203	16,466,790	17,635,774	15,946,989
Non-controlling interests		-	-	1,513,688	794,407
PROFIT FOR THE YEAR		15,518,203	16,466,790	19,149,462	16,741,396
Earnings per share	22				
Basic earnings per ordinary share (Rs)		31.50	34.40	35.80	33.31
Diluted earnings per ordinary share (Rs)		31.50	34.37	35.80	33.29
Dividend per share					
Dividend per share: Gross (Rs)		*8.50	8.50	*8.50	8.50

The notes to the financial statements from pages 145 to 304 form an integral part of these financial statements.

*Calculated on interim dividends 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	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
PROFIT FOR THE YEAR	15,518,203	16,466,790	19,149,462	16,741,396
Other comprehensive income that will not be reclassified to profit or loss in subsequent periods				
Change in fair value of investments in equity instruments designated at fair value through other comprehensive income	(1,203,893)	-	(1,203,893)	-
Remeasurement of post-employment benefit obligations	(100,911)	(284,960)	(77,042)	(292,000)
Revaluation of freehold land and buildings	2,868,546	2,981,379	7,468,816	4,146,677
Share of other comprehensive income of joint venture	-	-	1,171	-
Less: Tax expense relating to items that will not be reclassified to profit or loss	(803,094)	(2,900,320)	(3,913,040)	(4,465,972)
Total other comprehensive income that will not be reclassified to profit or loss	760,648	(203,901)	2,276,012	(611,295)
Other comprehensive income that will be reclassified to profit or loss in subsequent periods				
Debt instruments at fair value through other comprehensive income :				
Net losses on investments in debt instruments measured at fair value through other comprehensive income	(1,799,123)	-	(2,188,112)	-
Reclassification of net gains on derecognition of debt instruments at fair value through other comprehensive income to statement of profit or loss	-	-	(72,150)	-
Transfer from life policy holder reserve fund	-	-	416,567	-
Share of profits of joint ventures	-	-	66,368	-
Less: Tax expense relating to items that will be reclassified to profit or loss	503,754	-	512,042	-
Available-for-sale financial assets:				
Net change in fair value during the year	-	3,308,142	-	3,797,637
Transfer to life policy holder reserve fund	-	-	-	(414,402)
Net amount transferred to profit or loss (available-for-sale financial assets)	-	83,249	-	52,764
Less: Tax expense relating to items that will be reclassified to profit or loss	-	(926,481)	-	(933,251)
Share of other comprehensive income of equity accounted joint venture	-	-	-	(21,417)
Total other comprehensive income that will be reclassified to profit or loss	(1,295,369)	2,464,910	(1,265,285)	2,481,331
OTHER COMPREHENSIVE INCOME FOR THE YEAR, NET OF TAX	(534,721)	2,261,009	1,010,727	1,870,036
TOTAL COMPREHENSIVE INCOME FOR THE YEAR, NET OF TAX	14,983,482	18,727,799	20,160,189	18,611,432
Total comprehensive income attributable to:				
Equity holders of the Bank	14,983,482	18,727,799	18,651,179	17,784,291
Non-controlling interests	-	-	1,509,010	827,141
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	14,983,482	18,727,799	20,160,189	18,611,432

The notes to the financial statements from pages 145 to 304 form an integral part of these financial statements.

Statement of Financial Position

As at 31st December	Note	2018 Rs 000	Bank 2017 Rs 000	2018 Rs 000	Group 2017 Rs 000
ASSETS					
Cash and cash equivalents	25	25,141,890	21,739,800	24,966,831	21,924,898
Placements with banks	26	3,292,733	3,182,377	8,506,255	9,670,125
Balances with Central Bank of Sri Lanka	27	33,907,057	38,610,940	33,907,057	38,610,940
Reverse repurchase agreements	28	90,094	-	1,168,764	772,002
Derivative financial instruments	29	4,507,576	615,357	4,507,576	615,357
Financial assets recognised through profit or loss - measured at fair value	30	100,342	120,486	264,420	266,538
Financial assets at amortised cost - loans and advances	31	749,048,820	639,102,061	770,263,000	655,612,938
Financial assets at amortised cost - debt and other instruments / Financial investments - loans and receivables	32	160,145,680	122,199,048	165,821,983	125,031,671
Financial assets measured at fair value through other comprehensive income / Financial investments - available for sale	33	69,436,989	95,403,820	76,005,258	101,742,985
Financial investments - held to maturity	34	-	-	-	1,565,603
Investment in joint venture	35	755,000	755,000	2,027,201	1,689,263
Investment in subsidiaries	36	3,017,285	3,017,285	-	-
Investment properties	37	325,818	327,464	1,107,472	1,146,564
Property, plant and equipment	38	21,304,370	17,905,320	42,417,126	34,635,034
Intangible assets and goodwill	39	905,653	815,381	1,377,864	1,237,829
Other assets	40	14,509,951	11,083,242	16,273,512	13,038,222
Total assets		1,086,489,258	954,877,581	1,148,614,319	1,007,559,969
LIABILITIES					
Due to banks	41	77,492,582	62,463,497	77,976,010	62,464,391
Derivative financial instruments	29	2,519,172	1,305,900	2,519,172	1,305,900
Securities sold under repurchase agreements	42	16,678,946	5,064,360	16,678,946	5,064,360
Financial liabilities at amortised cost - due to depositors	43	799,975,357	701,519,297	818,041,962	718,770,051
Dividends payable	44	994,812	975,371	1,009,468	986,880
Financial liabilities at amortised cost - other borrowings	45	24,894,155	27,258,006	24,894,155	27,258,006
Debt securities issued	46	4,487,763	4,540,259	5,030,000	5,035,958
Current tax liabilities	48	9,184,814	3,974,624	9,559,852	4,066,087
Deferred tax liabilities	49	1,808,898	5,082,636	5,831,673	7,309,283
Insurance provision - life	50	-	-	12,256,686	10,915,858
Insurance provision - general	51	-	-	2,525,095	2,384,908
Other provisions		3,559,925	3,015,875	4,081,659	3,416,332
Other liabilities	52	6,908,911	5,720,896	8,944,789	7,359,236
Subordinated term debts	47	22,229,951	25,809,261	21,930,246	25,564,596
Total liabilities		970,735,286	846,729,982	1,011,279,713	881,901,846
EQUITY					
Stated capital	54	32,338,026	31,409,119	32,338,026	31,409,119
Statutory reserve fund	55	6,260,000	5,460,000	6,260,000	5,460,000
Retained earnings	56	15,728,513	15,193,585	20,181,416	18,082,284
Other reserves	57	61,427,433	56,084,895	73,881,954	67,058,017
Total shareholders' equity		115,753,972	108,147,599	132,661,396	122,009,420
Non-controlling interests	58	-	-	4,673,210	3,648,703
Total equity		115,753,972	108,147,599	137,334,606	125,658,123
Total equity and liabilities		1,086,489,258	954,877,581	1,148,614,319	1,007,559,969
Contingent liabilities and commitments	59	763,214,236	598,364,726	763,214,236	598,364,726
Net assets value per share (Rs)	63	234.96	219.64	269.28	247.79

The notes to the financial statements from pages 145 to 304 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
Chief Financial Officer

The Board of Directors is responsible for these financial statements.

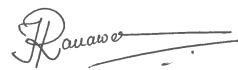
Approved and signed for and on behalf of the Board.



Jonathan Alles
Managing Director / Chief Executive Officer



Dinesh Weerakkody
Chairman



K A L Thushari Ranaweera (Mrs)
Deputy General Manager (Legal) / Company Secretary

20th February 2019
Colombo

Statement of Changes in Equity

Bank	Stated Capital		Other Reserves					Retained Earnings	Total	
	Voting Shares	Non-Voting Shares	Statutory Reserve	Capital Reserve	Available-for-Sale Reserve	Fair value Reserve	General Reserve			ESOP Reserve
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	
Balance as at 1st January 2017	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
Total comprehensive income for the year										
Net profit for the year 2017	-	-	-	-	-	-	-	-	16,466,790	16,466,790
Other comprehensive income, net of tax	-	-	-	81,059	2,464,910	-	-	-	(284,960)	2,261,009
Total comprehensive income for the year	-	-	-	81,059	2,464,910	-	-	-	16,181,830	18,727,799
Transactions with equity holders, recognised directly in equity										
Contributions by and distributions to equity holders										
Dividends to equity holders										
Final dividend 2016 - Cash	-	-	-	-	-	-	-	-	(1,451,296)	(1,451,296)
Final dividend 2016 - Scrip	1,044,073	262,093	-	-	-	-	-	-	(1,451,296)	(145,130)
Interim dividend 2017 - Cash	-	-	-	-	-	-	-	-	(732,745)	(732,745)
Proceeds from rights issue	12,326,592	2,218,619	-	-	-	-	-	-	-	14,545,211
Issue of shares under ESOP	143,110	20,568	-	-	-	-	-	-	-	163,678
Total contributions by and distributions to equity holders	13,513,775	2,501,280	-	-	-	-	-	-	(3,635,337)	12,379,718
Transfer of unclaimed dividends	-	-	-	-	-	-	-	-	22,856	22,856
Transfers during the year 2017	47,516	6,390	900,000	-	-	-	6,000,000	(53,906)	(6,900,000)	-
Balance as at 31st December 2017	25,900,025	5,509,094	5,460,000	8,725,542	4,166,167	-	43,100,000	93,186	15,193,585	108,147,599

Statement of Changes in Equity

Bank	Stated Capital		Other Reserves					Retained Earnings	Total	
	Voting Shares	Non-Voting Shares	Statutory Reserve	Capital Reserve	Available-for-Sale Reserve	Fair value Reserve	General Reserve			ESOP Reserve
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	
Balance as at 1st January 2018	25,900,025	5,509,094	5,460,000	8,725,542	4,166,167	-	43,100,000	93,186	15,193,585	108,147,599
Day 1 impact from the application of SLFRS 9	-	-	-	-	(4,166,167)	4,035,701	-	-	(4,042,519)	(4,172,985)
Restated balance as at 1st January 2018	25,900,025	5,509,094	5,460,000	8,725,542	-	4,035,701	43,100,000	93,186	11,151,066	103,974,614
Total comprehensive income for the year										
Net profit for the year 2018	-	-	-	-	-	-	-	-	15,518,203	15,518,203
Other comprehensive income, net of tax	-	-	-	2,065,452	-	(2,499,262)	-	-	(100,911)	(534,721)
Total comprehensive income for the year	-	-	-	2,065,452	-	(2,499,262)	-	-	15,417,292	14,983,482
Transactions with equity holders, recognised directly in equity										
Contributions by and distributions to equity holders										
Dividends to equity holders	-	-	-	-	-	-	-	-	(2,442,768)	(2,442,768)
Interim dividend 2017 - Cash	-	-	-	-	-	-	-	-	(977,592)	(977,592)
Final dividend 2017 - Scrip	706,515	173,318	-	-	-	-	-	-	(738,976)	(738,976)
Interim dividend 2018 - Cash	-	-	-	-	-	-	-	-	-	-
Issue of shares under ESOP	31,442	4,708	-	-	-	-	-	-	-	36,150
Total contributions by and distributions to equity holders	737,957	178,026	-	-	-	-	-	-	(4,159,336)	(3,243,353)
Transfer of unclaimed dividends	-	-	-	-	-	-	-	-	39,229	39,229
Transfers during the year 2018	11,478	1,446	800,000	-	-	-	6,000,000	(93,186)	(6,719,738)	-
Balance as at 31st December 2018	26,649,460	5,689,566	6,260,000	10,790,994	-	1,536,439	49,100,000	-	15,728,513	115,753,972

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	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	
Balance as at 1st January 2017	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
Total comprehensive income for the year											
Net profit for the year 2017	-	-	-	-	-	-	-	-	15,946,989	794,407	16,741,396
Other comprehensive income, net of tax	-	-	-	(338,076)	2,466,196	-	-	-	(290,818)	32,734	1,870,036
Total comprehensive income for the year	-	-	-	(338,076)	2,466,196	-	-	-	15,656,171	827,141	18,611,432
Transactions with equity holders, recognised directly in equity Contributions by and distributions to equity holders											
Dividends to equity holders											
Final dividend 2016 - Cash	-	-	-	-	-	-	-	-	(1,451,296)	(199,461)	(1,650,757)
Final dividend 2016 - Scrip	1,044,073	262,093	-	-	-	-	-	-	(1,451,296)	-	(145,130)
Interim dividend 2017 - Cash	-	-	-	-	-	-	-	-	(732,745)	-	(732,745)
Proceeds from rights issue	12,326,592	2,218,619	-	-	-	-	-	-	-	-	14,545,211
Issue of shares under ESOP	143,110	20,568	-	-	-	-	-	-	-	-	163,678
Total contributions by and distributions to equity holders	13,513,775	2,501,280	-	-	-	-	-	-	(3,635,337)	(199,461)	12,180,257
Transfer to life policy holder reserve fund	-	-	-	-	-	-	414,402	-	-	-	414,402
Deemed disposal gain through joint venture	-	-	-	-	-	-	-	-	117,478	-	117,478
Transfer of unclaimed dividends	-	-	-	-	-	-	-	-	22,856	-	22,856
Transfers during the year 2017	47,516	6,390	900,000	-	-	6,000,000	-	(53,906)	(6,900,000)	-	-
Balance as at 31st December 2017	25,900,025	5,509,094	5,460,000	19,433,829	4,207,731	43,100,000	223,271	93,186	18,082,284	3,648,703	125,658,123

Statement of Changes in Equity

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	Fair value Reserve	Life Policy Holder Reserve Fund	Restricted Regulatory Reserve	ESOP Reserve	Exchange Equalization 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	Rs 000	Rs 000	
Balance as at 1st January 2018	25,900,025	5,509,094	5,460,000	19,433,829	4,207,731	43,100,000	-	223,271	-	93,186	-	18,082,284	3,648,703	125,658,123
Day 1 impact from the application of SLFRS 9	-	-	-	-	(4,207,731)	-	4,058,756	(4,507)	-	-	-	(4,225,558)	(274,989)	(4,654,029)
Restated balance as at 1st January 2018	25,900,025	5,509,094	5,460,000	19,433,829	-	43,100,000	4,058,756	218,764	-	93,186	-	13,856,726	3,373,714	121,004,094
Total comprehensive income for the year														
Net profit for the year 2018	-	-	-	-	-	-	-	-	381,156	-	-	17,254,618	1,513,688	19,149,462
Other comprehensive income, net of tax	-	-	-	3,560,681	-	(2,521,033)	-	-	-	-	66,368	(90,611)	(4,678)	1,010,727
Total comprehensive income for the year	-	-	-	3,560,681	-	(2,521,033)	-	-	381,156	-	66,368	17,164,007	1,509,010	20,160,189
Transactions with equity holders, recognised directly in equity														
Contributions by and distributions to equity holders														
Dividends to equity holders	-	-	-	-	-	-	-	-	-	-	-	(2,442,768)	(209,514)	(2,652,282)
Interim dividend 2017 - Cash	-	-	-	-	-	-	-	-	-	-	-	(977,592)	-	(97,759)
Final dividend 2017 - Scrip	706,515	173,318	-	-	-	-	-	-	-	-	-	(738,976)	-	(738,976)
Interim dividend 2018 - Cash	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Issue of shares under ESOP	31,442	4,708	-	-	-	-	-	-	-	-	-	-	-	36,150
Total contributions by and distributions to equity holders	737,957	178,026	-	-	-	-	-	-	-	-	-	(4,159,336)	(209,514)	(3,452,867)
Transfer from life policy holder reserve fund	-	-	-	-	-	-	-	(416,567)	-	-	-	-	-	(416,567)
Deemed disposal gain through joint venture	-	-	-	-	-	-	-	-	-	-	-	528	-	528
Transfer of unclaimed dividends	-	-	-	-	-	-	-	-	-	-	-	39,229	-	39,229
Transfers during the year 2018	11,478	1,446	800,000	-	-	6,000,000	-	-	-	(93,186)	-	(6,719,738)	-	-
Balance as at 31st December 2018	26,649,460	5,688,566	6,260,000	22,994,510	-	49,100,000	1,537,723	(197,803)	381,156	-	66,368	20,181,416	4,673,210	137,334,606

The notes to the financial statements from pages 145 to 304 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 of 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	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Cash flows from operating activities				
Interest receipts	105,939,151	95,032,757	114,385,642	102,642,179
Interest payments	(62,689,239)	(57,225,691)	(64,957,879)	(54,672,229)
Net commission receipts	9,330,648	8,096,677	10,087,205	8,983,610
Trading income	2,989,088	547,165	2,986,670	530,850
Payments to employees	(9,171,330)	(8,427,884)	(11,379,438)	(10,224,168)
VAT & NBT on financial services	(6,244,330)	(5,198,271)	(6,590,515)	(5,613,721)
Receipts from other operating activities	1,935,073	3,217,536	9,861,573	5,753,404
Payments on other operating activities	(10,510,706)	(9,293,621)	(16,567,045)	(13,473,261)
Operating profit before change in operating assets & liabilities [Note (a)]	31,578,355	26,748,668	37,826,213	33,926,664
(Increase)/decrease in operating assets				
Balances with Central Bank of Sri Lanka	4,703,883	(4,833,326)	4,703,883	(4,833,326)
Financial assets at amortised cost - loans & advances	(121,270,426)	(58,931,158)	(128,173,581)	(62,659,442)
Reverse repurchase agreements	(90,000)	4,301,421	(396,668)	4,167,210
Other assets	(5,048,453)	(1,383,507)	(4,874,360)	(1,765,867)
	(121,704,996)	(60,846,570)	(128,740,726)	(65,091,425)
(Increase) / decrease in operating liabilities				
Financial liabilities at amortised cost - due to depositors	96,961,771	74,318,613	97,766,339	79,519,452
Financial liabilities at amortised cost - due to debt securities holders	-	(158,720)	-	(158,720)
Financial liabilities at amortised cost - due to other borrowers	13,069,681	(7,196,366)	13,552,214	(7,231,063)
Financial liabilities at amortised cost - Securities Sold under repurchase agreements	11,626,013	(8,106,159)	11,626,013	(8,106,159)
Other liabilities	1,108,990	28,303	2,529,775	(66,003)
	122,766,455	58,885,671	125,474,341	63,957,507
Net cash generated from operating activities before income tax	32,639,814	24,787,769	34,559,828	32,792,746
Income tax paid	(4,305,953)	(5,897,548)	(4,871,157)	(6,673,342)
Net cash from operating activities	28,333,861	18,890,221	29,688,671	26,119,404
Cash flows from investing activities				
Purchase of property, plant & equipment	(1,553,961)	(1,715,088)	(1,708,263)	(1,888,965)
Proceeds from the sale of property, plant & equipment	4,803	2,600	8,171	23,801
Net proceeds from sale, maturity and purchase of financial investments	(16,147,250)	(24,124,865)	(18,392,639)	(25,154,184)
Net purchase of intangible assets	(382,545)	(281,739)	(497,025)	(367,328)
Improvements to investment properties	-	-	-	(39,942)
Proceeds from deemed disposal of subsidiary company by joint venture	-	-	-	117,478
Dividend Received from joint venture	33,220	33,220	33,220	33,220
Dividends received from investment in subsidiaries and associates	221,095	1,790,871	-	-
Dividends received from other investments	187,905	197,937	192,639	206,706
Net cash used in investing activities	(17,636,733)	(24,097,064)	(20,363,897)	(27,069,214)

Statement of Cash Flows

For the year ended 31st December	Bank		Group	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Cash flows from financing activities				
Net proceeds from the issue of ordinary share capital	36,151	14,702,544	36,151	14,702,544
Repayment of subordinated debt	(4,000,000)	(500,000)	(4,055,661)	(490,500)
Dividend paid to non controlling interest	-	-	(206,368)	(196,341)
Dividend paid to shareholders of the parent company	(3,220,833)	(2,338,018)	(3,220,833)	(2,338,018)
Net cash (used in) / from financing activities	(7,184,682)	11,864,526	(7,446,711)	11,677,685
Net (increase) / decrease in cash & cash equivalents	3,512,446	6,657,683	1,878,063	10,727,875
Cash and cash equivalents at the beginning of the year	24,922,177	18,264,494	31,595,023	20,867,148
Cash and cash equivalents at the end of the year	28,434,623	24,922,177	33,473,086	31,595,023

Note [a] - Reconciliation of operating profit before changes in operating assets and liabilities

Profit before income tax	22,951,500	22,050,211	26,466,304	23,103,012
Amortisation of intangible assets	292,274	256,008	356,990	309,768
Amortisation of leasehold property	101,097	95,002	101,097	95,002
Accrual for interest payable	1,238,920	3,549,944	1,367,867	3,762,635
Accrual for interest receivable	(2,899,712)	(862,415)	(2,832,017)	(785,890)
Accrual for other payables	1,164,105	388,953	1,345,617	715,846
Accrual for other receivable	838,026	479,882	831,889	479,882
Depreciation of investment property	1,646	1,616	39,107	22,937
Depreciation of property, plant and equipment	959,745	776,176	1,329,274	1,129,136
Share issue expenses	-	6,346	-	6,346
Dividend income	(472,284)	(2,052,535)	(222,500)	(237,213)
Gain/(loss) on FCBU revaluation	(1,585,822)	(44,207)	(1,585,822)	(44,207)
Gain on disposal of property, plant and equipment	(3,040)	(7,800)	(3,407)	(14,178)
Impairment charge for loans and other losses	9,292,421	3,035,468	9,784,052	3,926,149
Increase in insurance contract liabilities - Life	-	-	1,721,984	2,168,002
Movement in general insurance reserve fund	-	-	140,187	463,341
Change in Contract Liability due to Transfer of one - off surplus	-	-	(381,156)	-
Net capital gain / (loss) from financial investments - other comprehensive income	-	-	(72,150)	(30,632)
Net capital gain / (loss) from financial investments - fair value through profit or loss	(727)	(6,152)	(2,033)	(8,048)
Net gain/(loss) from marked to market valuation on financial investments - fair value through profit or loss	7,984	(7,106)	51,800	(16,391)
Notional tax credit and WHT credit	(307,778)	(910,723)	(307,778)	(943,217)
Share of associate profits of associate and joint venture	-	-	(303,092)	(175,616)
	31,578,355	26,748,668	37,826,213	33,926,664

Note [b] - Cash and cash equivalents at the end of the year

Cash and cash equivalents [Note 25]	25,141,890	21,739,800	24,966,831	21,924,898
Placements with banks [Note 26]	3,292,733	3,182,377	8,506,255	9,670,125
	28,434,623	24,922,177	33,473,086	31,595,023

* Comparative figures reported in Bank and Group cash flows in 2017 were reclassified to be in line with the format issued by Central Bank of Sri Lanka (CBSL)

The notes to the financial statements from pages 145 to 304 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 2018 was 4,781 (2017 - 4,348).

1.2 Consolidated Financial Statements

The consolidated financial statements of the Group for the year ended 31st December 2018 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 subsidiary, HNB Finance Ltd 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 deposit acceptance, 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	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 Finance Ltd (Formerly known as HNB Grameen Finance Ltd)	Operating as a finance company and providing financial services
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 20th February 2019.

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.

Notes to the Financial Statements

Item	Basis of measurement
Derivative financial instruments	Fair value
Financial assets recognised through profit or loss	Fair value
Financial assets measured at fair value through other comprehensive income	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 on the date of revaluation
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 - "Presentation of Financial Statements".

2.2 Changes in Accounting Policies and Disclosures

2.2.1 Sri Lanka Accounting Standard SLFRS 9 – "Financial Instruments"

The Bank has applied Sri Lanka Accounting Standard SLFRS 9 - "Financial Instruments" (SLFRS 9) effective for annual periods beginning on or after 1st January 2018, for the first time when preparing these financial statements. This standard replaced Sri Lanka Accounting Standard LKAS 39 – "Financial Instruments: Recognition and Measurement" (LKAS 39).

SLFRS 9 brought about significant changes to the classification and measurement of financial instruments and impairment assessment pertaining to such instruments. These changes are discussed in Notes 2.2.1 (a) and 2.2.1 (b) to the financial statements.

2.2.1(a) Changes to the impairment calculation

The adoption of SLFRS 9 has fundamentally changed the Bank's accounting for loan loss impairment by replacing incurred loss approach as per LKAS 39 with a forward-looking expected credit loss (ECL) approach. SLFRS 9 requires the Bank to record an allowance for ECLs for all loans and other debt financial assets not held at FVPL, together with loan commitments and financial guarantee contracts. The allowance is based on the ECLs associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since origination. If the financial asset meets the definition of purchased or originated credit impaired (POCI), the allowance is based on the change in the ECLs over the life of the asset.

Details of the Bank's impairment method are disclosed in Note 31 (b) to the financial statements.

2.2.1(b) Changes to classification and measurement

To determine their classification and measurement category, SLFRS 9 requires 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 of financial assets (fair value through profit or loss (FVPL), available for sale (AFS), held-to-maturity and loans and receivables - amortised cost) have been replaced by:

- Debt instruments at amortised cost
- Debt instruments at fair value through other comprehensive income (FVOCI), with gains or losses recycled to profit or loss on derecognition
- Equity instruments at FVOCI, with no recycling of gains or losses to profit or loss on derecognition
- Financial assets FVPL

The accounting for financial liabilities remains largely the same as it was under LKAS 39, except for the treatment of gains or losses arising from an entity's own credit risk relating to liabilities designated at FVPL. Such movements are presented in OCI with no subsequent reclassification to the statement of profit or loss.

The adoption of classification principles of SLFRS 9 as at 1st January 2018 did not have a material impact on the Group.

The Bank's classification of its financial assets and liabilities is explained in Note 3.3 to the financial statements.

2.2.2 Sri Lanka Accounting Standard SLFRS 7R – “Financial Instruments: Disclosures”

To reflect the differences between SLFRS 9 and LKAS 39, SLFRS 7 “Financial Instruments: Disclosures” was updated and the Bank has adopted it, together with SLFRS 9, for the year beginning on 1st January 2018. Changes include transition disclosures as shown in Note 7 to the financial statements, detailed qualitative and quantitative information about the ECL calculations such as the assumptions and inputs used are set out in Note 31 (c) to the financial statements.

Reconciliations from opening to closing ECL allowances are presented in Notes 31 (e) (i) and 32 (b) to the financial statements.

2.2.3 Sri Lanka Accounting Standard SLFRS 15 – “Revenue from Contracts with Customers”

The Bank has applied SLFRS 15 for the first time in these financial statements, which is effective for annual periods beginning on or after 1st January 2018. Adoption of this standard did not impact the timing or amount of fee and commission income from contracts with customers and the related assets and liabilities recognised by the Bank for the year beginning 1st January 2018.

2.2.4 Application of Accounting Policies

Apart from the changes mentioned above, the Bank has consistently applied the accounting policies for all periods presented in the financial statements. The bank has not early adopted any other standard, interpretation or amendment that has been issued but not yet effective.

2.2.5 Comparative Information

The comparative information has been reclassified where ever necessary to conform with the current year's classification in order to provide a better presentation.

However, the Bank has not restated comparative information for 2017 in respect of financial instruments in the scope of SLFRS 9. Therefore, the comparative information of such instruments for 2017 is reported under LKAS 39 and is not comparable to the information presented for 2018. Differences arising from the adoption of SLFRS 9 have been recognised directly in retained earnings as of 1st January 2018 and are disclosed in Note 7 to the financial statements.

2.3 Significant Accounting Judgements, Estimates and Assumptions

The preparation of the Bank's consolidated financial statements requires management to make judgements, estimates and assumptions that affect the reported amount 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. In the process of applying the Bank's accounting policies, management has made the following judgements and assumptions concerning the future and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year. Existing circumstances and assumptions about future developments may change due to circumstances beyond the Bank's control and are reflected in the assumptions if and when they occur. Items with the most significant effect on the amounts recognised in the consolidated financial statements with substantial management judgement and/or estimates are collated below with respect to judgement/ estimates involved.

The areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements of the Group are as follows.

2.3.1 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

2.3.2 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

2.3.3 Impairment Losses on Loans and Advances

Individual impairment assessment

The Group reviewed 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 was required in the estimation of the amount and timing of future cash flows when determining the impairment loss. These estimates were 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 expected loss events.

Applicable prior to 1st January 2018

Prior to 1st January 2018 provisions were made for incurred loss events for which there is an objective evidence, but the effect 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 GDP growth, unemployment, inflation, interest rates, exchange rates, effect of regulatory changes), and trends in non-performing loans.

Applicable from 1st January 2018

The measurement of impairment losses under SLFRS 9 requires judgement across all categories of financial assets, in particular, the estimation of the amount and timing of future cash flows and collateral values when determining impairment losses and the assessment of a significant increase in credit risk. These estimates are driven by a number of factors, changes in which can result in different levels of impairment allowances.

The Bank's ECL calculations are outputs of complex models with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies. Elements of the ECL models that are considered for accounting judgements and estimates include:

- The Bank's criteria for assessing if there has been a significant increase in credit risk as a result of which allowances for financial assets should be measured on a LTECL basis and the qualitative assessment
- The segmentation of financial assets when their ECL is assessed on a collective basis
- Development of ECL models, including the various formulas and the choice of inputs
- Determination of associations between macro economic scenarios and, economic inputs, such as unemployment levels, GDP growth, inflation interest rates, exchange rates, and the effect on PDs, EADs and LGDs
- Selection of forward-looking macro economic scenarios and their probability weightings, to derive at the economic inputs into the ECL models

The Bank's policy is to regularly review its models in the context of actual loss experience and adjust when necessary.

The impairment loss on loans and advances is disclosed in Note 31 (e) (i) to the financial statements.

2.3.4 Impairment of Available for Sale Investments - Applicable Prior to 1st January 2018

Debt securities

The Group reviewed debt securities classified as available-for-sale investments at each reporting date to assess whether those are impaired. This required application of similar judgements as applied to individual assessment of loans and advances.

Equity investments

The Group also recorded impairment charges on available-for-sale equity investments when there had been a significant or prolonged decline in the fair value below the cost. The determination of what is 'significant' or 'prolonged' required judgement. In making this judgement, the Group evaluated, among other factors, historical share price movements, duration and extent to which the fair value of an investment is less than its cost.

2.3.5 Impairment of Financial Assets carried at Amortised Cost - Applicable from 1st January 2018 onwards

The Group assesses impairment for financial assets carried at amortised cost in line with the same principles used for assessment for impairment of loans and receivables.

The impairment loss on financial assets carried at amortised cost is disclosed in Note 32 (b) to the financial statements.

2.3.6 Impairment for Financial Guarantees, Letters of Credit and Undrawn Loan Commitments - Applicable from 1st January 2018

The Group assesses impairment for off balance sheet exposures such as financial guarantees letter of credit

and undrawn commitments inline with ECL principles as detailed in 2.3.3.

Impairment loss on above exposures is disclosed in Note 52 (a) to the financial statements.

2.3.7 Impairment of Investments in Subsidiaries

The Bank follows the guidance of Sri Lanka Accounting Standard - LKAS 36 on "Impairment of Assets" in determining whether an investment or a financial asset is impaired. This determination requires significant judgement. The Bank 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.

2.3.8 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 2018 is Rs 122.9 Mn (2017 :Rs 122.9 Mn).

The details on assessment of goodwill impairment is given in Note 39 (a) (i) to the financial statements..

2.3.9 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.

2.3.10 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 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 (a) vii to the financial statements.

2.3.11 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 the fair value of freehold land and buildings in terms of Sri Lanka Accounting Standard - SLFRS 13 on "Fair Value Measurement".

The methods used to determine the fair value of the freehold land and buildings, are further explained in Note 38 to the financial statements.

2.3.12 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. Management exercises judgement in the estimation of these values, rates, methods and hence those are subject to uncertainty.

2.3.13 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 judgement 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.

2.3.14 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

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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.

2.3.15 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.

2.3.16 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.

2.3.17 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 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.

2.3.18 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 those.

2.3.19 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 those are remote.

Details on commitments and contingencies are given in Note 59 to the financial statements.

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 the 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 acquired 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 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 as foreign exchange gain/ (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 with the exception of loans and advances to customers and balances due to customers 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

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established by regulation or convention in the market place. Loans and advances to customers are recognised when funds are transferred to the customers' accounts. The bank recognises balances due to customers when funds are transferred to the bank.

3.3.2 Recognition and Initial Measurement of Financial Instruments

The classification of financial instruments at initial recognition depends on their contractual terms and the business model for managing instruments as described in Note 3.4 to the financial statements.

All financial instruments are measured initially at their fair value, except in the case of financial assets and financial liabilities recorded at fair value through profit or loss. Transaction costs are added to, or subtracted from, this amount.

Trade receivables are measured at transaction price. When the fair value of financial instruments at initial recognition differs from the transaction price, the bank accounts for the 'Day 1' profit or loss, as described below.

3.3.2 (a) "Day 1" Profit or Loss

When the transaction price of the instrument differs from the fair value at origination and the fair value is based on a valuation technique using only inputs observable in market transactions, the Bank recognises the difference between the transaction price and fair value in net trading income. In those cases where fair value is determined based on models for which some of the inputs are not observable, the difference between the transaction price and the fair value deferred is only recognised in the statement of profit or loss when the inputs become observable, or when the instrument is de-recognised.

3.3.3 Measurement Categories of Financial Assets and Liabilities

From 1st January 2018, the Bank classifies all of its financial assets based on the business model for managing the assets and the asset's contractual terms, measured at either:

- Amortised cost, as explained in Note 31 to the financial statements.
- Fair Value through Other Comprehensive Income (FVOCI), as explained in Note 33 to the financial statements.
- Fair Value through Profit or Loss (FVPL) as explained in Note 30 to the financial statements.

The Bank classifies and measures its derivative and trading portfolio at FVPL as explained in Notes 29 and 30. The Bank may designate financial instruments at FVPL, if doing so eliminates or significantly reduces measurement or recognition inconsistencies, as explained in Note 30.

Before 1st January 2018, the Bank classified its financial assets as loans and receivables (amortised cost), FVPL, available-for-sale or held-to-maturity, as explained in Notes 32, 30 and 34.

Financial liabilities, other than loan commitments and financial guarantees, are measured at amortised cost or at FVPL. The financial liabilities are measured at FVPL when they are either derivative instruments, held for trading or the fair value designation is applied, as explained in Note 3.4.5 to the financial statements.

3.4 Financial Assets and Liabilities

3.4.1 Due from Banks, Loans and Advances to Customers, Financial Assets at Amortised Cost

Before 1st January 2018, due from banks and loans and advances to customers, included non-derivative financial assets with fixed or determinable payments that were not quoted in an active market, other than those:

- That the Bank intended to sell immediately or in the near term
- That the Bank, upon initial recognition, designated as FVPL or as available-for-sale
- For which the Bank may not recover substantially all of its initial investment, other than because of credit deterioration, which were designated as available-for-sale.

From 1st January 2018, the Bank only measures due from banks, loans and advances to customers and other financial assets at amortised cost if both of the following conditions are met:

- The financial asset is held within a business model with the objective to hold financial assets in order to collect contractual cash flows
- The contractual terms of the financial asset give rise on specified dates to cash flows that are Solely Payments of Principal and Interest (SPPI) on the principal amount outstanding.

The details of these conditions are outlined below.

3.4.2 Business Model Assessment

The Bank determines its business model at the level that best reflects how it manages groups of financial assets to achieve its business objective.

The Bank's business model is not assessed on an instrument-by-instrument basis, but at a higher level of aggregated portfolios and is based on observable factors such as:

- How the performance of the business model and the financial assets held within that business model are

evaluated and reported to the entity's key management personnel"

- The risks that affect the performance of the business model (and the financial assets held within that business model) and, in particular, the way those risks are managed
- How managers of the business are compensated (for example, whether the compensation is based on the fair value of the assets managed or on the contractual cash flows collected)
- The expected frequency, value and timing of sales are also important aspects of the Bank's assessment

The business model assessment is based on reasonably expected scenarios without taking into account "worse case" or "stress case" scenarios. If cash flows after initial recognition are realised in a way that is different from the Bank's original expectations, the Bank does not change the classification of the remaining financial assets held in that business model, but incorporates such information when assessing newly originated or newly purchased financial assets going forward.

3.4.3 The SPPI Test

As a second step of its classification process the Bank assesses the contractual terms of the financial assets to identify whether they meet the SPPI test.

"Principal" for the purpose of this test is defined as the fair value of the financial asset at initial recognition and may change over the life of the financial asset (for example, if there are repayments of principal or amortisation of the premium/discount).

The most significant elements of interest within a lending arrangement are typically the consideration for the time value of money and credit risk. To make the SPPI assessment, the Bank applies judgement and considers relevant factors such as the currency in which the financial asset is denominated, and the period for which the interest rate is set.

In contrast, contractual terms that introduce a more than "de minimis" exposure to risks or volatility in the contractual cash flows that are unrelated to a basic lending arrangement do not give rise to contractual cash flows that are solely payments of principal and interest on the amount outstanding. In such cases, the financial asset is required to be measured at FVPL.

3.4.4 Financial Liabilities at Fair Value Through Profit or Loss

Financial liabilities in this category are those that are not held for trading and have been either designated by the Bank upon initial recognition or are mandatorily required to be measured at fair value under SLFRS 9. Bank only designates an instrument at FVPL upon initial

recognition when one of the following criteria are met. Such designation is determined on an instrument-by-instrument basis:

- The designation eliminates, or significantly reduces, the inconsistent treatment that would otherwise arise from measuring the liabilities or recognising gains or losses on them on a different basis

Or

- The liabilities are part of a group of financial liabilities, which are managed and their performances are evaluated on a fair value basis, in accordance with a documented risk management or investment strategy

Or

- The liabilities containing one or more embedded derivatives, unless they do not significantly modify the cash flows that would otherwise be required by the contract, or it is clear with little or no analysis when a similar instrument is first considered that separation of the embedded derivative(s) is prohibited

Financial liabilities at FVPL are recorded in the statement of financial position at fair value.

Changes in fair value are recorded in profit and loss with the exception of movements in fair value of liabilities designated at FVPL due to changes in the Bank's own credit risk. Such changes in fair value are recorded in the own credit reserve through OCI and do not get recycled to the profit or loss. Interest earned or incurred on instruments designated at FVPL is accrued in interest income or interest expense, respectively, using the EIR, taking into account any discount/ premium and qualifying transaction costs being an integral part of the instrument.

3.4.5 Financial Guarantees, Letters of Credit and Undrawn Loan Commitments

The Bank issues financial guarantees, letters of credit and loan commitments.

Financial guarantees are initially recognised in the financial statements (within Provisions) 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

- under LKAS 39 – the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee, or
- under SLFRS 9 – an ECL provision as set out in Note 52 (a) to the financial statements..

The premium received is recognised in the statement of profit or loss in net fees and commission income on a straight line basis over the life of the guarantee.

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Undrawn loan commitments and letters of credits are commitments under which, over the duration of the commitment, the Bank is required to provide a loan with pre-specified terms to the customer. Similar to financial guarantee contracts, under LKAS 39, a provision was made if they were an onerous contract but, from 1st January 2018, these contracts are in the scope of the ECL requirements.

The nominal contractual value of financial guarantees, letters of credit and undrawn loan commitments, where the loan agreed to be provided is on market terms, are not recorded on in the statement of financial position.

The nominal values of these instruments together with the corresponding ECLs are disclosed in Note 52 (a) to the financial statements.

3.4.6 Reclassifications of Financial Instruments

From 1st January 2018, with the adoption of SLFRS 9, the Bank reclassifies its financial assets subsequent to the initial recognition when an only when the business model for managing such financial assets is changed. Such reclassifications is applied prospectively from the reclassification date. Financial liabilities are never reclassified.

If a financial asset is reclassified out of the amortised cost measurement category and into the fair value through profit or loss measurement category, its fair value is measured at the reclassification date. Any gain or loss arising from a difference between the previous amortised cost of the financial asset and fair value is recognised in statement of profit or loss.

If the reclassification takes place out of the fair value through profit or loss category into the amortised cost measurement category, its fair value at the reclassification date becomes the new gross carrying amount.

If the reclassification takes place out of the amortised cost measurement category and into the fair value through other comprehensive income measurement category, fair value is measured at the reclassification date. Any gain or loss arising from a difference between the previous amortised cost of the financial asset and fair value is recognised in other comprehensive income. The effective interest rate and the measurement of expected credit losses are not adjusted as a result of the reclassification.

The Bank did not reclassify any of its financial assets or liabilities in 2017 or in 2018.

3.4.7 De-recognition of Financial Instruments

3.4.7(a) Derecognition due to substantial modification of terms and conditions

The Bank derecognises a financial asset, such as a loan to a customer, when the terms and conditions have been renegotiated to the extent that, substantially, it becomes a

new loan, with the difference recognised as a derecognition gain or loss, to the extent that an impairment loss has not already been recorded. The newly recognised loans are classified as Stage 1 for ECL measurement purposes, unless the new loan is deemed to be a Purchased or Originated Credit Impaired (POCI) asset.

When assessing whether or not to derecognise a loan to a customer, amongst others, the Bank considers the following factors:

- Change in currency of the loan
- Introduction of an equity feature
- Change in counterparty
- If the modification is such that the instrument would no longer meet the SPPI criterion

If the modification does not result in cash flows that are substantially different, the modification does not result in derecognition. Based on the change in cash flows discounted at the original EIR, the Bank records a modification gain or loss, to the extent that an impairment loss has not already been recorded.

3.4.7(b) Derecognition other than for substantial modification

3.4.7(b) (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 derecognised when the rights to receive cash flows from the financial asset have expired. The Bank also derecognises the financial asset if it has both transferred the financial asset and the transfer qualifies for derecognition.

The Bank has transferred the financial asset if, and only if, either:

- The Bank has transferred its contractual rights to receive cash flows from the financial asset

Or

- It retains the rights to the cash flows, but has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement

Pass-through arrangements are transactions whereby the Bank retains the contractual rights to receive the cash flows of a financial asset (the 'original asset'), but assumes a contractual obligation to pay those cash flows to one or more entities (the 'eventual recipients'), when all of the following three conditions are met:

- The Bank has no obligation to pay amounts to the eventual recipients unless it has collected equivalent amounts from the original asset, excluding short-term advances with the right to full recovery of the amount lent plus accrued interest at market rates

- The Bank cannot sell or pledge the original asset other than as security to the eventual recipients
- The Bank has to remit any cash flows it collects on behalf of the eventual recipients without material delay.

In addition, the Bank is not entitled to reinvest such cash flows, except for investments in cash or cash equivalents including interest earned, during the period between the collection date and the date of required remittance to the eventual recipients.

A transfer only qualifies for derecognition if either:

- The Bank has transferred substantially all the risks and rewards of the asset

Or

- The Bank has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset

The Bank considers control to be transferred if and only if, the transferee has the practical ability to sell the asset in its entirety to an unrelated third party and is able to exercise that ability unilaterally and without imposing additional restrictions on the transfer

When the Bank has neither transferred nor retained substantially all the risks and rewards and has retained control of the asset, the asset continues to be recognised only to the extent of the Bank's continuing involvement, in which case, the Bank 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 Bank 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 the Bank could be required to pay.

If continuing involvement takes the form of a written or purchased option (or both) on the transferred asset, the continuing involvement is measured at the value the Bank would be required to pay upon repurchase. In the case of a written put option on an asset that is measured at fair value, the extent of the entity's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

3.4.7(b) (ii) Financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged, cancelled or expires. 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 a derecognition 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 statement of profit or loss.

3.5 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.

Notes to the Financial Statements

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.

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 four board sub committees as follows,

- Board Integrated Risk Management Committee (BIRMC)
- Board Audit Committee (BAC)
- Board Credit Committee
- Board Strategic Planning and Investment Committee (BSP & IC)

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 and risk goals. The BCC 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 pertaining to risk management;

- Executive Risk Management and Credit Policy Committee
- Operational Risk Steering Committee
- Asset and Liability 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 identification, 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 Committee (BCC) ensuring consistency with the Bank's business strategy.

Policy decisions and implementation plans are discussed at the ERMCP meeting, chaired by Managing Director/ Chief Executive Officer.

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. The Bank has invested in implementing a state of the art loan origination system to streamline credit assessment and approval work flow.

A suite of internal risk rating models are in place for to assess business entities and customers above threshold of exposures are being internally rated prior to credit assessment. The Bank has currently engaged in a project to validate the existing risk rating model, recalibrate and development of new risk rating models and upgrade the rating platform. 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. Credit administration was moved out of the risk management division's purview during the year to maintain clear lines of defence independence. 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/ risk goals) 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) to the financial statements.

4.3.1 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.

4.3.2 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.

Notes to the Financial Statements

4 FINANCIAL RISK MANAGEMENT (Contd.)

4.3.2 (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.

Bank As at 31st December	2018		2017	
	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	3,292,870	3,292,870	3,182,377	3,182,377
Reverse repurchase agreements	90,094	-	-	-
Derivative financial instruments	4,507,576	4,507,576	615,357	615,357
Financial assets recognised - fair value through profit or loss	100,342	100,342	120,486	120,486
Financial assets at amortised cost - loans and advances (gross)	771,692,625	340,295,895	649,547,067	264,132,296
Financial assets measured at fair value through other comprehensive income/ Financial investments - available for sale	69,436,989	69,436,989	95,403,820	95,403,820
Financial assets at amortised cost - debt and other instruments/Financial investments - loans and receivables	161,430,692	161,430,692	122,199,048	122,199,048
Other assets	466,252	466,252	405,437	405,437
	1,011,017,440	579,530,616	871,473,592	486,058,821
Guarantees, letters of credit and acceptances	190,179,196	185,782,366	170,594,808	168,722,698

Group As at 31st December	2018		2017	
	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	8,506,725	8,506,725	9,670,125	9,670,125
Reverse repurchase agreements	1,168,764	-	772,002	-
Derivative financial instruments	4,507,576	4,507,576	615,357	615,357
Financial assets recognised - fair value through profit or loss	264,419	264,419	266,538	266,538
Financial assets at amortised cost - loans and advances (gross)	794,715,100	353,679,570	666,768,376	276,509,429
Financial assets measured at fair value through other comprehensive income/ Financial investments - available for sale	76,005,258	76,005,258	101,742,985	101,742,985
Financial assets at amortised cost - debt and other instruments/Financial investments - loans and receivables	167,625,146	167,625,146	125,031,671	125,031,671
Other assets	669,871	574,327	1,451,427	1,451,427
	1,053,462,859	611,163,021	906,318,481	515,287,532
Guarantees, letters of credit and acceptances	190,179,196	185,782,366	170,594,808	168,722,698

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 main types of collateral obtained are, as follows:

- For securities lending and reverse repurchase transactions, cash or securities
- For corporate and small business lending, charges over real estate properties, inventory and trade receivables and, in special circumstances, government guarantees
- For retail lending, mortgages over residential properties

The Bank also obtains guarantees from parent companies for loans to their subsidiaries.

Management monitors the market value of collateral and will request additional collateral in accordance with the underlying agreement.

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.

Notes to the Financial Statements

4 FINANCIAL RISK MANAGEMENT (Contd.)

4.3.2 (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.

Bank As at 31st December 2018	Neither Past Due nor Impaired											
	High Grade				Standard Grade				Sub-Standard Grade			
	Stage 1	Stage 2	Stage 3	Exposures not subject to ECL	Stage 1	Stage 2	Stage 3	Exposures not subject to ECL	Stage 1	Stage 2	Stage 3	Exposures not subject to ECL
	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	24,918,299	-	-	-	147,539	-	-	-	76,052	-	-	-
Placements with banks	3,292,870	-	-	-	-	-	-	-	-	-	-	-
Balances with Central Bank of Sri Lanka	33,907,057	-	-	-	-	-	-	-	-	-	-	-
Derivative financial instruments	-	-	-	3,006,286	-	-	-	375,176	-	-	-	976,083
Reverse repurchase agreements	90,094	-	-	-	-	-	-	-	-	-	-	-
Financial assets recognised - through profit or loss												
Equity securities	4,372	-	-	-	2,604	-	-	-	-	-	-	-
Government securities	1,286	-	-	-	-	-	-	-	-	-	-	-
Financial assets at amortised cost - loans and advances (gross)	156,400,674	-	-	-	105,604,994	-	-	-	18,398,915	-	-	-
Financial assets measured at fair value through other comprehensive income												
Government securities	64,818,694	-	-	-	-	-	-	-	-	-	-	-
Equity securities - quoted	3,981,142	-	-	-	-	-	-	-	-	-	-	-
Equity securities - unquoted	-	-	-	-	-	-	-	-	-	-	-	-
Financial assets at amortised cost - debt and other instruments												
Government securities	149,234,396	-	-	-	-	-	-	-	-	-	-	-
Debt securities - quoted	10,221,538	-	-	-	1,395,948	512,918	-	-	-	-	-	-
Other assets	-	-	-	-	-	-	-	-	-	-	-	-
	446,870,422	-	-	3,006,286	107,151,085	512,918	-	375,176	18,474,967	-	-	976,083

Bank As at 31st December 2017	Neither Past Due nor Impaired			
	High Grade	Standard Grade	Sub-Standard Grade	Unrated
	Rs 000	Rs 000	Rs 000	Rs 000
Financial Assets				
Cash and cash equivalents	21,739,800	-	-	-
Placements with banks	2,175,681	1,006,696	-	-
Balances with Central Bank of Sri Lanka	38,610,940	-	-	-
Derivative financial instruments	436,662	157,914	125	20,656
Financial assets recognised through profit or loss				
Equity securities	55,101	9,405	-	55,980
Loans and receivables to customers (gross)	159,803,360	128,325,115	20,376,117	124,089,606
Financial investments - available-for-sale				
Government securities	89,770,656	-	-	-
Equity securities - quoted	4,912,813	-	-	276,300
Equity securities - unquoted	-	-	-	444,051
Financial investments - loans and receivables				
Government securities	108,844,057	-	-	-
Debt securities - quoted	9,317,062	4,037,929	-	-
Other assets	-	-	-	-
	435,666,132	133,537,059	20,376,237	124,886,593

	Unrated				Exposures not Subject to Rating			Past Due but not Impaired			Past Due and Impaired			Individually Impaired Stage 3	Total
	Stage 1	Stage 2	Stage 3	Exposures not subject to ECL	Stage 1	Stage 2	Stage 3	Stage 1	Stage 2	Stage 3	Stage 1	Stage 2	Stage 3		
	Rs 000	Rs 000	Rs 000		Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000		
	-	-	-	-	-	-	-	-	-	-	-	-	-	-	25,141,890
	-	-	-	-	-	-	-	-	-	-	-	-	-	-	3,292,870
	-	-	-	-	-	-	-	-	-	-	-	-	-	-	33,907,057
	-	-	-	150,031	-	-	-	-	-	-	-	-	-	-	4,507,576
	-	-	-	-	-	-	-	-	-	-	-	-	-	-	90,094
	92,080	-	-	-	-	-	-	-	-	-	-	-	-	-	99,056
	-	-	-	-	-	-	-	-	-	-	-	-	-	-	1,286
	158,324,369	-	-	-	19,570,784	-	-	175,923,627	104,854,835	-	-	-	16,204,689	16,409,738	771,692,625
	-	-	-	-	-	-	-	-	-	-	-	-	-	-	64,818,694
	240,000	-	-	-	-	-	-	-	-	-	-	-	-	-	4,221,142
	397,153	-	-	-	-	-	-	-	-	-	-	-	-	-	397,153
	-	-	-	-	-	-	-	-	-	-	-	-	-	-	149,234,396
	-	-	-	-	-	-	-	-	-	-	-	-	-	65,892	12,196,296
	-	-	-	-	466,252	-	-	-	-	-	-	-	-	-	466,252
	159,053,602	-	-	150,031	20,037,036	-	-	175,923,627	104,854,835	-	-	-	16,204,689	16,475,630	1,070,066,387

	Exposures not Subject to Rating	Past Due but not Impaired	Past Due and Impaired	Individually Impaired	Total
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
	-	-	-	-	21,739,800
	-	-	-	-	3,182,377
	-	-	-	-	38,610,940
	-	-	-	-	615,357
	-	-	-	-	120,486
	50,968,145	150,936,342	7,234,335	7,814,047	649,547,067
	-	-	-	-	89,770,656
	-	-	-	-	5,189,113
	-	-	-	-	444,051
	-	-	-	-	108,844,057
	-	-	-	-	13,354,991
	405,437	-	-	-	405,437
	51,373,582	150,936,342	7,234,335	7,814,047	931,824,332

Notes to the Financial Statements

4 FINANCIAL RISK MANAGEMENT (Contd.)

Group

As at 31st December 2018

	Neither Past Due nor Impaired											
	High Grade				Standard Grade				Sub- Standard Grade			
	Stage 1	Stage 2	Stage 3	Exposures not subject to ECL	Stage 1	Stage 2	Stage 3	Exposures not subject to ECL	Stage 1	Stage 2	Stage 3	Exposures not subject to ECL
	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	24,743,240	-	-	-	147,539	-	-	-	76,052	-	-	-
Placements with banks	8,506,725	-	-	-	-	-	-	-	-	-	-	-
Balances with Central Bank of Sri Lanka	33,907,057	-	-	-	-	-	-	-	-	-	-	-
Derivative financial instruments	-	-	-	3,006,286	-	-	-	375,176	-	-	-	976,083
Reverse repurchase agreements	1,168,764	-	-	-	-	-	-	-	-	-	-	-
Financial assets recognised through profit or loss												
Equity securities	107,039	-	-	-	2,604	-	-	-	-	-	-	-
Government securities	17,054	-	-	-	-	-	-	-	-	-	-	-
Financial assets at amortised cost - loans and advances (gross)	153,600,000	-	-	-	105,604,994	-	-	-	18,398,915	-	-	-
Financial assets measured at fair value through other comprehensive income												
Government securities	71,374,533	-	-	-	-	-	-	-	-	-	-	-
Equity securities - quoted	3,981,142	-	-	-	-	-	-	-	-	-	-	-
Equity securities - unquoted	-	-	-	-	-	-	-	-	-	-	-	-
Financial assets at amortised cost - debt and other instruments												
Government securities	151,096,186	-	-	-	-	-	-	-	-	-	-	-
Debt securities - quoted	13,377,445	-	-	-	1,799,612	512,918	-	-	-	-	-	-
Other assets	-	-	-	-	-	-	-	-	-	-	-	-
	461,879,185	-	-	3,006,286	107,554,749	512,918	-	375,176	18,474,967	-	-	976,083

Group

As at 31st December 2017

	Neither Past Due nor Impaired			
	High Grade	Standard Grade	Sub-Standard Grade	Unrated
	Rs 000	Rs 000	Rs 000	Rs 000
Financial Assets				
Cash and cash equivalents	21,924,898	-	-	-
Placements with banks	8,663,429	1,006,696	-	-
Balances with Central Bank of Sri Lanka	38,610,940	-	-	-
Reverse repurchase agreements	772,002	-	-	-
Derivative financial instruments	436,662	157,914	125	20,656
Financial assets recognised through profit or loss				
Equity securities	137,330	9,405	-	119,803
Loans and receivables to customers	159,803,360	127,889,878	20,376,112	138,615,425
Financial investments - available-for-sale				
Government securities	96,019,316	-	-	-
Equity securities - quoted	4,952,726	-	-	301,032
Equity securities - unquoted	-	-	-	456,481
Financial investments - loans and receivables				
Government securities	108,844,057	-	-	-
Debt securities - quoted	11,256,271	4,624,230	-	-
Other loans and receivables	-	-	-	307,113
Other assets	-	-	-	-
	451,420,991	133,688,123	20,376,237	139,820,510

	Unrated			Exposures not Subject to Rating			Past Due but not Impaired			Past Due and Impaired			Individually Impaired Stage 3	Total	
	Stage 1	Stage 2	Stage 3	Exposures not subject to ECL	Stage 1	Stage 2	Stage 3	Stage 1	Stage 2	Stage 3	Stage 1	Stage 2			Stage 3
	Rs 000	Rs 000	Rs 000		Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000			Rs 000
-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	24,966,831
-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	8,506,725
-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	33,907,057
-	-	-	150,031	-	-	-	-	-	-	-	-	-	-	-	4,507,576
-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	1,168,764
-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
137,723	-	-	-	-	-	-	-	-	-	-	-	-	-	-	247,366
-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	17,054
172,833,874	2,792,174	2,780,473	-	19,570,784	-	-	179,888,560	104,854,833	-	1,776,065	-	16,204,689	16,409,738	794,715,100	
-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	71,374,533
240,000	-	-	-	-	-	-	-	-	-	-	-	-	-	-	4,221,142
409,583	-	-	-	-	-	-	-	-	-	-	-	-	-	-	409,583
-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-	-	-	-	-	-	773,092	151,869,278
-	-	-	-	-	-	-	-	-	-	-	-	-	-	65,892	15,755,867
-	-	-	-	669,871	-	-	-	-	-	-	-	-	-	-	669,871
173,621,180	2,792,174	2,780,473	150,031	20,240,655	-	-	179,888,560	104,854,833	-	1,776,065	-	16,204,689	17,248,722	1,112,336,747	

Exposures not Subject to Rating	Past Due but not Impaired	Past Due and Impaired	Individually Impaired	Total
Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
-	-	-	-	21,924,898
-	-	-	-	9,670,125
-	-	-	-	38,610,940
-	-	-	-	772,002
-	-	-	-	615,357
-	-	-	-	266,538
50,968,145	153,357,200	7,455,196	8,303,060	666,768,376
-	-	-	-	96,019,316
-	-	-	13,430	5,267,188
-	-	-	-	456,481
-	-	-	-	108,844,057
-	-	-	-	15,880,501
-	-	-	-	307,113
1,451,427	-	-	-	1,451,427
52,419,572	153,357,200	7,455,196	8,316,490	966,854,319

Notes to the Financial Statements

4 FINANCIAL RISK MANAGEMENT (Contd.)

4.3.2 (c) Age Analysis of Financial Assets that are Past Due but not Impaired

As at 31st December	Bank		Group	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Past due but not impaired				
1-30 days	175,923,627	110,897,015	176,911,532	111,280,682
31-60 days	89,809,536	36,369,846	90,322,574	37,248,739
61-90 days	15,045,299	2,151,494	17,509,287	2,361,006
91-120 days	N/A	671,734	N/A	1,146,571
121-150 days	N/A	437,283	N/A	504,731
151-180 days	N/A	408,968	N/A	815,471
	280,778,462	150,936,340	284,743,393	153,357,200

With the adoption of SLFRS 9, Bank advanced the default point to 90 days in arrears or to the point at which the customer facility is classified as a non performing advances in accordance with CBSL directions.

With the adoption of SLFRS 9, Bank advanced the default point to go days in arrears or the customer facility being classified as non performing advances in accordance with CBSL directions.

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 rescheduled, it remains in this category independent of satisfactory performance after restructuring. At the time of rescheduling 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 2018, the Bank rescheduled loans and advances with a carrying value of Rs 4,572.84 Mn (2017 - Rs 8,126.84 Mn) and recognised an impairment charge of Rs 19.69 Mn (2017 - impairment reversal of Rs1.9 Mn) in the statement of profit or loss.

4.3.2 (d) Concentrations of Credit Risk

The Bank monitors concentration of credit risk by sector and by geographic location.

4.3.2 (d) i Concentration by Location

Concentration of loans and advances by location is given below.

As at 31st December	Bank				Group			
	2018		2017		2018		2017	
	Rs 000	%	Rs 000	%	Rs 000	%	Rs 000	%
Western	570,631,727	73.95	472,561,107	72.75	576,652,469	72.56	479,746,617	71.92
Southern	33,209,835	4.30	28,350,100	4.36	35,355,553	4.45	29,790,031	4.47
Uva	9,757,054	1.26	8,808,193	1.36	11,199,292	1.41	9,869,321	1.48
North Central	10,624,236	1.38	9,744,839	1.5	12,686,333	1.60	10,631,130	1.6
North Western	36,000,796	4.67	30,501,479	4.7	39,627,553	4.99	32,013,863	4.81
Eastern	15,884,033	2.06	14,913,571	2.3	17,866,829	2.25	16,496,774	2.48
Northern	18,472,610	2.39	17,164,352	2.64	20,347,872	2.56	18,533,843	2.78
Sabaragamuwa	14,908,657	1.93	13,300,461	2.05	16,390,858	2.06	14,268,868	2.14
Central	38,317,969	4.97	35,566,168	5.48	40,702,634	5.12	36,781,131	5.52
Overseas	23,885,708	3.10	18,636,797	2.87	23,885,708	3.01	18,636,797	2.8
	771,692,625	100	649,547,067	100	794,715,100	100	666,768,376	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 lending 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	
	2018	2017	2018	2017
	Rs 000	Rs 000	Rs 000	Rs 000
Gross carrying value	7,110,806	8,572,868	15,299,261	9,017,744
Impairment allowance	(13,632)	(19,237)	(209,092)	(17,979)
Net carrying value	7,097,174	8,553,631	15,090,169	8,999,765

Total unutilised overdrafts approved to above customers as at 31st December 2018 amounts to Rs 21.07 Mn (2017 : Rs 672.96 Mn).

Notes to the Financial Statements

4 FINANCIAL RISK MANAGEMENT (Contd.)

4.3.2 (d) ii Concentration by Sector

As at 31st December 2018	Agriculture and fishing	Manufacturing	Tourism	Transport and Storage	Construction and Infrastructure	Wholesale and Retail
Bank	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000

Financial Assets

Cash and cash equivalents	-	-	-	-	-	-
Placements with banks	-	-	-	-	-	-
Balances with Central Bank of Sri Lanka	-	-	-	-	-	-
Reverse repurchase agreements	-	-	-	-	-	-
Derivative Financial instruments	-	-	-	-	-	-
Financial assets recognised through profit or loss	-	22,033	24,434	2,604	2	-
Financial assets at amortised cost - loans and advances (gross)	58,113,215	89,363,244	35,160,396	12,447,297	114,301,299	158,889,049
Financial assets measured at fair value through other comprehensive income	-	-	-	-	-	-
Financial assets at amortised cost - debt and other instruments	-	1,003,302	-	-	2,031,873	-
Other assets	-	-	-	-	-	-
	58,113,215	90,388,579	35,184,830	12,449,901	116,333,174	158,889,049

As at 31st December 2017	Agriculture and fishing	Manufacturing	Tourism	Transport	Construction	Traders
Bank	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000

Financial Assets

Cash and cash equivalents	-	-	-	-	-	-
Placements with banks	-	-	-	-	-	-
Balances with Central Bank of Sri Lanka	-	-	-	-	-	-
Reverse repurchase agreements	-	-	-	-	-	-
Derivative Financial instruments	-	-	-	-	-	-
Financial assets recognised through profit or loss	34,497	-	27,926	-	-	2,604
Loans and receivables to customers (gross)	59,681,649	82,385,162	47,951,418	13,256,321	77,827,018	126,980,093
Financial investments available-for-sale	-	-	-	-	-	-
Financial investments - loans and receivables	-	2,025,049	-	-	-	500,616
Other assets	-	-	-	-	-	-
	59,716,146	84,410,211	47,979,344	13,256,321	77,827,018	127,483,313

Information technology and communication services	Financial Services	Professional, scientific and Technical services	Art, Entertainment and Recreation	Education	Healthcare, Social services and Support services	Consumption	Other	Lending to Overseas entities	Total
Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
-	25,141,890	-	-	-	-	-	-	-	25,141,970
-	3,292,870	-	-	-	-	-	-	-	3,292,870
-	33,907,057	-	-	-	-	-	-	-	33,907,057
-	90,094	-	-	-	-	-	-	-	90,094
-	4,507,576	-	-	-	-	-	-	-	4,507,576
-	37,956	-	-	-	-	-	13,313	-	100,342
6,763,543	101,371,513	1,308,272	123,026	880,613	1,400,518	8,042,628	163,092,553	20,435,459	771,692,625
-	69,436,989	-	-	-	-	-	-	-	69,436,989
-	157,894,901	-	-	-	-	-	500,616	-	161,630,692
-	466,252	-	-	-	-	-	-	-	466,252
6,763,543	396,147,098	1,308,272	123,026	880,613	1,400,518	8,042,628	163,606,482	20,435,459	1,070,266,467

New Economy	Financial and Business	Infrastructure	Other Services	Other	Total
Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
-	21,739,800	-	-	-	21,739,800
-	3,182,377	-	-	-	3,182,377
-	38,610,940	-	-	-	38,610,940
-	-	-	-	-	-
-	615,357	-	-	-	615,357
-	33,446	4	22,008	-	120,485
7,845,252	75,649,970	46,560,612	61,664,687	49,744,886	649,547,067
-	95,403,820	-	-	-	95,403,820
-	117,962,215	1,518,534	192,634	-	122,199,048
-	405,437	-	-	-	405,437
7,845,252	353,603,362	48,079,150	61,879,329	49,744,886	931,824,331

Notes to the Financial Statements

4 FINANCIAL RISK MANAGEMENT (Contd.)

4.3.2 (d) ii Concentration by Sector

As at 31st December 2018	Agriculture and fishing	Manufacturing	Tourism	Transport and Storage	Construction and Infrastructure	Wholesale and Retail
Group	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Financial Assets						
Cash and cash equivalents	-	-	-	-	-	-
Placements with banks	-	-	-	-	-	-
Balances with	-	-	-	-	-	-
Central Bank of Sri Lanka	-	-	-	-	-	-
Reverse repurchase	-	-	-	-	-	-
agreements	-	-	-	-	-	-
Derivative	-	-	-	-	-	-
Financial instruments	-	-	-	-	-	-
Financial assets recognised through profit or loss	-	51,179	24,434	2,604	10,846	-
Financial assets at amortised cost - loans and advances (gross)	63,718,842	92,814,397	35,501,046	12,447,297	114,639,137	164,655,641
Financial assets measured at fair value through other comprehensive income	-	-	-	-	-	-
Financial assets at amortised cost - debt and other instruments	-	1,392,607	-	-	2,158,705	82,472
Other assets	-	-	-	-	-	-
	63,718,842	94,258,183	35,525,480	12,449,901	116,808,688	164,738,113

As at 31st December 2017	Agriculture and fishing	Manufacturing	Tourism	Transport	Construction	Traders
Group	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Financial Assets						
Cash and cash equivalents	-	-	-	-	-	-
Placements with banks	-	-	-	-	-	-
Balances with Central Bank of Sri Lanka	-	-	-	-	-	-
Reverse repurchase agreements	-	-	-	-	-	-
Derivative Financial instruments	-	-	-	-	-	-
Financial assets recognised through profit or loss	38,336	34,469	27,926	-	-	2,604
Loans and receivables to customers	63,631,994	85,827,612	48,203,833	13,324,780	77,146,282	131,795,262
Financial investments available-for-sale	-	22,199	-	-	13,611	-
Financial investments - loans and receivables	-	2,119,820	-	-	-	606,733
Other assets	-	-	-	-	-	-
	63,670,330	88,004,100	48,231,759	13,324,780	77,159,893	132,404,599

Information technology and communication services	Financial Services	Professional, scientific and Technical services	Art, Entertainment and Recreation	Education	Healthcare, Social services and Support services	Consumption	Other	Lending to Overseas entities	Total
Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
-	24,966,831	-	-	-	-	-	-	-	24,966,911
-	8,506,725	-	-	-	-	-	-	-	8,506,255
-	-	-	-	-	-	-	-	-	-
-	33,907,057	-	-	-	-	-	-	-	33,907,057
-	-	-	-	-	-	-	-	-	-
-	1,168,764	-	-	-	-	-	-	-	1,168,764
-	-	-	-	-	-	-	-	-	-
-	4,507,576	-	-	-	-	-	-	-	4,507,576
-	150,730	-	-	-	-	-	24,627	-	264,420
6,763,543	98,327,726	1,308,272	123,026	880,613	1,400,518	8,042,628	173,656,955	20,435,459	794,715,100
-	76,005,258	-	-	-	-	-	-	-	76,005,258
148,523	163,239,704	-	-	-	-	-	603,134	-	167,625,145
-	466,252	-	-	-	-	-	203,619	-	669,871
6,912,066	411,246,623	1,308,272	123,026	880,613	1,400,518	8,042,628	174,488,335	20,435,459	1,112,336,757

New Economy	Financial and Business	Infrastructure	Other Services	Other	Total
Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
-	21,924,898	-	-	-	21,924,898
-	9,670,125	-	-	-	9,670,125
-	38,610,940	-	-	-	38,610,940
-	772,002	-	-	-	772,002
-	615,357	-	-	-	615,357
-	123,904	4	39,295	-	266,538
7,845,253	75,073,074	46,560,612	62,627,661	54,732,014	666,768,376
-	101,704,823	-	2,352	-	101,742,985
-	120,353,068	1,645,043	307,007	-	125,031,671
-	1,451,427	-	-	-	1,451,427
7,845,253	370,299,618	48,205,659	62,976,315	54,732,014	966,854,319

Notes to the Financial Statements

4 FINANCIAL RISK MANAGEMENT (Contd.)

4.3.2 (e) Commitments and Guarantees

The Bank enters into various irrevocable commitments and assumes 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.

As at 31st December	2018	2017
	Rs 000	Rs 000
Acceptances	19,065,908	17,913,826
Documentary credit	29,760,771	28,291,149
Guarantees	141,352,517	124,389,833
Undrawn commitments to lend - direct facilities	175,446,454	165,822,760
Undrawn commitments to lend - indirect facilities	252,105,256	142,969,759
	617,730,906	479,387,327

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 and behavioural 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.

	2018	2017
	Rs 000	Rs 000
Net loans / total assets	68.94%	66.93%
Gross loans / customer deposits	96.46%	92.59%
Liquid Asset Ratio (LAR)		
As at 31st December	24.40%	26.29%
Average for the year	24.88%	24.81%
Maximum for the year	27.47%	27.60%
Minimum for the year	22.99%	22.30%

Components of the Bank's liquid assets portfolio used for the purpose of calculating statutory liquid asset ratio as at 31st December 2018 (average balance for the month of December) is given below.

As at 31st December	2018	2017
	Rs 000	Rs 000
Cash	21,177,193	19,085,747
Balances with licensed commercial banks	413,473	463,466
Money at call in Sri Lanka	420,323	4,753,419
Treasury bills and securities issued or guaranteed by the government of Sri Lanka which have a maturity not exceeding one year	197,328,491	188,418,351
Import Bills	2,398	980
Export bills	1,334,312	2,071,335
Cash items in the process of collection	888,895	1,037,160
Balances with banks abroad	3,979,875	1,601,368
Total average liquid assets for the month of December	225,544,960	217,431,826

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 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 2018 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.

Notes to the Financial Statements

4 FINANCIAL RISK MANAGEMENT (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 2018	Up to 3 months	3 - 12 months	1 - 3 years	3 - 5 years	More than 5 years	Total
Bank	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Financial Assets						
Cash and cash equivalents	25,141,890	-	-	-	-	25,141,890
Placements with banks	3,300,996	-	-	-	-	3,300,996
Balances with Central Bank of Sri Lanka	33,907,057	-	-	-	-	33,907,057
Reverse Repurchase Agreements	90,164	-	-	-	-	90,164
Derivative financial instruments	1,534,009	2,973,567	-	-	-	4,507,576
Financial assets recognised through profit or loss	100,385	-	-	-	-	100,385
Financial assets at amortised cost - loans and advances	349,328,972	172,186,665	226,900,627	110,019,122	86,270,525	944,705,911
Financial assets at amortised cost - debt and other instruments	9,224,406	9,479,031	109,444,201	49,143,834	11,731,472	189,022,944
Financial assets measured at fair value through other comprehensive income	3,104,451	36,501,601	25,840,598	7,209,675	9,333,963	81,990,287
Other assets	-	500,000	-	-	-	500,000
Total undiscounted financial assets	425,732,330	221,640,864	362,185,426	166,372,631	107,335,960	1,283,267,210
Financial Liabilities						
Due to banks	18,337,334	46,856,739	14,881,119	1,220,565	297,296	81,593,053
Derivative financial instruments	1,781,616	737,556	-	-	-	2,519,172
Securities sold under repurchase agreements	16,605,462	87,452	-	-	-	16,692,913
Financial liabilities at amortised cost - due to depositors	495,817,751	299,257,049	13,881,000	16,174,646	364	825,130,810
Dividends payable	994,812	-	-	-	-	994,812
Financial liabilities at amortised cost - due to other borrowers	3,308,813	5,673,542	14,569,317	2,455,035	2,012,906	28,019,612
Financial liabilities at amortised cost - debt securities issued	-	3,127,974	334,001	2,334,001	90,715	5,886,692
Other liabilities	12,956	-	-	-	-	12,956
Subordinated term debts	787,500	1,433,675	19,954,658	5,867,021	1,362,800	29,405,654
Total undiscounted financial liabilities	537,646,243	357,173,987	63,620,095	28,051,268	3,764,081	990,255,674
Net undiscounted financial assets/(liabilities)	(111,913,914)	(135,533,123)	298,565,331	138,321,363	103,571,879	293,011,536

The table below shows the contractual expiry by maturity of the Bank's contingent liabilities and commitments.

	Up to 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	15,381,063	3,519,386	165,460	-	-	19,065,908
Documentary credit	21,410,066	8,350,705				29,760,771
Guarantees	33,385,951	69,163,414	34,674,846	1,780,664	2,347,642	141,352,517
Undrawn commitments to lend						
direct facilities	175,446,454	-	-	-	-	175,446,454
Undrawn commitments to lend						
indirect facilities	252,105,256	-	-	-	-	252,105,256
	497,728,790	81,033,505	34,840,306	1,780,664	2,347,642	617,730,906

31st December 2017	Up to 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
Bank						

Financial Assets

Cash and cash equivalents	21,739,800	-	-	-	-	21,739,800
Placements with banks	3,191,117	-	-	-	-	3,191,117
Balances with						
Central Bank of Sri Lanka	-	-	-	-	38,610,940	38,610,940
Derivative financial instruments	447,570	167,787	-	-	-	615,357
Financial assets recognised through profit or loss	120,486	-	-	-	-	120,486
Loans and receivables to customers	268,886,797	144,831,674	209,713,474	92,876,440	80,543,193	796,851,578
Financial investments - loans and receivables	7,670,864	14,916,277	77,938,407	41,351,493	57,839	141,934,880
Financial investments - available-for-sale	11,346,276	39,262,285	25,845,470	20,467,935	12,875,813	109,797,779
Other assets	-	172,279	1,952,668	-	-	2,124,947
Total undiscounted financial assets	313,402,910	199,350,302	315,450,019	154,695,868	132,087,785	1,114,986,884

Financial Liabilities

Due to banks	14,636,087	13,151,151	32,963,399	6,119,609	546,530	67,416,776
Derivative financial instruments	486,790	813,267	5,843	-	-	1,305,900
Securities sold under repurchase agreements	4,712,068	381,838	-	-	-	5,093,906
Due to customers	475,541,780	224,091,038	9,086,501	9,634,299	5,947	718,359,565
Dividends payable	975,371	-	-	-	-	975,371
Other borrowings	2,831,212	4,888,494	14,392,759	6,854,763	1,766,333	30,733,561
Debt securities issued	-	380,687	3,294,975	334,001	2,257,716	6,267,379
Other liabilities	22,984	-	-	-	-	22,984
Subordinated term debts	787,500	5,895,541	7,965,232	14,670,287	5,882,800	35,201,360
Total undiscounted financial liabilities	499,993,792	249,602,016	67,708,709	37,612,959	10,459,326	865,376,802
Net undiscounted financial assets/(liabilities)	(186,590,882)	(50,251,714)	247,741,310	117,082,909	121,628,459	249,610,082

Notes to the Financial Statements

4 FINANCIAL RISK MANAGEMENT (Contd.)

The table below shows the contractual expiry by maturity of the Bank's contingent liabilities and commitments.

	Up to 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	13,412,451	4,436,330	65,045	-	-	17,913,826
Documentary credit	26,186,188	2,103,735	1,226	-	-	28,291,149
Guarantees	21,049,706	48,443,528	39,649,411	8,111,542	7,135,646	124,389,833
Undrawn commitments to lend						
direct facilities	165,822,760	-	-	-	-	165,822,760
Undrawn commitments to lend						
indirect facilities	142,969,759	-	-	-	-	142,969,759
	369,440,864	54,983,593	39,715,682	8,111,542	7,135,646	479,387,327

The Bank expects that not all of the contingent liabilities or commitments will be drawn before expiry of the commitments.

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) 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 based mainly on historical simulation, by the Bank is upon a 99 percent confidence level and assumes 1-day and a 10-day holding period. 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 Rs 000	Average Rs 000	Maximum Rs 000	Minimum Rs 000
2018				
Foreign currency risk (USD NOP)*	5,663	5,031	8,860	1,468
Equity risk	3,457	3,476	4,788	2,737
2017				
Foreign currency risk (USD NOP)*	2,900	8,480	17,785	2,900
Equity risk	4,262	13,481	27,089	4,262

* Only USD exposure has been considered as it represents over 98.52% of the foreign currency transactions.

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	2018	2017
Trading	0.9093	-
Non trading	3.2269	2.9968

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 2018 is as follows.

	Decrease of 100 bps	Decrease of 200 bps	Increase of 100 bps	Increase of 200 bps
LKR Portfolio (Rs 000)	(3,391,804)	(6,810,763)	3,333,856	6,588,279
USD Portfolio (USD 000)	11,503	23,661	(10,894)	(21,220)

Notes to the Financial Statements

4 FINANCIAL RISK MANAGEMENT (Contd.)

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 CBSL. Basel II guidelines were effective till 30th June 2017 and since 1st July 2017, the Bank is required to comply with the provisions of the Basel III framework in respect of regulatory capital and capital to cover any additional risk. All Domestic Systemically Important Banks (D-SIBs) in Sri Lanka including HNB need to maintain a minimum Capital Adequacy Ratio (CAR) of 12.875% and a Tier 1 Ratio of at least 8.875% for year 2018. As per the CBSL road map in implementing Basel III directive, all D-SIBs are required to maintain a minimum CAR of 14% by year 2019.

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.

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 assets measured at fair value through other comprehensive income (FVOCI)/Financial investments - available for sale

Government debt securities classified as financial assets measured at fair value through other comprehensive income / 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 FVOCI / 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 FVOCI / financial investments - available-for-sale are valued using manager's selling price. Unquoted shares classified as FVOCI / financial investments - available-for-sale are valued at cost.

Financial investments assets recognised through profit or loss (FVPL)

Government debt securities classified as financial investments assets recognised through profit or loss are valued using yield curves published by the Central Bank of Sri Lanka, while quoted equities classified as financial investments recognised 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 recognised through profit or loss are valued using manager's selling price.

Notes to the Financial Statements

5 FAIR VALUE OF ASSETS AND LIABILITIES (Contd.)

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 fair values of the Bank's freehold land and buildings are determined by independent valuers 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 2018. The methods used to determine the fair value of freehold land and buildings are explained in Note 38 (b) to the financial statements.

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. The amounts are based on the values recognised in the statement of financial position.

As at 31st December 2018	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	-	4,059,033	-	4,059,033	-	4,059,033	-	4,059,033
Forward foreign exchange contracts	-	448,543	-	448,543	-	448,543	-	448,543
	-	4,507,576	-	4,507,576	-	4,507,576	-	4,507,576
Financial investments								
- recognised through profit or loss								
Quoted shares	99,056	-	-	99,056	238,214	-	-	238,214
Quoted units	-	-	-	-	9,152	-	-	9,152
Government of Sri Lanka treasury bills	1,286	-	-	1,286	1,286	-	-	1,286
Government of Sri Lanka treasury bonds	-	-	-	-	15,768	-	-	15,768
	100,342	-	-	100,342	264,420	-	-	264,420
Financial assets measured at fair value through other comprehensive income								
Quoted shares	3,981,142	-	-	3,981,142	3,981,142	-	-	3,981,142
Quoted units	240,000	-	-	240,000	240,000	-	-	240,000
Unquoted shares	-	-	24,780	24,780	-	-	37,210	37,210
Unquoted units	-	372,373	-	372,373	-	372,373	-	372,373
Government of Sri Lanka treasury bills	18,382,857	-	-	18,382,857	18,382,857	-	-	18,382,857
Government of Sri Lanka treasury bonds	46,435,837	-	-	46,435,837	52,991,676	-	-	52,991,676
	69,039,836	372,373	24,780	69,436,989	75,595,675	372,373	37,210	76,005,258
Non-financial assets measured at fair value								
Freehold land and buildings	-	-	17,643,465	17,643,465	-	-	37,342,041	37,342,041
	-	-	17,643,465	17,643,465	-	-	37,342,041	37,342,041
Financial liabilities measured at fair value								
Derivative financial instruments								
Currency swaps	-	190,473	-	190,473	-	190,473	-	190,473
Forward foreign exchange contracts	-	2,328,699	-	2,328,699	-	2,328,699	-	2,328,699
	-	2,519,172	-	2,519,172	-	2,519,172	-	2,519,172

As at 31st December 2017	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	-	321,253	-	321,253	-	321,253	-	321,253
Forward foreign exchange contracts	-	294,104	-	294,104	-	294,104	-	294,104
	-	615,357	-	615,357	-	615,357	-	615,357
Financial investments								
- recognised through profit or loss								
Quoted shares	120,486	-	-	120,486	238,529	-	-	238,529
Quoted units	-	-	-	-	12,241	-	-	12,241
Government of Sri Lanka treasury bonds	-	-	-	-	15,768	-	-	15,768
	120,486	-	-	120,486	266,538	-	-	266,538
Financial investments - available for sale								
Quoted shares	4,912,813	-	-	4,912,813	4,990,887	-	-	4,990,887
Quoted units	276,300	-	-	276,300	276,300	-	-	276,300
Unquoted shares	-	-	25,405	25,405	-	-	37,835	37,835
Unquoted units	-	418,646	-	418,646	-	418,646	-	418,646
Government of Sri Lanka treasury bills	34,516,140	-	-	34,516,140	34,733,447	-	-	34,733,447
Government of Sri Lanka treasury bonds	55,254,516	-	-	55,254,516	61,285,870	-	-	61,285,870
	94,959,769	418,646	25,405	95,403,820	101,286,504	418,646	37,835	101,742,985
Non-financial assets measured at fair value								
Freehold land and buildings	-	-	14,838,402	14,838,402	-	-	29,750,358	29,750,358
	-	-	14,838,402	14,838,402	-	-	29,750,358	29,750,358
Financial liabilities measured at fair value								
Derivative financial instruments								
Currency swaps	-	1,238,991	-	1,238,991	-	1,238,991	-	1,238,991
Forward foreign exchange contracts	-	66,909	-	66,909	-	66,909	-	66,909
	-	1,305,900	-	1,305,900	-	1,305,900	-	1,305,900

5.4 Fair Value Measurement of Assets Classified as Level 3

5.4.1 Property, Plant and Equipment

The reconciliation of property, plant and equipment is given in Note 38 to the financial statements.

5.4.2 Unobservable Inputs used in Measuring Fair Value

The information about significant unobservable inputs used in measuring non financial assets categorised as Level 3 in the fair value hierarchy as at 31st December 2018 is given in Note 38 (b) to the financial statements.

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

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 2018	Carrying Value	Bank			Total	Carrying Value	Group			Total
		Fair Value					Fair Value			
		Level 1	Level 2	Level 3			Level 1	Level 2	Level 3	
		Rs 000	Rs 000	Rs 000			Rs 000	Rs 000	Rs 000	
Assets										
Financial assets at amortised cost - loans and advances to customers	749,048,820	-	745,343,270	-	745,343,270	770,263,000	-	767,031,069	-	767,031,069
Financial assets at amortised cost - debt and other instruments / Financial investments - loans and receivables	160,145,680	-	144,474,322	-	144,474,322	165,821,983	1,846,646	148,188,913	-	150,035,559
Investment properties	325,818	-	-	3,879,750	3,879,750	1,107,472	-	-	2,687,051	2,687,051
Liabilities										
Due to customers	799,975,357	-	799,850,277	-	799,850,277	818,041,962	-	818,262,986	-	818,262,986
Debt securities issued	4,487,763	-	4,550,912	-	4,550,912	5,030,000	-	5,092,248	-	5,092,248
Subordinated term debts	22,229,951	-	22,432,225	-	22,432,225	21,930,246	-	22,139,443	-	22,139,443
As at 31st December 2017										
As at 31st December 2017	Carrying Value	Bank			Total	Carrying Value	Group			Total
		Fair Value					Fair Value			
		Level 1	Level 2	Level 3			Level 1	Level 2	Level 3	
		Rs 000	Rs 000	Rs 000			Rs 000	Rs 000	Rs 000	
Assets										
Financial assets at amortised cost - loans and advances to customers	639,102,061	-	634,274,319	-	634,274,319	655,612,938	-	650,703,678	-	650,703,678
Financial investments held to maturity	-	-	-	-	-	1,565,603	1,569,757	-	-	1,569,757
Financial investments - loans and receivables	122,199,048	-	122,579,818	-	122,579,818	125,031,671	-	125,391,888	-	125,391,888
Investment properties	327,464	-	-	3,197,575	3,197,575	1,146,564	-	-	2,474,005	2,474,005
Liabilities										
Due to customers	701,519,297	-	701,102,245	-	701,102,245	718,770,051	-	718,371,451	-	718,371,451
Debt securities issued	4,540,259	-	4,329,624	-	4,329,624	5,035,958	-	4,831,199	-	4,831,199
Subordinated term debts	25,809,261	-	25,776,122	-	25,776,122	25,564,596	-	25,897,151	-	25,897,151

Fair values of the following assets and liabilities are estimated for the purpose of disclosure as described below:

Financial assets at amortised cost - loans and advances 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 assets at amortised cost - debt and other instruments / financial investments - Loans and receivables

These comprise of investments in Sri Lanka development bonds, Sri Lanka sovereign bonds, 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 at 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.

Subordinated term debts

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 2018 and 2017.

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 of Sri Lanka (CA Sri Lanka), which are not yet effective as at 31st December 2018. Accordingly, these accounting standards have not been applied in the preparation of financial statements for the year ended 31st December 2018.

Sri Lanka Accounting Standard - SLFRS 9 "Financial Instruments"

Temporary Exemption from SLFRS 9 for Subsidiary, HNB Assurance PLC

SLFRS 9 addresses the accounting for financial instruments and is effective for annual periods beginning on or after 1st January 2018. However, for an insurer that meets the criteria in paragraph 20B of SLFRS 9 it provides a temporary exemption that permits, but does not require, the insurer to apply LKAS 39 rather than SLFRS 9 for annual periods beginning before 1st January 2021.

An insurer may apply the temporary exemption from SLFRS 9 if, and only if:

- (a) it has not previously applied any version of SLFRS 9, other than only the requirements for the presentation of gains and losses on financial liabilities designated at fair value through profit or loss in paragraphs 5.7.1(c), 5.7.7 – 5.7.9, 7.2.14 and B5.7.5 – B5.7.20 of SLFRS 9; and
- (b) its activities are predominantly connected with insurance, as described in paragraph 20D, at its annual reporting date that immediately precedes 1st April 2016, or at a subsequent annual reporting date as specified in paragraph 20G of SLFRS 9.

Since HNB Assurance PLC and HNB General Insurance Limited are predominantly connected with Insurance activities, having considering the above criteria, both the companies may continue to apply LKAS 39 rather than SLFRS 9 for annual periods beginning before 1st January 2021.

However, the financial statements of HNB Assurance PLC has been prepared in line with SLFRS 9 for the preparation of consolidated financial statements.

Amendments to Sri Lanka Accounting Standard - LKAS 28 "Investments in Associates and Joint Ventures"

The amendments address the conflict between Sri Lanka Accounting Standard - SLFRS 10 "Consolidated Financial Statements" and LKAS 28 in dealing with the loss of control of a subsidiary that is sold or contributed to an associate or joint venture. The amendments clarify that the gain or loss resulting from the sale or contribution of assets that constitute a business, as defined in Sri Lanka Accounting Standard - SLFRS 3 "Business Combinations" between an investor and its associate or joint venture, is recognised in full. Any gain or loss resulting from the sale or contribution of assets that do not constitute a business, however, is recognised only to the extent of unrelated investors' interests in the associate or joint venture. The effective date of these amendments were deferred indefinitely, but an entity that early adopts the amendments must apply them prospectively. The Group will apply these amendments when they become effective.

Sri Lanka Accounting Standard - SLFRS 16 "Leases"

SLFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, i.e. the customer ("lessee") and the supplier ("lessor"). SLFRS 16 will replace Sri Lanka Accounting Standard - LKAS 17 (Leases) and related interpretations, SLFRS 16 introduces a single accounting model for the lessee, eliminating the present classification of leases in LKAS 17 as either operating leases or finance leases.

The new standard requires a lessee to:

- Recognise assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value
- Present depreciation of lease assets separately, from interest on lease liabilities in the income statement.

SLFRS 16 substantially carries forward the lessor accounting requirement under LKAS 17. Accordingly, a lessor continues to classify its leases as operating lease or finance lease, and to account for those two types of leases differently

SLFRS 16 will become effective on 1st January 2019. The Group is currently assessing the impact on the implementation of the above standards.

IFRIC Interpretation 23 "Uncertainty over Income Tax Treatment"

This interpretation addresses the accounting for income taxes when tax treatments involve uncertainty that affects the application of Sri Lanka Accounting Standard - LKAS 12 "Income tax" and does not apply to taxes or levies outside the scope of LKAS 12, nor does it specifically include requirements relating to interest and penalties associated with uncertain tax treatments. The interpretation specifically addresses the following:

- Whether an entity considers uncertain tax treatments separately
- The assumptions an entity makes about the examination of tax treatments by taxation authorities
- How an entity determines taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates
- How an entity considers changes in facts and circumstances An entity must determine whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments. The approach that better predicts the resolution of the uncertainty should be followed. The interpretation is effective for annual reporting periods beginning on or after 1st January 2019, the Group may need to establish processes and procedures to obtain information that is necessary to apply the Interpretation on a timely basis.

6.1 Amendments to Existing Accounting Standards Effective from 1st January 2018

Amendments to existing accounting standards effective from 1st January 2018 as published by the Institute of Chartered Accountants of Sri Lanka did not have any material impact on the financial statements of the Group.

Notes to the Financial Statements

7 TRANSITION DISCLOSURES

The impact of adopting SLFRS 9 on the balance sheet and retained earnings including the effect of replacing incurred credit loss calculations of LKAS 39 with ECL calculations of SLFRS 9 is given below.

7.1 Reconciliation between the carrying amounts under LKAS 39 to the balances reported under SLFRS 9 as of 1st January 2018 - Bank

	Note	Bank						
		LKAS 39		Re-classification	Remeasurement		SLFRS 9	
		Category	Amount Rs 000		ECL	Other	Amount Rs 000	Category
Financial assets								
Cash and cash equivalents		L&R	21,739,800	-	(6,089)	-	21,733,711	AC
Placements with banks		L&R	3,182,377	-	(38,492)	-	3,143,885	AC
Balances with central banks		L&R	38,610,940	-	-	-	38,610,940	AC
Reverse repurchase agreements		L&R	-	-	-	-	-	AC
Derivative financial instruments		FVPL	615,357	-	-	-	615,357	FVPL
Financial assets recognised through profit or loss								
- measured at fair value		FVPL	120,486	-	-	-	120,486	FVPL
From : Financial investments - available for sale			-	-	-	-	-	
			120,486	-	-	-	120,486	
Financial assets at amortised cost								
- loans & advances		L&R	639,102,061	-	(3,813,460)	-	635,288,601	AC
Financial investments - loans and receivables		L&R	122,199,048	(122,199,048)	-	-	-	N/A
To : Financial assets at amortised cost								
- debt and other instruments		A	-	(122,199,048)	-	-	-	
			122,199,048	(122,199,048)	-	-	-	
Financial assets at amortised cost								
- debt and other instruments		N/A	-	122,199,048	(498,056)	-	121,700,992	AC
From : Financial investments - loans and receivables		A	-	122,199,048	(498,056)	-	121,700,992	
			-	122,199,048	(498,056)	-	121,700,992	
Financial investments - available for sale								
Financial investments measured at		AFS	95,403,820	(95,403,820)	-	-	-	N/A
To : Financial assets measured at								
fair value through other comprehensive income		B	-	(95,403,820)	-	-	-	
			95,403,820	(95,403,820)	-	-	-	
Financial assets measured at								
fair value through other comprehensive income		N/A	-	95,403,820	-	-	95,403,820	FVOCI
From : Financial investments - available for sale		B	-	95,403,820	-	-	95,403,820	
			-	95,403,820	-	-	95,403,820	
Non financial assets								
Investment in joint venture		N/A	755,000	-	-	-	755,000	N/A
Investment in subsidiaries		N/A	3,017,285	-	-	-	3,017,285	N/A
Investment properties		N/A	327,464	-	-	-	327,464	N/A
Property plant and equipment		N/A	17,905,320	-	-	-	17,905,320	N/A
Intangible assets and goodwill		N/A	815,381	-	-	-	815,381	N/A
Other assets		N/A	11,083,242	-	-	-	11,083,242	N/A

	Bank							
	Note	LKAS 39		Re-classification Rs 000	Remeasurement		SLFRS 9	
		Category	Amount Rs 000		ECL Rs 000	Other Rs 000	Amount Rs 000	Category
Total assets			954,877,581	-	(4,356,097)	-	950,521,484	
Financial liabilities								
Due to banks		AC	62,463,497	-	-	-	62,463,497	AC
Derivative financial instruments		AC	1,305,900	-	-	-	1,305,900	AC
Securities sold under repurchase agreements		AC	5,064,360	-	-	-	5,064,360	AC
Financial liabilities at amortised cost - due to depositors		AC	701,519,297	-	-	-	701,519,297	AC
Dividends payable		AC	975,371	-	-	-	975,371	AC
Financial liabilities at amortised cost - other borrowings		AC	27,258,006	-	-	-	27,258,006	AC
Debt securities issued		AC	4,540,259	-	-	-	4,540,259	AC
Subordinated term debts		AC	25,809,261	-	-	-	25,809,261	AC
Non financial liabilities								
Current tax liabilities		N/A	3,974,624	-	-	-	3,974,624	N/A
Deferred tax		N/A	5,082,636	-	-	(1,090,082)	3,992,554	N/A
Other provisions		N/A	3,015,875	-	-	-	3,015,875	N/A
Other liabilities		N/A	5,720,896	-	-	906,970	6,627,866	N/A
Total liabilities			846,729,982	-	-	(183,112)	846,546,870	

Explanatory Notes

- A. As of 1st January 2018, the Bank did not have any debt instruments that did not meet the SPPI criterion within its financial investments - loans and receivables portfolio. Therefore, the Bank elected to classify all of these instruments as financial assets at amortised cost - debt and other instruments.
- B. As of 1st January 2018, the Bank assessed its investments in government securities held as liquidity portfolio which had previously been classified as financial assets available for sale. The Bank concluded that, these instruments are managed within a business model of collecting contractual cash flows and selling the financial assets. Accordingly, the Bank has classified these investments as financial assets measured at fair value through other comprehensive income. Further, the Bank elected the option to irrevocably designate the equity investments previously held as financial investments - available for sale as financial assets measured at fair value through other comprehensive income.
- C. The impact of adopting SLFRS 9 on deferred tax is set out in Note 49 to the financial statements.

Notes to the Financial Statements

7 TRANSITION DISCLOSURES (Contd.)

7.2 Reconciliation between the carrying amounts under LKAS 39 to the balances reported under SLFRS 9 as of 1st January 2018 - Group

	Note	Group						
		LKAS 39		Re-classification	Remeasurement		SLFRS 9	
		Category	Amount Rs 000		ECL	Other	Amount Rs 000	Category
Financial assets								
Cash and cash equivalents		L&R	21,924,898	-	(6,091)	-	21,918,807	AC
Placements with banks		L&R	9,670,125	-	(38,775)	-	9,631,350	AC
Balances with central banks		L&R	38,610,940	-	-	-	38,610,940	AC
Reverse repurchase agreements		L&R	772,002	-	-	-	772,002	AC
Derivative financial instruments		FVPL	615,357	-	-	-	615,357	FVPL
Financial assets recognised through profit or loss								
- measured at fair value		FVPL	266,538	-	-	-	266,538	FVPL
From : Financial investments - available for sale	A		-	78,075	-	-	-	
			-	78,075	-	-	78,075	
Financial assets at amortised cost								
- loans & advances		L&R	655,612,938	-	(4,471,646)	-	651,141,292	AC
Financial investments - loans and receivables		L&R	125,031,671	(125,031,671)	-	-	-	N/A
To : Financial assets at amortised cost								
- debt and other instruments	B		-	(125,031,671)	-	-	-	
			125,031,671	(125,031,671)	-	-	-	
Financial assets at amortised cost								
- debt and other instruments		N/A	-	126,813,537	(498,848)	-	126,314,689	AC
From : Financial investments - loans and receivables	B		-	125,031,671	(498,056)	-	124,533,615	
From : Financial investments - held to maturity	D		-	1,565,603	-	-	1,565,603	
From : Financial investments - available for sale	C		-	216,263	(792)	-	215,471	
			-	126,813,537	(498,848)	-	126,314,689	
Financial investments - available for sale								
To : Financial investments		AFS	101,742,985	(101,742,985)	-	-	-	N/A
- fair value through profit or loss	A		-	(78,075)	-	-	-	
To : Financial assets at amortised cost								
- debt and other instruments	C		-	(217,307)	-	-	-	
To : Financial assets measured at								
fair value through other comprehensive income	A & C		-	(101,447,603)	-	-	-	
			101,742,985	(101,742,985)	-	-	-	
Financial assets measured at								
fair value through other comprehensive income		N/A	-	101,447,603	-	-	101,447,603	FVOCI
From : Financial investments - available for sale	A & C		-	101,447,603	-	-	-	
			-	101,447,603	-	-	101,447,603	
Financial investments - held to maturity								
To : Financial assets at amortised cost	D	HTM	1,565,603	(1,565,603)	-	-	-	N/A
- debt and other instruments			-	(1,565,603)	-	-	-	
			1,565,603	(1,565,603)	-	-	-	
Non financial assets								
Investment in joint venture		N/A	1,689,263	-	-	-	1,689,263	N/A

	Group							
	Note	LKAS 39		Re-classification Rs 000	Remeasurement		SLFRS 9	
		Category	Amount Rs 000		ECL Rs 000	Other Rs 000	Amount Rs 000	Category
Investment properties	N/A	1,146,564	-	-	-	1,146,564	N/A	
Property, plant and equipment	N/A	34,635,034	-	-	-	34,635,034	N/A	
Intangible assets and goodwill	N/A	1,237,829	-	-	-	1,237,829	N/A	
Other assets	N/A	13,038,222	-	-	-	13,038,222	N/A	
Total assets		1,007,559,969	(1,044)	(5,015,360)		- 1,002,543,565		
Financial liabilities								
Due to banks	AC	62,464,391	-	-	-	62,464,391	AC	
Derivative financial instruments	AC	1,305,900	-	-	-	1,305,900	AC	
Securities sold under repurchase agreements	AC	5,064,360	-	-	-	5,064,360	AC	
Financial liabilities at amortised cost - due to depositors	AC	718,770,051	-	-	-	718,770,051	AC	
Dividends payable	AC	986,880	-	-	-	986,880	AC	
Financial liabilities at amortised cost - other borrowings	AC	27,258,006	-	-	-	27,258,006	AC	
Debt securities issued	AC	5,035,958	-	-	-	5,035,958	AC	
Subordinated term debts	AC	25,564,596	-	-	-	25,564,596	AC	
Non financial liabilities								
Current tax liabilities	N/A	4,066,087	-	-	-	4,066,087	N/A	
Deferred tax	N/A	7,309,283	-	-	(1,167,625)	6,141,658	N/A	
Insurance provision - life	N/A	10,915,858	-	-	-	10,915,858	N/A	
Insurance provision - non life	N/A	2,384,908	-	-	-	2,384,908	N/A	
Other provisions	N/A	3,416,332	-	-	-	3,416,332	N/A	
Other liabilities	N/A	7,359,236	-	-	906,970	78,266,206	N/A	
Total liabilities		881,901,846	-	-	(260,655)	881,641,191		

Explanatory Notes

- A As of 1st January 2018, the Group elected the option to irrevocably designate the equity investments previously held as financial investments - available for sale as financial assets measured at fair value through other comprehensive income while the subsidiaries elected to classify part of its equity securities previously held as financial investments - available for sale into financial assets recognised through profit or loss.
- B As of 1st January 2018, the Group did not have any debt instruments that did not meet the SPPI criterion within its financial investments - loans and receivables portfolio. Therefore, the Group elected to classify all of these instruments as financial assets at amortised cost - debt and other instruments.
- C As of 1st January 2018, the Bank has assessed its investments in government securities held as liquidity portfolio which had previously been classified as financial assets available for sale. The Bank concluded that, these instruments are managed within a business model of collecting contractual cash flows and selling the financial assets. Accordingly, the Bank has classified these investments as financial assets measured at fair value through other comprehensive income. As of 1st January 2018, the subsidiaries classified part of its investments in government securities previously held as financial investments - available for sale into financial assets at amortised cost - debt and other instruments.
- D As of 1st January 2018, the Group classified its investments in government securities previously held as financial investments - held to maturity into financial assets at amortised cost - debt and other instruments.
- E The impact of adopting SLFRS 9 on deferred tax is set out in Note 49 to the financial statements.

Notes to the Financial Statements

7 TRANSITION DISCLOSURES (Contd.)

7.3 The impact of transition to SLFRS 9 on reserves and retained earnings (Day 1 impact)

	Bank Rs 000	Group Rs 000
Available-for-sale reserve		
Closing balance under LKAS 39 (31st December 2017)	4,166,167	4,207,731
Reclassification of available-for-sale reserve as fair value reserve in relation to adopting SLFRS 9	(4,166,167)	(4,205,438)
Reclassification of available-for-sale reserve as Financial Asset - Amortised cost in relation to adopting SLFRS 9	-	(626)
Reclassification of available for sale reserve as FVPL in relation to adopting SLFRS 9	-	(1,666)
Restated opening balance under SLFRS 9 (1st January 2018)	-	-
Fair value reserve		
Closing balance under LKAS 39 (31st December 2017)	-	-
Reclassification of available-for-sale reserve as fair value reserve in relation to adopting SLFRS 9	4,166,167	4,205,438
Reversal of impairment provisions previously recognised for equity securities carried as FVOCI	(130,466)	(146,682)
Restated opening balance under SLFRS 9 (1st January 2018)	4,035,701	4,058,756
Life policyholder's reserve fund		
Closing balance under LKAS 39 (31st December 2017)	-	223,271
Reclassification of available-for-sale reserve as fair value reserve in relation to adopting SLFRS 9	-	(4,507)
Restated opening balance under SLFRS 9 (1st January 2018)	-	218,764
Non - Controlling Interest		
Closing balance under LKAS 39 (31st December 2017)	-	3,648,703
Recognition of SLFRS 9 ECLs including those measured at FVOCI	-	(379,843)
Reclassification of available-for-sale reserve as Financial Asset - Amortised cost in relation to adopting SLFRS 9	-	(418)
Reclassification of investment securities (debt and equity) from available-for-sale to FVPL	-	(1,111)
Deferred tax in relation to the above	-	106,383
Restated opening balance under SLFRS 9 (1st January 2018)	-	3,373,714
Retained earnings		
Closing balance under LKAS 39 (31st December 2017)	15,193,585	18,082,284
Recognition of SLFRS 9 ECLs including those measured at FVOCI	(5,263,067)	(5,539,864)
Reversal of impairment provisions previously recognised for equity securities carried as FVOCI	130,466	146,681
Deferred tax in relation to the above	1,090,082	1,167,625
Restated opening balance under SLFRS 9 (1st January 2018)	11,151,066	13,856,726
Total change in equity due to adopting SLFRS 9	(4,172,985)	(4,654,029)

7.4 Reconciliation of loan loss provisions

The following table reconciles the aggregate opening loan loss provision allowances under LKAS 39 and provisions for loan commitments and financial guarantee contracts in accordance with LKAS 37 "Provisions for Contingent Liabilities and Contingent Assets" to the ECL allowances under SLFRS 9.

	Bank			Group		
	Loan loss provision under LKAS 39/ LKAS 37 as at 31st December 2017 Rs 000	Re-measurement Rs 000	ECLs under SLFRS 9 as at 1st January 2018 Rs 000	Loan loss provision under LKAS 39/ LKAS 37 as at 31st December 2017 Rs 000	Re-measurement Rs 000	ECLs under SLFRS 9 as at 1st January 2018 Rs 000
Impairment allowance for						
Cash and cash equivalents	-	6,089	6,089	-	6,091	6,091
Placements with banks	-	38,492	38,492	-	38,775	38,775
Financial assets at amortised cost - loans and advances	10,445,006	3,813,460	14,258,466	11,155,438	4,471,646	15,627,084
Financial assets at amortised cost - debt and other instruments/Financial investments - loans and receivables	57,839	498,056	555,895	523,817	498,848	1,022,665
	10,502,845	4,356,097	14,858,942	11,679,255	5,015,360	16,694,615
Bank guarantees and letters of credit for customers	-	100,627	100,627	-	100,627	100,627
Loans and other commitments	-	806,343	806,343	-	806,343	806,343
	10,502,845	5,263,067	15,765,912	11,679,255	5,922,330	17,601,585

7.5 Impact to Capital Adequacy Ratio from the First Day impact Arising From the Adoption of SLFRS 9 - "Financial Instruments"

In line with the "Guideline to Licensed Banks on the Adoption of Sri Lanka Accounting Standard - "SLFRS 9" Financial Instruments" issued by Central Bank of Sri Lanka, Bank can stagger the audited additional credit loss provisions arising from SLFRS 9 when compared with credit loss provisions under LKAS 39 as at first day of adoption of SLFRS 9, net of any other adjustment on first day impact to retained earnings and net of tax effects, throughout a transitional period of four years.

Accordingly, the total impact to Capital Adequacy Ratio (CAR) from the adoption of SLFRS 9 amounted to Rs 4.2 Bn. Bank has adjusted 25% of such impact amounting to Rs 1.05 Bn when computing CAR as at 31st December 2018 and the presented ratio has decreased by 0.13% as a result.

Notes to the Financial Statements

8 GROSS INCOME

Accounting Policy

Gross revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group 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	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Interest income [Note 9 (a)]	108,104,923	96,175,453	116,488,588	103,908,195
Fee and commission income (Note 10)	9,540,862	8,415,579	10,382,030	9,227,529
Net gain / (loss) from trading (Note 11)	(356,594)	(3,711,203)	(396,918)	(3,695,658)
Net gain from financial assets at fair value through other comprehensive income / financial investments - available for sale (Note 12)	215,551	212,129	217,896	247,166
Net gain on de-recognition of financial assets	-	-	72,150	-
Net insurance premium income (Note 13)	-	-	7,431,823	6,326,292
Other operating income (Note 14)	3,851,347	5,203,236	4,054,982	3,745,582
	121,356,089	106,295,194	138,250,551	119,759,106

9 NET INTEREST INCOME

Accounting Policy

Interest income and expenses under both SLFRS 9 and LKAS 39, are recorded using the effective interest rate (EIR) method for all financial instruments measured at amortised cost and financial instruments designated at FVPL. Interest income on interest bearing financial assets measured at FVOCI under SLFRS 9, similarly to interest bearing financial assets classified as available-for-sale or held to maturity under LKAS 39 are also recorded by using the EIR method. The EIR is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset.

The EIR (and therefore, the amortised cost of the asset) is calculated by taking into account any discount or premium on acquisition, fees and costs that are an integral part of the EIR. The Bank recognises interest income using a rate of return that represents the best estimate of a constant rate of return over the expected life of the loan. The calculation includes all fees and points received or paid between parties to the contract that are an integral part of EIR.

If expectations regarding the cash flows on the financial asset are revised for reasons other than credit risk, the adjustment is booked as a positive or negative adjustment to the carrying amount of the asset in the balance sheet with an increase or reduction in interest income. The adjustment is subsequently amortised through Interest and similar income in the profit or loss.

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.

For the year ended 31st December	Bank		Group	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Interest income [Note 9 (a)]	108,104,923	96,175,453	116,488,588	103,908,195
Interest expense [Note 9 (b)]	60,525,342	56,526,138	62,852,424	58,446,928
Net interest income	47,579,581	39,649,315	53,636,164	45,461,267

9 (a) Interest income

The Bank calculates interest income by applying the EIR to the gross carrying amount of financial assets other than credit-impaired assets.

When a financial asset becomes credit-impaired (as set out in Note 31 (c) (i) to the financial statements) and is, therefore, regarded as 'Stage 3', the Bank calculates interest income by applying the effective interest rate to the net amortised cost of the financial asset. If the financial assets cure (as outlined in Note 31 (c) (i) to the financial statements) and is no longer credit-impaired, the Bank reverts to calculating interest income on a gross basis.

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.

For purchased or originated credit-impaired (POCI) financial assets (as set out in Note 31 (b) to the financial statements), the Bank calculates interest income by calculating the credit-adjusted EIR and applying that rate to the amortised cost of the asset. The credit-adjusted EIR is the interest rate that, at original recognition, discounts the estimated future cash flows (including credit losses) to the amortised cost of the POCI assets.

Interest income on all trading assets and financial assets mandatorily required to be measured at FVPL is recognised using the contractual interest rate in net trading income and Net gains/(losses) on financial assets at fair value through profit or loss, respectively.

For the year ended 31st December	Bank		Group	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Cash and cash equivalents	25,221	24,311	36,378	86,471
Securities purchased under resale agreements	55,817	198,392	132,658	290,213
Placements with banks	146,535	156,826	759,427	625,538
Interest income accrued on impaired financials assets	285,770	40,326	285,770	40,326
Financial assets recognised through profit or loss				
- Measured at fair value	3,441	4	4,921	1,724
Financial assets at amortised cost				
- Loans and receivables to customers	90,639,156	78,912,222	97,184,483	84,859,754
- Debt and other instruments	9,463,467	7,009,086	9,980,012	7,339,101
Financial assets at fair value through other comprehensive income / financial investments - available for sale	7,423,655	9,781,219	8,103,895	10,569,776
Financial investments - held to maturity	-	-	-	95,108
Other interest income	61,861	53,067	1,044	184
	108,104,923	96,175,453	116,488,588	103,908,195

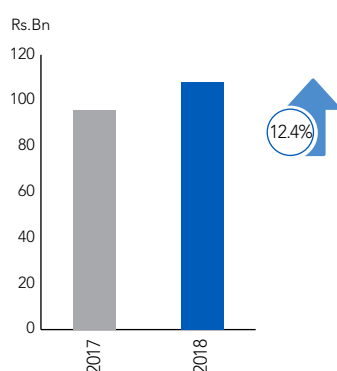
Notes to the Financial Statements

9 NET INTEREST INCOME (Contd.)

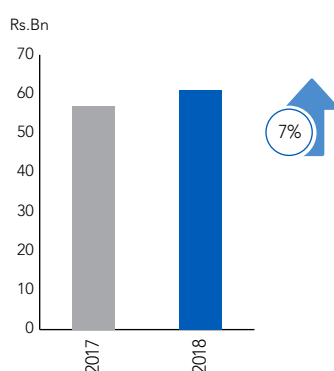
9 (b) Interest Expenses

For the year ended 31st December	Bank		Group	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Securities sold under repurchase agreements	463,870	1,076,289	463,870	1,076,289
Due to banks	3,727,094	3,233,113	3,727,094	3,233,113
Deposits from customers (due to customers)	51,793,156	47,511,413	54,030,026	49,350,749
Debt securities issued	439,440	442,556	526,607	544,288
Other borrowings	1,582,040	1,437,027	1,593,445	1,437,099
Subordinated term debts	2,518,720	2,825,639	2,510,360	2,805,289
Other interest expenses	1,022	101	1,022	101
	60,525,342	56,526,138	62,852,424	58,446,928

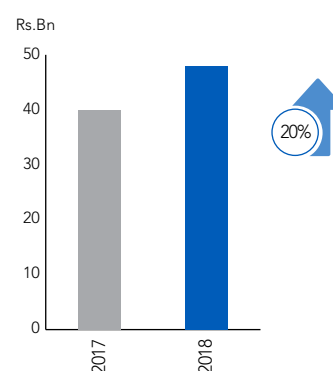
Interest Income - Bank



Interest Expenses - Bank



Net Interest Income - Bank



9 (c) Net Interest Income from Sri Lanka Government Securities

For the year ended 31st December	Bank		Group	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Interest income	15,639,302	15,567,143	16,547,056	16,458,457
Less : Interest expenses	463,870	1,076,289	463,870	1,076,289
Net interest income from Sri Lanka Government Securities	15,175,432	14,490,854	16,083,186	15,382,168

Notional tax credit for withholding tax on government securities on secondary market transactions

Section 137 of the Inland Revenue Act No 10 of 2006 provided that a company which derives interest income from the secondary market transactions in government securities (treasury bills, treasury bonds and Central Bank securities) was 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 3 months ended 31st March 2018 by the Bank / Group has been grossed up in the financial statements and the resulting notional tax credit recognised for the period amounted to Rs 232.6 Mn for the Bank and Rs 289.1 Mn for the Group. The notional tax credit recognised in the year 2017 amounted to Rs. 907 Mn for the Bank and Rs 984 Mn for the Group.

10 NET FEE AND COMMISSION INCOME

Accounting Policy

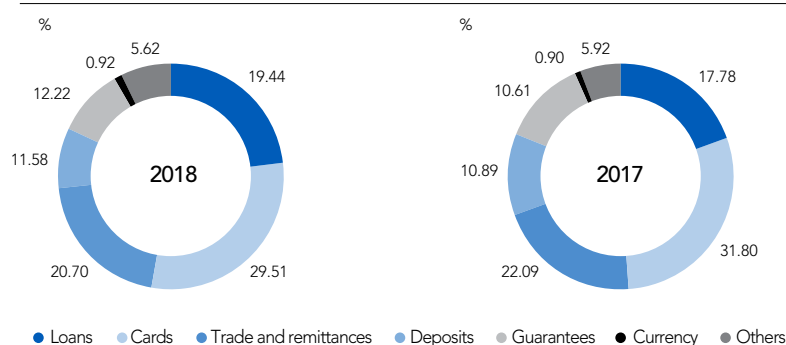
The Group earns fee and commission income from a diverse range of services it provides to its customers which can be divided in to the following two categories.

- (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.

For the year ended 31st December	Bank		Group	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Fee and commission income	9,540,862	8,415,579	10,382,030	9,227,529
Less: Fee and commission expenses	141,592	105,482	284,080	213,143
Net fee and commission income	9,399,270	8,310,097	10,097,950	9,014,386
Comprising :				
Loans	1,671,658	1,615,869	2,342,804	2,301,429
Cards	2,989,048	2,452,506	2,989,048	2,452,506
Trade and remittances	2,076,348	1,720,104	2,076,348	1,720,104
Deposits	1,024,047	962,266	878,730	851,893
Guarantees	997,176	1,015,770	997,176	1,015,770
Currency	84,437	76,146	84,437	76,146
Others	556,556	467,436	729,407	596,538
Net fee and commission income	9,399,270	8,310,097	10,097,950	9,014,386

Net Fee and Commission Income - Bank



Notes to the Financial Statements

11 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 from 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	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Financial assets - Held for trading				
Fixed income				
Net marked to market gain / (loss)	(3)	-	(3)	1,185
Net capital gain	(913)	146	(913)	146
Equities				
Net marked to market gain / (loss)	(7,981)	7,106	(51,797)	15,206
Net capital gain	1,640	6,006	2,946	7,902
Dividend income	2,418	16,315	4,604	20,679
Derivative financial instruments				
Gain / (loss) on revaluation of foreign currency derivatives				
- With banks	(478,822)	(3,740,180)	(478,822)	(3,740,180)
- With customers	127,067	(596)	127,067	(596)
Total net loss from trading	(356,594)	(3,711,203)	(396,918)	(3,695,658)

12 NET GAIN FROM FINANCIAL INVESTMENTS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME / FINANCIAL INVESTMENTS AVAILABLE FOR SALE

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	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Fixed Income				
Net capital gain / (loss)	-	-	-	16,070
Equities				
Net capital gain / (loss)	-	-	-	14,562
Dividend income	215,551	212,129	217,896	216,534
Total net gain from financial investments	215,551	212,129	217,896	247,166

13 NET INSURANCE PREMIUM INCOME

Accounting Policy

Insurance Premiums

Life Insurance Business

Gross Written Premium on life insurance contracts are recognised as revenue when a premium is due from a policyholder. (policies within the 30 day grace period are considered as due). Premium received in advance, are not recorded as revenue but recorded as liability until the premium is due, unless otherwise the relevant policy conditions require such premium to be recognised as revenue. 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 Written Premium on General Insurance comprise the total premiums received / receivable for the whole period of cover provided by contracts entered into during the accounting period. Premium is generally recognised upon the inception of the policy as written and are earned primarily on a pro-rata basis over the term of the related policy coverage.

Gross Written Premium of General Business (GWP) is deferred over the term of the underlying policies' risk attached period according to the Regulation of Insurance Industry Act, No. 43 of 2000 and subsequent amendment there to. Unearned premium is the proportion of premium that relate to the period of risk after the respective reporting period. Group uses 1/24th basis to defer the GWP of all policies except for the Marine Insurance policies and Title Insurance policies, where Marine Insurance premiums are deferred based on 60 : 40 basis and total premiums on Title Insurance are transferred to Title Insurance Reserve for the reporting period.

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. Value of the 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).

For the year ended 31st December	Group	
	2018 Rs 000	2017 Rs 000
Gross insurance premium income	8,708,080	7,755,683
Reinsurers' share of gross insurance premium income	(1,059,269)	(1,100,573)
Net written premium	7,648,811	6,655,110
Net change in reserves for unearned premium	(216,988)	(328,818)
Net insurance premium income	7,431,823	6,326,292

14 NET 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 Bank'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	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Auditorium hire income	2,095	1,831	2,095	1,831
Dividend income from subsidiaries and joint venture	254,315	1,824,091	-	-
Foreign exchange gain / (loss)				
- With banks	1,837,229	1,932,575	1,879,996	1,936,632
- With customers	1,545,470	1,315,940	1,545,470	1,315,940
Gain on disposal of property, plant and equipment (net)	3,040	7,800	3,407	14,178
Rental income	9,696	9,583	217,326	202,736
Rental income from investment properties	53,059	60,023	114,268	118,720
Recovery of loans written off in prior years	109,630	34,082	125,308	46,776
Recovery of operational losses provided for in prior years	735	2,156	735	2,156
Miscellaneous	36,078	15,155	166,377	106,613
	3,851,347	5,203,236	4,054,982	3,745,582

15 IMPAIRMENT CHARGE FOR LOANS AND OTHER LOSSES

Accounting Policy

The Group recognises the changes in the impairment provisions for loans and receivables. These provisions are assessed as per SLFRS 9 - "Financial Instruments" w.e.f. 1st January 2018 while the impairment charge for the year ended 31st December 2017 has been 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 Group also makes provisions/(write-backs) for impairment of debt instruments carried at fair value through other comprehensive income and financial assets carried at amortised cost in accordance with SLFRS 9. Prior to 1st January 2018 group recognised impairment provisions in respect 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.

The table below shows the ECL charges on financial instruments for the year recorded in the statement of profit or loss:

	Bank				Group			
	Individual Rs. 000	Collective Rs. 000	Others Rs. 000	Total Rs. 000	Individual Rs. 000	Collective Rs. 000	Others Rs. 000	Total Rs. 000
Financial assets at amortised cost - loans and advances	3,938,643	4,305,093	-	8,243,736	3,938,643	4,745,232	-	8,683,875
Stage 1	-	732,234	-	732,234	-	675,217	-	675,217
Stage 2	-	1,269,310	-	1,269,310	-	1,322,724	-	1,322,724
Stage 3	3,938,643	2,303,549	-	6,242,192	3,938,643	2,747,291	-	6,685,934
Financial assets at amortised cost - debt instruments	-	-	729,118	729,118	-	-	780,610	780,610
Stage 1	-	-	632,769	632,769	-	-	632,769	632,769
Stage 2	-	-	88,296	88,296	-	-	88,296	88,296
Stage 3	-	-	8,053	8,053	-	-	59,545	59,545
Financial assets at amortised cost - balances with banks	-	-	(2,271)	(2,271)	-	-	(2,271)	(2,271)
Stage 1	-	-	(2,271)	(2,271)	-	-	(2,271)	(2,271)
Stage 2	-	-	-	-	-	-	-	-
Stage 3	-	-	-	-	-	-	-	-
Financial assets at amortised cost - placements with banks	-	-	(38,355)	(38,355)	-	-	(38,355)	(38,355)
Stage 1	-	-	(38,355)	(38,355)	-	-	(38,355)	(38,355)
Stage 2	-	-	-	-	-	-	-	-
Stage 3	-	-	-	-	-	-	-	-
Contingent liabilities and commitments	-	-	368,954	368,954	-	-	368,954	368,954
Stage 1	-	-	147,613	147,613	-	-	147,613	147,613
Stage 2	-	-	127,450	127,450	-	-	127,450	127,450
Stage 3	-	-	93,891	93,891	-	-	93,891	93,891
Direct write offs	-	-	52	52	-	-	52	52
Reversal of impairment on Property, plant and equipment [Note 38]	-	-	(40,501)	(40,501)	-	-	(40,501)	(40,501)
Other charges for impairment	-	-	31,688	31,688	-	-	31,688	31,688
	3,938,643	4,305,093	1,048,685	9,292,421	3,938,643	4,745,232	1,100,177	9,784,052

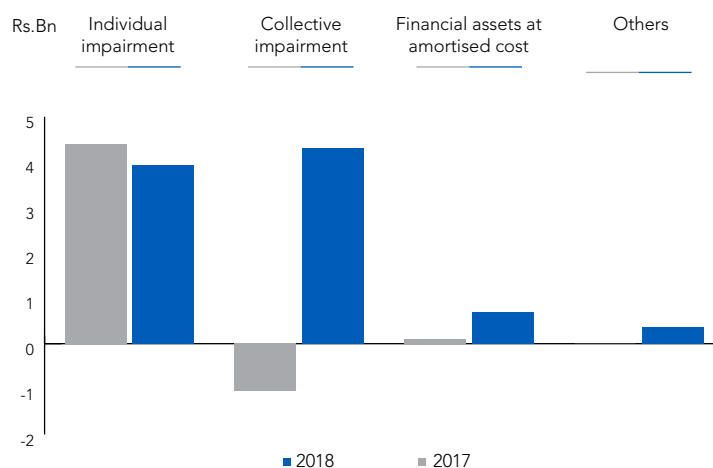
Notes to the Financial Statements

15 IMPAIRMENT CHARGE FOR LOANS AND OTHER LOSSES (Contd.)

The table below shows the impairment charges recorded in the statement of profit or loss under LKAS 39 during 2017:

For the year ended 31st December	Bank	Group
	2017	2017
	Rs 000	Rs 000
Loans and receivables to customers		
Individual impairment	4,397,848	4,397,848
Collective impairment	(1,470,163)	(1,047,317)
Direct write offs	5	5
Others	(1,990)	(1,990)
Financial assets measured at fair value through other comprehensive income / financial investments – available for sale	94,359	96,215
Financial investments - loans and receivables	7,860	473,839
Reversal of impairment - Property, plant and equipment (Note 38)	(64,178)	(64,178)
Other charges for impairment	71,727	71,727
	3,035,468	3,926,149

Impairment Charge / (Reversal) for Loans and Other Losses - Bank



16 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	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Salaries and bonus	7,829,535	7,401,523	9,433,949	9,196,844
Contributions to Employees' Provident Fund	1,009,464	577,269	1,188,025	730,384
Contributions to Employees' Trust Fund	161,833	143,981	206,262	181,889
Contribution to defined benefit plan [Note 16 (a)]	427,361	345,806	507,769	418,104
Increase in liability for EPF interest guarantee	11,218	1,518	11,218	1,518
Increase in liability for accumulated leave	7,885	3,678	7,885	3,678
Others	552,787	392,867	935,643	383,867
	10,000,083	8,866,642	12,290,751	10,916,284

16 (a) Contribution to Defined Benefit Plan

For the year ended 31st December	Bank		Group	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Current service cost	611,349	587,759	611,349	587,759
Net interest on defined benefit asset	(183,988)	(241,953)	(183,988)	(241,953)
Provision for gratuities	-	-	80,408	72,298
	427,361	345,806	507,769	418,104

17 BENEFITS, CLAIMS AND UNDERWRITING EXPENDITURE

Accounting Policy

Gross Benefits and Claims

Benefits and Claims paid - Life Insurance

Claims by death and maturity are charged on notification of death or on expiry of the term. The interim payments and surrenders are accounted for only at the time of settlement.

Benefits and Claims Paid - General Insurance

General insurance claims include all claims occurred 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) are 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 quarterly 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 the relevant 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 claims are recognised according to the terms of the relevant contract.

Underwriting and Net Acquisition Cost

Reinsurance commission income is accrued according to the agreed terms with the reinsurers.

For the year ended 31st December	Group	
	2018 Rs 000	2017 Rs 000
Net insurance benefits and claims paid	3,123,585	2,178,556
Net change in insurance claims outstanding	112,904	114,850
Change in contract liabilities - Life fund	1,698,517	2,166,427
Change in contract liability due to transfer of one-sff surplus	(381,156)	-
Underwriting and net acquisition costs	1,125,419	1,026,031
	5,679,269	5,485,864

18 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	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Advertising and related expenses	197,660	251,319	325,942	312,371
Auditors' remuneration [Note 18 (a)]	22,156	22,153	34,112	32,818
Business promotion and product expenses	843,918	765,997	843,918	775,989
Crop insurance levy	157,000	201,630	192,192	221,710
Deposit insurance premium	692,980	621,468	719,378	644,073
Depreciation and amortisation [Note 18 (b)]	1,354,762	1,128,802	1,826,468	1,556,843
Direct operating expenses on investment property	-	-	9,464	7,760
Directors' emoluments	85,187	119,102	117,350	147,562
Donations	14,258	10,363	14,602	11,374
Legal expenses and professional fees	79,780	83,830	106,173	98,037
Office administration and establishment expenses	7,206,121	6,218,958	7,974,162	6,535,343
Operational risk event losses	73,530	76,792	73,530	76,792
Other overhead expenses	1,348,531	1,183,047	2,116,659	1,980,696
Share issue expenses	-	6,346	-	6,346
	12,075,883	10,689,807	14,353,950	12,407,714

Notes to the Financial Statements

18 OTHER EXPENSES (Contd.)

18 (a) Auditors' Remuneration

For the year ended 31st December	Bank		Group	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Audit fees and expenses	12,500	11,360	21,950	20,448
Audit related fee and expenses	2,463	1,954	3,618	3,006
Non-audit expenses	7,193	8,839	8,544	9,364
	22,156	22,153	34,112	32,818

18 (b) Depreciation and amortization expenses

Amortisation of intangible assets (Note 39)	292,274	256,008	356,990	309,768
Depreciation of investment property (Note 37)	1,646	1,616	39,107	22,937
Depreciation of property, plant and equipment (Note 38)	1,060,842	871,178	1,430,371	1,224,138
	1,354,762	1,128,802	1,826,468	1,556,843

19 VALUE ADDED TAX (VAT), NATION BUILDING TAX (NBT) AND DEBT RECOVERY LEVY (DRL) ON FINANCIAL SERVICES

Value Added Tax (VAT) and Nation Building Tax (NBT)

The base of the calculation of Value Added Tax (VAT) and Nation Building Tax (NBT) on financial services is the operating profit before VAT and NBT on financial services adjusted for emoluments of employees and economic depreciation.

VAT rate applied during 2018 is 15% (2017 - 15%). The NBT rate applied in 2018 is 2% (2017 - 2%).

Debt Recovery Levy (DRL)

In accordance with Section 36 of Finance Act No 35 of 2018, Debt Recovery Levy is charged and levied for every month commencing from October 2018 till December 2021 from every financial institution at the rate of 7% on profit or loss prior to deducting the tax payable under the said section, the value added tax payable under section 25A of the Value Added Tax Act, No. 14 of 2002 and the Nation Building Tax payable under paragraph (iii) of subsection (2) of the Nation Building Tax Act, No. 9 of 2009

For the year ended 31st December	Bank		Group	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Value Added Tax on financial services	5,003,424	4,417,660	5,378,936	4,784,030
Nation Building Tax on financial services	667,123	603,786	715,376	651,598
Debt Recovery Levy	698,721	-	748,501	-
	6,369,268	5,021,446	6,842,813	5,435,628

20 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	
	2018 Rs 000	2017 Rs 000
Share of profit of joint venture before income tax	152,065	191,236
Income tax on share of operating results of joint venture [(charge)/reversal]	151,027	(15,620)
Share of profit of joint venture (net of income tax) [Note 35 (b)]	303,092	175,616

21 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 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;

Notes to the Financial Statements

21 INCOME TAX EXPENSE (Contd.)

Accounting Policy

- 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.

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 below.

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 applicable Inland Revenue Act. In estimating, the Bank had applied the provisions, Inland Revenue Act No 10 of 2006 and the amendments thereto until 31st March 2018 and the provisions of Inland Revenue Act No. 24 of 2017 and the amendments thereto, have been applied w.e.f. 1st April 2018.

The applicable income tax rates are as follows

Hatton National Bank PLC	28%
HNB Assurance PLC and its subsidiary HNB General Insurance Ltd	28%
HNB Finance Ltd	28%
Sithma Development (Pvt) 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) was 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 is applicable to the company.

The deferred tax liabilities / assets are disclosed under Note 49 to the financial statements.

21 (a) Current Income Tax Expense

For the year ended 31st December	Bank		Group	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Current tax on profit for the year	9,916,291	5,472,063	10,824,398	6,170,141
Under / (over) provision in previous years	-	(913,112)	100,010	(912,493)
	9,916,291	4,558,951	10,924,408	5,257,648

21 (b) Deferred Tax Expense

For the year ended 31st December	Bank		Group	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Recognition / (realisation) of deferred tax liability [Note 49 (a) i and 49 (a) ii]	(510,330)	273,830	(186,779)	673,579
(Recognition) / realisation of deferred tax asset [Note 49 (b)]	(1,972,664)	750,640	(3,420,787)	430,389
	(2,482,994)	1,024,470	(3,607,566)	1,103,968
Total income tax expense [Note 21 (d)]	7,433,297	5,583,421	7,316,842	6,361,616
Effective tax rate	32.39%	25.32%	27.65%	27.54%
Effective tax rate (excluding deferred tax)	43.21%	20.68%	41.28%	22.76%

21 (c) Current Tax on Profit for the year - Subsidiaries

For the year ended 31st December	Group	
	2018 Rs 000	2017 Rs 000
Sithma Development (Pvt)Ltd	180,661	6,022
HNB Assurance PLC	7,833	35,221
HNB Finance Ltd	719,613	657,454
Total	908,107	698,697

21 (d) Reconciliation of Effective Tax Rate

For the year ended 31st December	Bank				Group			
	%	2018 Rs 000	%	2017 Rs 000	%	2018 Rs 000	%	2017 Rs 000
Profit before income tax		22,951,500		22,050,211		26,466,304		23,103,012
Tax using the corporate tax rate	28.00	6,426,420	28.00	6,174,060	28.00	7,410,565	28.00	6,468,843
Disallowable expenses	10.39	2,383,557	11.52	2,540,822	11.34	3,002,194	15.51	3,583,157
Tax effects on:								
Allowable expenses	0.10	20,160	(1.27)	(279,639)	0.06	12,718	(1.20)	(276,809)
Tax exempt income	(6.10)	(1,396,840)	(8.79)	(1,938,710)	(7.99)	(2,113,527)	(10.75)	(2,482,494)
Undistributable profits of subsidiaries and joint venture	-	-	-	-	0.52	137,379	-	-
Utilisation of previously unrecognised tax losses	-	-	-	-	(4.66)	(1,232,497)	-	-
Tax loss utilised	-	-	-	-	-	-	(0.08)	(18,588)
	32.39	7,433,297	29.46	6,496,533	27.27	7,216,832	31.49	7,274,109
Under / (over) provision in prior years	-	-	(4.14)	(913,112)	0.38	100,010	(3.95)	(912,493)
Income tax expense [Note 21 (b)]	32.39	7,433,297	25.32	5,583,421	27.65	7,316,842	27.54	6,361,616

Notes to the Financial Statements

21 INCOME TAX EXPENSE (Contd.)

21 (e) Tax Losses Brought Forward and Utilised during the Year

For the year ended 31st December	Group	
	2018 Rs 000	2017 Rs 000
Balance as at 1st January	5,706,098	4,708,101
Adjustment for brought forward tax losses	(81,248)	182,524
Tax losses incurred during the year	170,709	881,859
Tax losses recognised and utilised during the year	(1,183,576)	(66,386)
Tax losses carried forward	4,611,983	5,706,098

HNB Assurance PLC, subsidiary of the Bank recognised a deferred tax asset of Rs 1,280.40 Mn on brought forward tax losses during the year.

22 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".

22 (a) Basic Earnings per Share

For the year ended 31st December	Bank		Group	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Amount used as the numerator				
Profit attributable to equity holders of the Bank (Rs 000)	15,518,203	16,466,790	17,635,774	15,946,989
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)	492,593	478,711	492,593	478,711
Basic earnings per ordinary share (Rs)	31.50	34.40	35.80	33.31

22 (b) Diluted Earnings per Share

Amount used as the numerator				
Profit attributable to equity holders of the Bank (Rs 000)	15,518,203	16,466,790	17,635,774	15,946,989
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)	492,593	478,711	492,593	478,711
Effect of dilution:				
Weighted average number of potential ordinary shares outstanding under ESOP ('000)	190	946	190	946
Weighted average number of potential ordinary shares that would have been issued at average market price ('000)	(118)	(558)	(118)	(558)
Weighted average number of potential ordinary shares that would have been issued for zero consideration under ESOP	72	388	72	388
Weighted average number of ordinary shares outstanding during the year used as the denominator for diluted EPS ('000)	492,665	479,099	492,665	479,099
Diluted earnings per ordinary share (Rs)	31.50	34.37	35.80	33.29

23 DIVIDENDS PAID AND PROPOSED

For the year ended 31st December	2018			2017		
	Gross Dividend	Dividend Tax	Net Dividend	Gross Dividend	Dividend Tax	Net Dividend
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Interim dividends paid						
Rs 1.50 cash dividend per share declared and paid in 2017	-	-	-	732,745	-	732,745
Rs 5.00 cash dividend per share declared for 2017 and paid in 2018	2,442,768	111,661	2,331,107	-	-	-
Rs 1.50 cash dividend per share declared for 2018 and paid in 2018	738,976	43,233	695,743	-	-	-
Final dividends paid						
Rs 3.50 cash dividend per share declared in 2016 and paid in 2017	-	-	-	1,451,296	107,698	1,343,598
Rs 3.50 scrip dividend per share declared in 2016 and paid in 2017	-	-	-	1,451,296	144,577	1,306,719
Rs 2.00 scrip dividend per share declared in 2017 and paid in 2018	977,592	97,085	880,507	-	-	-
Total dividends paid	4,159,336	251,979	3,907,357	3,635,337	252,275	3,383,062

23 (a) Proposed Dividends

The Directors recommend that a final dividend of Rs. 7.00 per share by way of Rs. 3.50 per share, cash and Rs. 3.50 per share, scrip dividend (2017 Rs. 2.00 per share, cash) on both voting and non-voting shares of the Bank, be paid for the financial year ended 31st December 2018.

The final dividend is to be approved at the Annual General Meeting to be held on 29th March 2019. In accordance with Sri Lanka Accounting Standard – LKAS 10 on “Events after the reporting period”, this final dividend have not been recognised as a liability as at 31st December 2018 under the Inland Revenue Act No. 24 of 2017, a withholding tax of 14% has been imposed on dividends declared. The interim dividend of Rs 1.50 per share (2017 : 1st interim dividend Rs 1.50 per share and second interim dividend on Rs 5.00 per share) was paid to the shareholders on 19th December 2018. Final dividend proposed amounts to Rs. 3,449 Mn (2017 final dividend proposed : Rs 977 Mn).

24 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

24 ANALYSIS OF FINANCIAL INSTRUMENTS BY MEASUREMENT BASIS (Contd.)

24 (a) Analysis of Financial Instruments by Measurement Basis - Bank

	Fair Value through Profit or Loss	Amortised Cost	Fair Value through Other Comprehensive Income	Total Carrying Amount
As at 31st December 2018	Rs 000	Rs 000	Rs 000	Rs 000
Assets				
Cash and cash equivalents	-	25,141,890	-	25,141,890
Placements with banks	-	3,292,733	-	3,292,733
Balances with Central Bank of Sri Lanka	-	33,907,057	-	33,907,057
Reverse repurchase agreements	-	90,094	-	90,094
Derivative financial instruments	4,507,576	-	-	4,507,576
Financial assets recognised through profit or loss	100,342	-	-	100,342
Financial assets at amortised cost - loans and advances	-	749,048,820	-	749,048,820
Financial assets at amortised cost - debt and other instruments	-	160,145,680	-	160,145,680
Financial assets measured at fair value through other comprehensive income	-	-	69,436,989	69,436,989
Other assets	-	466,252	-	466,252
Total financial assets	4,607,918	972,092,526	69,436,989	1,046,137,433
Liabilities				
Due to banks	-	77,492,582	-	77,492,582
Derivative financial instruments	2,519,172	-	-	2,519,172
Securities sold under repurchase agreements	-	16,678,946	-	16,678,946
Financial liabilities at amortised cost - due to depositors	-	799,975,356	-	799,975,356
Dividends payable	-	994,812	-	994,812
Financial liabilities at amortised cost - other borrowings	-	24,894,155	-	24,894,155
Debt securities issued	-	4,487,763	-	4,487,763
Other liabilities	-	12,951	-	12,951
Subordinated term debts	-	22,229,951	-	22,229,951
Total financial liabilities	2,519,172	946,766,522	-	949,285,694

As at 31st December 2017	Fair Value Through Profit or Loss Rs 000	Loans and Receivable Rs 000	Available- for-Sale Rs 000	Total Carrying Amount Rs 000
Assets				
Cash and cash equivalents	-	21,739,800	-	21,739,800
Placements with banks	-	3,182,377	-	3,182,377
Balances with Central Bank of Sri Lanka	-	38,610,940	-	38,610,940
Derivative financial instruments	615,357	-	-	615,357
Financial assets recognised through profit or loss	120,486	-	-	120,486
Loans and receivables to customers	-	639,102,061	-	639,102,061
Financial investments - loans and receivables	-	122,199,048	-	122,199,048
Financial investments - available-for-sale	-	-	95,403,820	95,403,820
Other assets	-	405,437	-	405,437
Total financial assets	735,843	825,239,663	95,403,820	921,379,326
Liabilities				
Due to banks	-	62,463,497	-	62,463,497
Derivative financial instruments	1,305,900	-	-	1,305,900
Securities sold under repurchase agreements	-	5,064,360	-	5,064,360
Financial liabilities at amortised cost - due to depositors	-	701,519,297	-	701,519,297
Dividends payable	-	975,371	-	975,371
Financial liabilities at amortised cost - Other borrowings	-	27,258,006	-	27,258,006
Debt securities issued	-	4,540,259	-	4,540,259
Other liabilities	-	22,985	-	22,985
Subordinated term debts	-	25,809,261	-	25,809,261
Total financial liabilities	1,305,900	827,653,036	-	828,958,936

Notes to the Financial Statements

24 ANALYSIS OF FINANCIAL INSTRUMENTS BY MEASUREMENT BASIS (Contd.)

24 (b) Analysis of Financial Instruments by Measurement Basis - Group

	Fair Value through Profit or Loss	Amortised Cost	Fair Value through Other Comprehensive Income	Total Carrying Amount
As at 31st December 2018	Rs 000	Rs 000	Rs 000	Rs 000
Assets				
Cash and cash equivalents	-	24,966,831	-	24,966,831
Placements with banks	-	8,506,255	-	8,506,255
Balances with Central Bank of Sri Lanka	-	33,907,057	-	33,907,057
Reverse repurchase agreements	-	1,168,764	-	1,168,764
Derivative financial instruments	4,507,576	-	-	4,507,576
Financial assets recognised through profit or loss	264,420	-	-	264,420
Financial assets at amortised cost - loans and advances	-	770,263,000	-	770,263,000
Financial assets at amortised cost - debt and other instruments	-	165,821,983	-	165,821,983
Financial assets measured at fair value through other comprehensive income	-	-	76,005,258	76,005,258
Other assets	-	1,322,063	-	1,322,063
Total financial assets	4,771,996	1,005,955,953	76,005,258	1,086,733,207
Liabilities				
Due to banks	-	77,976,010	-	77,976,010
Derivative financial instruments	2,519,172	-	-	2,519,172
Securities sold under repurchase agreements	-	16,678,946	-	16,678,946
Financial liabilities at amortised cost - due to depositors	-	818,041,962	-	818,041,962
Dividends payable	-	1,009,468	-	1,009,468
Financial liabilities at amortised cost - other borrowings	-	24,894,155	-	24,894,155
Debt securities issued	-	5,030,000	-	5,030,000
Other liabilities	-	2,124,432	-	2,124,432
Subordinated term debts	-	21,930,246	-	21,930,246
Total financial liabilities	2,519,172	967,692,978	-	970,212,150

As at 31st December 2017	Fair Value Through Profit or Loss Rs 000	Held to Maturity Rs 000	Loans and Receivable Rs 000	Available- for-Sale Rs 000	Total Carrying Amount Rs 000
Assets					
Cash and cash equivalents	-	-	21,924,898	-	21,924,898
Placements with banks	-	-	9,670,125	-	9,670,125
Balances with Central Bank of Sri Lanka	-	-	38,610,940	-	38,610,940
Reverse repurchase agreements	-	-	772,002	-	772,002
Derivative financial instruments	615,357	-	-	-	615,357
Financial assets recognised through profit or loss	266,538	-	-	-	266,538
Loans and receivables to customers	-	-	655,612,938	-	655,612,938
Financial investments - loans and receivables	-	-	125,031,671	-	125,031,671
Financial investments - available-for-sale	-	-	-	101,742,985	101,742,985
Financial investments - held to maturity	-	1,565,603	-	-	1,565,603
Other assets	-	-	1,451,429	-	1,451,429
Total financial assets	881,895	1,565,603	853,074,003	101,742,985	957,264,486
Liabilities					
Due to banks	-	-	62,464,391	-	62,464,391
Derivative financial instruments	1,305,900	-	-	-	1,305,900
Securities sold under repurchase agreements	-	-	5,064,360	-	5,064,360
Financial liabilities at amortised cost - due to customers	-	-	718,770,051	-	718,770,051
Dividends payable	-	-	986,880	-	986,880
Financial liabilities at amortised cost - other borrowings	-	-	27,258,006	-	27,258,006
Debt securities issued	-	-	5,035,958	-	5,035,958
Other liabilities	-	-	1,268,066	-	1,268,066
Subordinated term debts	-	-	25,564,596	-	25,564,596
Total financial liabilities	1,305,900	-	846,412,308	-	847,718,208

Notes to the Financial Statements

25 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 fair value and are used by the Group in the management of its short term commitments. These are brought to financial statements at the face values or gross values. Cash and cash equivalents are carried at amortised cost in the statement of financial position.

For the year ended 31st December	Bank		Group	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Local currency in hand	21,632,025	19,724,781	21,843,384	19,790,818
Foreign currency in hand	1,224,769	1,087,729	1,224,769	1,087,729
Balances with banks	2,288,914	927,290	1,902,498	1,046,351
Less : Allowance for impairment losses [Note 25 (a)]	(3,818)	-	(3,820)	-
	25,141,890	21,739,800	24,966,831	21,924,898

All cash and cash equivalent balances held by the group entities were available for use by the Group.

25 (a) Movement in Impairment during the year

For the year ended 31st December	Bank	Group
	2018 Rs 000	2018 Rs 000
Stage 1		
Opening balance as at 1st January 2018	6,089	6,091
Net impairment charge for the year	(2,271)	(2,271)
Closing balance as at 31st December 2018	3,818	3,820

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.

For the year ended 31st December	Bank		Group	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Placements - within Sri Lanka	1,829,948	3,182,377	7,043,753	9,670,125
Placements - outside Sri Lanka	1,462,922	-	1,462,922	-
Less : Allowance for impairment losses [Note 26 (a)]	(137)	-	(420)	-
	3,292,733	3,182,377	8,506,255	9,670,125

26 (a) Movement in Impairment during the year

	Bank 2018 Rs 000	Group 2018 Rs 000
For the year ended 31st December		
Stage 1		
Opening balance as at 1st January 2018	38,492	38,775
Net impairment charge for the year	(38,355)	(38,355)
Closing balance as at 31st December 2018	137	420

All cash and cash equivalent balances held by the group entities were available for use by the Group.

27 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 6% as at 31st December 2018 (2017 : 7.5%).

There is no reserve requirement for deposit liabilities of the Foreign Currency Banking Unit (FCBU) and foreign currency deposit liabilities in the Domestic Banking Unit (DBU).

	Bank		Group	
For the year ended 31st December	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Statutory balance with Central Bank of Sri Lanka	33,907,057	38,610,940	33,907,057	38,610,940
	33,907,057	38,610,940	33,907,057	38,610,940

28 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).

	Bank		Group	
For the year ended 31st December	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Securities purchased under reverse repurchase agreements				
With banks	-	-	-	-
With customers	90,094	-	1,168,764	772,002
	90,094	-	1,168,764	772,002

Notes to the Financial Statements

29 DERIVATIVE FINANCIAL INSTRUMENTS

Accounting Policy

A derivative is a financial instrument or other contract with all three of the following characteristics:

- Its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided that, in the case of a non-financial variable, it is not specific to a party to the contract (i.e., the 'underlying').
- It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts expected to have a similar response to changes in market factors.
- It is settled at a future date.

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 11) to the financial statements. 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.

For the year ended 31st December	Bank/Group			
	2018		2017	
	Assets Rs 000	Liabilities Rs 000	Assets Rs 000	Liabilities Rs 000
Currency swaps				
Sales	10,706	6,171	13,454	1,682
Purchases	4,048,327	184,303	307,799	1,237,309
Forward foreign exchange contracts				
Sales	13,887	2,326,882	273,613	29,771
Purchases	434,656	1,816	20,491	37,138
	4,507,576	2,519,172	615,357	1,305,900

30 FINANCIAL ASSETS RECOGNISED THROUGH PROFIT OR LOSS MEASURED AT FAIR VALUE

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 held for trading

The Bank classifies financial assets as held for trading when they have been purchased or issued primarily for short-term profit making through trading activities or form part of a portfolio of financial instruments that are managed together, for which there is evidence of a recent pattern of short-term profit taking. Financial assets held-for-trading are recorded and measured in the statement of financial position at fair value. Changes in fair value are recognised in "net gain / (loss) from trading" (Note 11). Interest income is recorded in "Interest income" and dividend income is recorded in "net gain / (loss) from trading" (Note 11) according to the terms of the contract, or when the right to receive the payment has been established.

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.

Financial assets at fair value through profit or loss

Financial assets in this category are those that are not held for trading and have been either designated by management upon initial recognition or are mandatorily required to be measured at fair value under SLFRS 9. Management only designates an instrument at FVPL upon initial recognition when one of the following criteria are met. Such designation is determined on an instrument-by-instrument basis:

- The designation eliminates, or significantly reduces, the inconsistent treatment that would otherwise arise from measuring the assets or recognising gains or losses on them on a different basis

Or

- The assets until 1st January 2018 under LKAS 39 are part of a group of financial assets, or both under LKAS 39, which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy

Or

- The assets until 1st January 2018 under LKAS 39 containing one or more embedded derivatives, unless they do not significantly modify the cash flows that would otherwise be required by the contract, or it is clear with little or no analysis when a similar instrument is first considered that separation of the embedded derivative(s) is prohibited

Financial assets at FVPL are recorded in the statement of financial position at fair value. Interest earned on assets mandatorily required to be measured at FVPL is recorded using contractual interest rate. Dividend income from equity instruments measured at FVPL is recorded in profit or loss as "other operating income" when the right to the payment has been established.

As at 31st December	2018 Fair Value Rs 000	2017 Fair Value Rs 000
Quoted shares - Bank [Note 30 (a)]	99,057	120,486
Government of Sri Lanka treasury bills [Note 30 (b)]	1,286	-
Total financial assets recognised through profit or loss - Bank [Note 30 (f)]	100,343	120,486
Quoted shares - Subsidiaries [Note 30 (c)]	139,157	118,043
Government of Sri Lanka treasury bonds - Subsidiaries [Note 30 (d)]	15,768	15,768
Quoted units in unit trusts - Subsidiaries [Note 30 (e)]	9,152	12,241
Total financial assets recognised through profit or loss - Subsidiaries	164,077	146,052
Total financial assets recognised through profit or loss - Group [Note 30 (f)]	264,420	266,538

Notes to the Financial Statements

30 FINANCIAL ASSETS RECOGNISED THROUGH PROFIT OR LOSS MEASURED AT FAIR VALUE (Contd.)

30 (a) Quoted Shares Held by the Bank

As at 31st December	2018				2017			
	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	13.06	32,300	34,000	23,035	12.49	28,053
National Development Bank PLC	40,913	10,451	5.92	4,370	39,535	10,264	5.56	5,393
Sector Total		33,486		36,670		33,299		33,446
Chemicals and Pharmaceuticals								
CIC Holdings PLC	556,396	47,850	27.13	22,033	556,396	47,850	25.94	34,497
Sector Total		47,850		22,033		47,850		34,497
Construction and Engineering								
Access Engineering PLC	175	6	-	2	175	6	-	4
Sector Total		6		2		6		4
Diversified Holdings								
Aitken Spence PLC	278,515	30,625	17.36	13,313	278,515	30,625	16.60	15,207
Softlogic Holdings PLC	-	-	-	-	544,065	8,275	4.49	6,801
Sector Total		30,625		13,313		38,900		22,008
Hotels and Travels								
Aitken Spence Hotel Holdings PLC	575,301	45,998	26.08	15,534	575,301	45,998	24.93	16,971
Asian Hotels & Properties PLC	207,476	14,918	8.46	8,901	207,476	14,918	8.09	10,955
Sector Total		60,916		24,435		60,916		27,926
Motors								
United Motors Lanka PLC	33,385	3,522	2.00	2,604	33,385	3,522	1.91	2,605
Sector Total		3,522		2,604		3,522		2,605
Total		176,405		99,057		184,493		120,486
Unrealised loss from marked to market valuation		(77,349)				(64,007)		
Total quoted shares - Bank		99,056		99,057		120,486		120,486

30 (b) Government of Sri Lanka Treasury Bills

As at 31st December	2018		2017	
	Cost of Investment Rs 000	Fair Value Rs 000	Cost of Investment Rs 000	Fair Value Rs 000
Year of maturity				
2019	1,289	1,286	-	-
Unrealised loss from marked to market valuation	(3)	-	-	-
Total Government of Sri Lanka treasury bills	1,286	1,286	-	-

30 (c) Quoted shares Held by Subsidiaries

As at 31st December	2018				2017			
	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								
Central Finance Company PLC	153,075	11,464	7.81	13,578	-	-	-	-
National Development Bank PLC	3,408	364	0.25	364	11,729	1,600	1.69	1,600
Sampath Bank PLC	101,830	18,759	12.79	23,930	59,087	11,925	12.57	18,654
Nations Trust Bank PLC	89,529	6,083	4.15	7,986	87,261	6,083	6.41	6,806
Peoples Leasing & Finance PLC	721,543	12,988	8.85	11,761	721,543	12,988	13.69	12,266
Seylan Bank PLC - (Non-Voting)	538,707	21,066	14.36	23,972	316,216	11,243	11.85	17,708
Sector Total		70,724		81,591		43,839		57,034
Chemicals and Pharmaceuticals								
CIC Holdings PLC	-	-	-	-	61,920	4,363	4.60	3,839
Sector Total		-		-		4,363	-	3,839
Diversified Holdings								
John Keells Holdings PLC	38,274	5,622	3.83	6,112	38,274	5,622	5.92	5,684
Richard Peiris and Company PLC	312,851	4,351	2.97	3,285	312,851	4,351	4.58	4,067
Vallibel One PLC	305,925	5,521	3.76	5,201	305,925	5,521	5.82	5,415
Melstacorp PLC	124,532	7,381	5.03	6,264	195,000	11,559	12.18	11,603
Sector Total		22,875		20,862		27,053		26,769
Beverage Food and Tobacco								
Distilleries Company of Sri Lanka PLC	45,786	-	-	738	-	-	-	-
Sector Total		-		738		-		-
Land and Property								
Overseas Realty (Ceylon) PLC	657,205	16,702	11.38	10,844	-	-	-	-
Sector Total		16,702		10,844		-		-
Manufacturing								
Royal Ceramic Lanka PLC	78,000	10,385	7.08	5,819	28,000	4,317	4.55	3,205
ACL Cables PLC	126,400	3,053	2.08	4,675	126,400	3,053	3.22	5,359
Tokyo Cement Company (Lanka) PLC	580,471	22,970	15.66	14,628	330,869	12,278	12.94	21,837
Sector Total		36,408		25,122		19,648		30,401
Total		146,709		139,157		94,903		118,043
Unrealised gain / (loss) from marked to market valuation		(7,552)				23,140		
Total quoted shares - Subsidiaries		139,157		139,157		118,043		118,043

Notes to the Financial Statements

30 FINANCIAL ASSETS RECOGNISED THROUGH PROFIT OR LOSS MEASURED AT FAIR VALUE (Contd.)

30 (d) Government of Sri Lanka Treasury Bonds Held by Subsidiaries

As at 31st December	2018		2017	
	Cost of Investment	Fair Value	Cost of Investment	Fair Value
	Rs 000	Rs 000	Rs 000	Rs 000
Year of Maturity				
2021	16,370	15,768	16,370	15,768
Unrealised loss from marked to market valuation	(602)	-	(602)	-
Total Government of Sri Lanka treasury bonds - Subsidiaries	15,768	15,768	15,768	15,768

30 (e) Quoted Units in Unit Trusts Held by Subsidiaries

As at 31st December	2018			2017		
	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	9,152	114,400	7,203	12,241
Unrealised gain from marked to market valuation		1,949			5,038	-
Total quoted units - Subsidiaries		9,152	9,152		12,241	12,241

30 (f) Analysis

As at 31st December	Bank		Group	
	2018 Fair Value	2017 Fair Value	2018 Fair Value	2017 Fair Value
	Rs 000	Rs 000	Rs 000	Rs 000
By collateralisation				
Pledged as collateral	-	-	-	-
Unencumbered	100,342	120,486	264,420	266,538
Total	100,342	120,486	264,420	266,538
By currency				
Sri Lankan Rupee	100,342	120,486	264,420	266,538
Total	100,342	120,486	264,420	266,538

31 FINANCIAL ASSETS AT AMORTISED COST - LOANS AND ADVANCES TO CUSTOMERS

Accounting Policy

Before 1st January 2018, loans and advances to customers, included non-derivative financial assets with fixed or determinable payments that were not quoted in an active market, other than those:

- That the Bank intended to sell immediately or in the near term
- That the Bank, upon initial recognition, designated at FVPL or as available-for-sale
- For which the Bank may not recover substantially all of its initial investment, other than because of credit deterioration, which were designated as available-for-sale.

From 1st January 2018, the Bank measures due from banks, loans and advances to customers and other financial investments at amortised cost if both of the following conditions are met:

- The financial asset is held within a business model with the objective to hold financial assets in order to collect contractual cash flows
- The contractual terms of the financial asset give rise on specified dates to cash flows that are Solely Payments of Principal and Interest (SPPI) on the principal amount outstanding.

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

The Bank's accounting policy under SLFRS 9 remains the same as it was under LKAS 39. Loans (and the related impairment allowance accounts) are normally written off, either partially or in entirety, when there is no realistic prospect of recovery and all possible steps have been exhausted in recovering dues. Where loans are secured, this is generally after receipt of any proceeds from the realisation of security. If the amount to be written off is greater than the accumulated loss allowance, the difference is first treated as an addition to the allowance that is then applied against the gross carrying amount. If a write-off is later recovered, the recovery is credited to "other operating income".

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 Bank's accounting policy under SLFRS 9 remains the same as it was under LKAS 39. 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's accounting policy under SLFRS 9 remains the same as it was under LKAS 39. The Bank'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.

Notes to the Financial Statements

31 FINANCIAL ASSETS AT AMORTISED COST - LOANS AND ADVANCES TO CUSTOMERS (Contd.)

Rescheduled Loans

The Bank sometimes makes concessions or modifications to the original terms of loans as response to the borrower's financial difficulties, rather than taking possession or to otherwise enforce collection of collateral. The Bank considers a loan to be rescheduled when such concessions or modifications are provided as a result of the borrower's present or expected financial difficulties and the Bank would not have agreed to them if the borrower had been financially healthy. Indicators of financial difficulties include defaults on covenants, or significant concerns raised by the Credit Risk Department. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, any impairment is measured using the original EIR as calculated before the modification of terms. It is the Bank's policy to monitor forborne loans to help ensure that future payments continue to be likely to occur. Derecognition decisions and classification between Stage 2 and Stage 3 are determined on a case-by-case basis. If these procedures identify a loss in relation to a loan, it is disclosed and managed as an impaired Stage 3 forborne asset until it is collected or written off.

From 1 January 2018, when the loan has been renegotiated or modified but not derecognised, the Bank also reassesses whether there has been a significant increase in credit risk, as set out in Note 31 (d) (iii) to the financial statements. Accordingly, all rescheduled loans are classified as Stage 3 unless upgraded due to satisfactory performing period as specified in the Banking Act Directions. Further loans which have been restructured up to two times unless upgraded due to satisfactory performing period as specified in "Guidelines to Licensed banks on the Adoption of Sri Lanka Accounting Standard - SLFRS 9 : Financial Instruments" issued by Central Bank of Sri Lanka are classified as Stage 2 while such loans which have been restructured more than two times are classified as Stage 3.

As at 31st December	Bank		Group	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Gross loans and advances	771,692,625	649,547,067	794,715,100	666,768,376
Stage 1	637,950,611	-	657,991,619	-
Stage 2	106,367,291	-	106,568,285	-
Stage 3	27,374,723	-	30,155,196	-
Less : Accumulated impairment under:	22,643,805	10,445,006	24,452,100	11,155,438
Stage 1 [Note 31 (e) (i)]	3,336,650	-	4,013,171	-
Stage 2 [Note 31 (e) (i)]	3,714,854	-	3,940,900	-
Stage 3 [Note 31 (e) (i)]	15,592,301	-	16,498,029	-
Individual impairment allowance	-	5,390,947	-	5,390,947
Collective impairment allowance	-	5,054,059	-	5,764,491
Net loans and advances	749,048,820	639,102,061	770,263,000	655,612,938

31 (a) Analysis of Loans and Advances

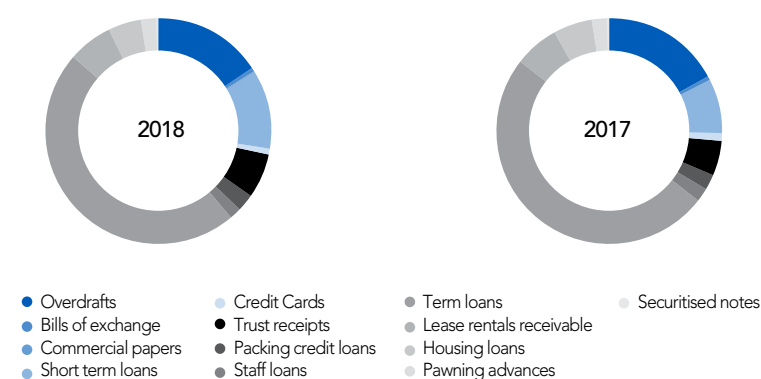
31 (a) i By Product

As at 31st December	Bank		Group	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Overdrafts	122,582,431	111,332,217	122,372,938	111,190,557
Bills of exchange	2,501,543	3,171,579	2,501,543	3,171,579
Commercial papers	154,193	154,365	154,193	154,365
Short term loans	87,921,676	50,852,930	88,164,789	51,015,215
Credit cards	7,926,448	7,072,669	7,926,448	7,072,669
Pawning advances	17,449,986	15,529,655	17,449,986	15,529,655
Trust receipts	49,026,148	32,738,671	49,026,148	32,738,671
Packing credit loans	18,607,105	13,972,361	18,607,105	13,972,361
Staff loans	13,139,967	12,038,721	13,830,322	12,716,383
Term loans	365,549,468	324,665,313	380,211,412	337,379,808
Lease and hire purchase receivable [Note 31 (f)]	49,924,690	42,982,671	57,561,246	46,791,198
Housing loans	36,303,859	34,466,310	36,303,859	34,466,310
Lease backed securities	605,111	569,605	605,111	569,605
Total gross loans and advances (Note 31)	771,692,625	649,547,067	794,715,100	666,768,376

31 (a) ii By Currency

As at 31st December	Bank		Group	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Sri Lankan Rupees	677,463,768	572,606,594	700,486,243	589,827,903
United States Dollars	92,069,540	74,984,565	92,069,540	74,984,565
Great Britain Pounds	717,738	528,595	717,738	528,595
Euros	1,303,480	1,339,934	1,303,480	1,339,934
Other currencies	138,099	87,379	138,099	87,379
Total gross loans and advances (Note 31)	771,692,625	649,547,067	794,715,100	666,768,376

Analysis of Loans and Advances



31 FINANCIAL ASSETS AT AMORTISED COST - LOANS AND ADVANCES TO CUSTOMERS (Contd.)

31 (b) Impairment of Financial Assets

Accounting Policy

As described in Note 2.2.1 to the financial statements, the adoption of SLFRS 9 has fundamentally changed the Bank's loan loss impairment provisioning method by replacing LKAS 39's incurred loss approach with a forward-looking ECL approach. Accordingly, the Bank has recorded an expected credit loss allowance in 2018 for all loans and other debt financial assets not held at FVPL, together with loan commitments and financial guarantee contracts which are commonly referred to as "financial instruments". Equity instruments are not subject to impairment under SLFRS 9.

The ECL allowance is based on the credit losses expected to arise over the life of the asset (the lifetime expected credit loss or LTECL), unless there has been no significant increase in credit risk since origination, in which case, the allowance is based on the 12 months' expected credit loss (12mECL) as outlined in Note 15 to the financial statements). The Bank's policies for determining whether there has been a significant increase in credit risk are set out in Note 31 (d) (iii) to the financial statements.

The 12mECL is the portion of LTECLs that represent the ECLs resulting from default events of a financial instrument that are possible within the 12 months after the reporting date.

Both LTECLs and 12mECLs are calculated either on an individual basis or on collective basis, depending on the nature of the underlying portfolio of financial instruments. The Bank's policy for grouping financial assets measured on a collective basis is explained in Note 31 (d) to the financial statements.

The Bank has established a policy to perform an assessment, at the end of each reporting period, of whether a financial instrument's credit risk has increased significantly since initial recognition, by considering the change in the risk of default occurring over the remaining life of the financial instrument.

Based on the above process, the Bank grouped its loans into Stage 1, Stage 2, Stage 3 and POCI as described below:

- Stage 1 : When loans are first recognised, the Bank recognises an allowance based on 12mECLs. Stage 1 loans also include facilities where the credit risk has improved and the loan has been reclassified from Stage 2.
- Stage 2 : When a loan has shown a significant increase in credit risk since origination, the Bank records an allowance for the LTECLs. Stage 2 loans also include facilities, where the credit risk has improved and the loan has been reclassified from Stage 3.
- Stage 3 : The Bank records an allowance for LTECLs for loans considered credit-impaired.
- POCI : Purchased or originated credit impaired (POCI) assets are financial assets that are credit impaired on initial recognition. POCI assets are recorded at fair value at original recognition and interest income is subsequently recognised based on a credit-adjusted EIR. ECLs are only recognised or released to the extent that there is a subsequent change in the expected credit losses.

For financial assets in respect of which the Bank has no reasonable expectations of recovering either the entire outstanding amount, or a proportion thereof, the gross carrying amount of the financial asset is reduced. This is considered a (partial) derecognition of the financial asset.

The calculation of ECLs

The Bank calculates ECLs based on a three probability-weighted scenarios to measure the expected cash shortfalls, discounted at an approximation to the EIR. A cash shortfall is the difference between the cash flows that are due to the Bank in accordance with the contract and the cash flows that the Bank expects to receive.

The mechanics of the ECL calculations are outlined below and the key elements are, as follows:

PD : The Probability of Default is an estimate of the likelihood of default over a given time horizon. A default may only happen at a certain time over the assessed period, if the facility has not been previously derecognised and is still in the portfolio. The concept of PDs is further explained in Note 31 (d) to the financial statements.

EAD : The Exposure at Default is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and interest, whether scheduled by contract or otherwise, expected drawdowns on committed facilities, and accrued interest from missed payments. The EAD is further explained in Note 31 (d) (i) to the financial statements.

LGD : The Loss Given Default is an estimate of the loss arising in the case where a default occurs at a given time. It is based on the difference between the contractual cash flows due and those that the Bank would expect to receive, including from the realisation of any collateral. It is usually expressed as a percentage of the EAD. The LGD is further explained in Note 31 (d) (ii) to the financial statements.

When estimating the ECLs, the Bank considers three economic scenarios (base case, best case and worse case). Each of these scenarios are associated with different loss rates.

For all products Bank considers the maximum period over which the credit losses are determined is the contractual life of a financial instrument.

Impairment losses and releases are accounted for and disclosed separately from modification losses or gains that are accounted for as an adjustment of the financial asset's gross carrying value.

The mechanics of the ECL method are summarised below:

- Stage 1 : The 12mECL is calculated as the portion of LTECLs that represent the ECLs that result from default events on a financial instrument that are possible within the 12 months after the reporting date. The Bank calculates the 12mECL allowance based on the expectation of a default occurring in the 12 months following the reporting date. These expected 12-month default probabilities are applied to a forecast EAD and multiplied by the expected LGD and discounted by an approximation to the original EIR.
- Stage 2 : When a loan has shown a significant increase in credit risk since origination, the Bank records an allowance for the LTECLs. The mechanics are similar to those explained above, including the use of multiple scenarios, but PDs and LGDs are estimated over the lifetime of the instrument. The expected cash shortfalls are discounted by an approximation to the original EIR.
- Stage 3 : For loans considered credit-impaired the Bank recognises the lifetime expected credit losses. The method is similar to that of Stage 2 assets, with the PD set at 100%.
- POCI : POCI assets are financial assets that are credit impaired on initial recognition. The Bank only recognises the cumulative changes in lifetime ECLs since initial recognition, based on a probability-weighting of the three scenarios, discounted by the credit adjusted EIR.

Loan Commitments and letters of credit: When estimating LTECLs for undrawn loan commitments, the Bank estimates the expected portion of the loan commitment that will be drawn down over its expected life. The ECL is then based on the present value of the expected shortfalls in cash flows if the loan is drawn down, based on a probability-weighting of the three scenarios. The expected cash shortfalls are discounted at an approximation to the expected EIR on the loan. For credit cards and revolving facilities that include both a loan and an undrawn commitment, ECLs are calculated and presented together with the loan. For loan commitments, letters of credit, guarantees and acceptances the ECL is recognized with "other liabilities".

Financial Guarantee contracts: 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 ECL provision. For this purpose, the Bank estimates ECLs based on the present value of the expected payments to reimburse the holder for a credit loss that it incurs. The shortfalls are discounted by the risk adjusted interest rate relevant to the exposure. The calculation is made using a probability-weighting of the three scenarios. The ECLs related to the financial guarantee contracts are recognised within other liabilities.

31 FINANCIAL ASSETS AT AMORTISED COST - LOANS AND ADVANCES TO CUSTOMERS (Contd.)

Debt instruments measured at fair value through OCI

The ECLs for debt instruments measured at FVOCI do not reduce the carrying amount of these financial assets in the statement of financial position, which remains at fair value. Instead, an amount equal to the allowance that would arise if the assets were measured at amortised cost is recognised in OCI as an accumulated impairment amount, with a corresponding charge to profit or loss. The accumulated loss recognised in OCI is recycled to the profit or loss upon derecognition of the assets.

Revolving facilities

The Bank's product offering includes a variety of corporate and retail overdraft and credit card facilities, in which the Bank has the right to cancel and/or reduce the facilities with one day's notice. The Bank does not limit its exposure to credit losses to the contractual notice period, but, instead calculates ECL over a period that reflects the Bank's expectations of the customer behaviour, its likelihood of default and the Bank's future risk mitigation procedures, which could include reducing or cancelling the facilities.

The ongoing assessment of whether a significant increase in credit risk has occurred for revolving facilities is similar to other lending products. This is based on shifts in the customer's delinquency.

The calculation of ECLs, including the estimation of the expected period of exposure and discount rate is made on an individual basis for individually significant loans and on a collective basis for other loans. The collective assessments are made separately for portfolios of facilities with similar credit risk characteristics.

Forward looking information

In its ECL models, the Bank relies on a broad range of forward looking information as economic inputs, such as:

- GDP growth
- Inflation
- Interest rate
- Unemployment rates
- Exchange rate
- Average LTV
- Government policies, status of the industry & regulatory impacts etc.

31 (c) Impairment assessment (Policy applicable from 1st January 2018)

31 (c) (i) Definition of default and cure

The Bank considers a financial instrument defaulted and therefore assessed in Stage 3 (as credit-impaired) for ECL calculations in all cases when the borrower becomes 90 days past due on its contractual payments or the credit facility/customer is classified as a non performing advance in accordance with CBSL directions.

As a part of a qualitative assessment of whether a customer is in default, the Bank also considers a variety of instances that may indicate unlikelihood to pay. When such events occur, the Bank carefully considers whether the event should result in treating the customer as defaulted and therefore assessed as Stage 3 for ECL calculations or whether Stage 2 is appropriate. Such events include:

- Internal rating of the borrower indicating default or near-default
- Modifications of terms resulting in concessions, including extensions, deferment of payments, waiver of covenants etc. (reschedule/restructure)
- The borrower having past due liabilities to other financial institutions

- The borrower is deceased
- A material decrease in the underlying collateral value where the recovery of the loan is expected from the sale of the collateral
- A material decrease in the borrower's turnover or the loss of a major customer
- A covenant breach not waived by the Bank
- The debtor filing for bankruptcy application/protection
- Borrower has been categorized into the "watch listed" portfolio
- Litigation against the borrower/liquidation filed against the borrower

It is the Bank's policy to consider a financial instrument as 'cured' and therefore re-classified out of Stage 3 when none of the default criteria is no longer present. The decision whether to classify an asset as Stage 2 or Stage 1 once cured depends on the updated credit grade, at the time of the cure, and whether there has been a significant increase in credit risk compared to initial recognition. Further restructured facilities are considered as "cured" once a satisfactory performing period of a minimum 90 days subsequent to the 1st capital and/or interest instalment post-restructure is in place, while upgrading of rescheduled facilities are carried out in accordance with the Banking Act Directions No 3/4 of 2008 on "Classification of Loans and Advances, Income Recognition and Provisioning".

31 (d) Probability of Default Estimation Process

The Bank estimates the Probability of Default (PD) based on historical information with regard to delinquency of loans and advances. In this process historical information pertaining to 3-5 years have been used depending on the nature of the product.

31 (d) (i) Exposure at default

The exposure at default (EAD) represents the gross carrying amount of the financial instruments subject to the impairment calculation, addressing both the client's ability to increase its exposure while approaching default and potential early repayments too.

To calculate the EAD for a Stage 1 loan, the Bank assesses the possible default events within 12 months in the calculation of the 12mECL. For Stage 2, Stage 3 and POCI financial assets, the exposure at default is considered for events over the lifetime of the instruments.

The Bank determines EADs by modelling the range of possible exposure outcomes at various points in time. The SLFRS 9 PDs are then assigned to the EAD so derived.

31 (d) (ii) Loss given default

The Bank segments its lending portfolio into homogeneous portfolios, based on key characteristics that are relevant to the estimation of future cash flows. The loss given default is estimated based on historically collected loss data.

31 (d) (iii) Significant increase in credit risk

The Bank continuously monitors all assets subject to ECLs. In order to determine whether an instrument or a portfolio of instruments is subject to 12mECL or LTECL, the Bank assesses whether there has been a significant increase in credit risk since initial recognition. The Bank considers an exposure to have significantly increased in credit risk when the borrower becomes 30 days past due from the contractual due date.

The Bank also applies a secondary qualitative method for triggering a significant increase in credit risk for an asset, such as moving a customer/facility to the watch list, or reschedulement or restructure. Regardless of the change in credit grades, if contractual payments are more than 30 days past due, the credit risk is deemed to have increased significantly since initial recognition.

When estimating ECLs on a collective basis for a group of similar assets, the Bank applies the same principles for assessing whether there has been a significant increase in credit risk since initial recognition.

31 FINANCIAL ASSETS AT AMORTISED COST - LOANS AND ADVANCES TO CUSTOMERS (Contd.)

31 (d) (iv) Grouping financial assets measured on a collective basis

ECLs are calculated either on a collective or an individual basis, dependent on the following factors.

The Bank calculates ECL on an individual basis for corporate & SME exposures identified as individually significant loans and investments in debt securities. All other exposures other than the above together with individually significant exposures not attracting an ISL provision are assessed for ECL on a collective basis. The Bank groups these exposures into smaller homogeneous portfolios, based on product type and customer segment.

31 (e) Impairment of financial assets (Policy applicable before 1st January 2018)

Prior to 1st January 2018, if there was an objective evidence that an impairment loss has been incurred, impairment losses on assets carried at amortised cost were 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 had a variable interest rate, the discount rate for measuring any impairment loss was the current effective interest rate. If the Group had reclassified trading assets to loans and receivables, the discount rate for measuring any impairment loss was the new effective interest rate which was determined at the date of reclassification. The impairment allowances on individually significant accounts were reviewed more regularly when circumstances required. This normally encompassed re-assessment of the enforceability of any collateral held and the timing and amount of actual and anticipated receipts. Individually assessed impairment allowances were only released when there is a reasonable and objective evidence of a reduction in the established loss estimate. Interest on impaired assets continued to be recognised through the unwinding of the discount.

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 15 to the financial statements.

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 (e) (i) Movement in Impairment during the year - 2018

For the year ended 31st December	Bank	Group
	2018	2018
	Rs 000	Rs 000
Stage 1		
Opening balance as at 1st January 2018	-	-
Day 1 impact from the application of SLFRS 9	2,604,416	3,334,420
Restated opening balance as at 1st January 2018	2,604,416	3,334,240
Net impairment charge for the year	732,234	678,931
Write-offs during the year	-	-
Other movements	-	-
Closing balance as at 31st December 2018 [Note 31]	3,336,650	4,013,171
Stage 2		
Opening balance as at 1st January 2018	-	-
Day 1 impact from the application of SLFRS 9	2,445,544	2,616,773
Restated opening balance as at 1st January 2018	2,445,544	2,616,773
Net impairment charge for the year	1,269,310	1,324,127
Write-offs during the year	-	-
Other movements	-	-
Closing balance as at 31st December 2018 [Note 31]	3,714,854	3,940,900
Stage 3		
Opening balance as at 1st January 2018	-	-
Day 1 impact from the application of SLFRS 9	9,208,508	9,670,494
Restated opening balance as at 1st January 2018	9,208,508	9,670,494
Net impairment charge for the year	6,242,192	6,685,934
Write-offs during the year	(475,069)	(475,069)
Other movements	616,670	616,670
Closing balance as at 31st December 2018 [Note 31]	15,592,301	16,498,029

31 (e) (ii) Movement in Impairment during the year - 2017

As at 31st December	Bank		Group	
	2017	2017	2017	2017
	Individual	Collective	Individual	Collective
	Rs 000	Rs 000	Rs 000	Rs 000
Balance as at 1st January	3,366,278	7,734,914	3,366,278	8,131,945
Net impairment charge for the year	4,680,044	(1,470,163)	4,680,044	(1,047,317)
Write-offs during the year	(2,373,179)	(1,210,692)	(2,373,179)	(1,320,137)
Interest accrued on impaired loans and receivables	(282,196)	-	(282,196)	-
Balance as at 31st December	5,390,947	5,054,059	5,390,947	5,764,491

Notes to the Financial Statements

31 FINANCIAL ASSETS AT AMORTISED COST - LOANS AND ADVANCES TO CUSTOMERS (Contd.)

31 (e) (iii) Product wise Movement in Allowance for Impairment Losses - Bank

As at 31st December	2018				2017
	Lease and Hire Purchases Rs 000	Loans and Receivables Rs 000	Pawning Rs 000	Total Rs 000	Total Rs 000
Balance as at 1st January	281,795	10,151,412	11,799	10,445,006	11,101,192
Day 1 impact from application of SLFRS 9	272,247	3,523,097	18,118	3,813,462	-
Restated balance as at 1st January	554,042	13,674,509	29,917	14,258,468	11,101,192
Net impairment charge for the year	66,398	8,392,122	330	8,458,850	3,209,881
Write-offs during the year	(42,725)	(432,344)	-	(475,069)	(3,583,871)
Interest accrued on impaired loans and receivables	-	(215,114)	-	(215,114)	(282,196)
Other movement	-	616,670	-	616,670	-
Balance as at 31st December	577,715	22,035,843	30,247	22,643,805	10,445,006

31 (e) (iv) Product wise Movement in Allowance for Impairment Losses - Group

As at 31st December	2018				2017
	Lease and Hire Purchases Rs 000	Loans and Receivables Rs 000	Pawning Rs 000	Total Rs 000	Total Rs 000
Balance as at 1st January	323,824	10,819,815	11,799	11,155,438	11,498,223
Day 1 impact from application of SLFRS 9	272,247	4,180,211	18,118	4,470,576	-
Restated balance as at 1st January	596,071	15,000,026	29,917	15,626,014	11,498,223
Net impairment charge for the year	66,398	8,832,872	330	8,899,600	3,632,727
Write-offs during the year	(42,725)	(432,344)	-	(475,069)	(3,693,316)
Interest accrued on impaired loans and receivables	-	(215,115)	-	(215,115)	(282,196)
Other movement	-	616,670	-	616,670	-
Balance as at 31st December	619,744	23,802,109	60,164	24,452,100	11,155,438

31 (e) (v) Sensitivity of factors used to determine impairment provisions

Increase /(decrease) in Property Realization Period of ISL Impaired Customers	Change in Loss Given Default (LGD)	Change in Economic Factor Adjustment (EFA)	Change in Deemed Loss Period	Sensitivity Effect on Impairment Provisions for the year Rs 000
Advanced by one year				(572,561)
Deferred by one year				469,489
	+ 1%			150,838
	- 1%			(150,838)
		Worst case degrades by 5%		30,608
		Worst case upgrades by 5%		(31,223)
			Reduction by 1 year	(150,204)
			Increase by 1 year	59,681

31 (f) 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	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Total lease and hire purchase rentals receivable	61,090,872	51,845,102	71,682,792	57,242,525
Unearned lease income	(11,166,182)	(8,862,431)	(14,121,545)	(10,451,327)
Gross lease and hire purchase receivable	49,924,690	42,982,671	57,561,246	46,791,198
Impairment allowance for lease and hire purchase receivable - Individual	(50,934)	(20,979)	(50,934)	(20,979)
Impairment allowance for lease and hire purchase receivable - Collective	(633,932)	(260,817)	(889,352)	(302,846)
Net lease and hire purchase receivable	49,239,824	42,700,875	56,620,960	46,467,373
Net lease and hire purchase receivables within one year [Note 31 (f) (i)]	18,127,154	16,079,225	20,213,819	17,024,939
Net lease and hire purchase receivables from one to five years [Note 31 (f) (ii)]	30,911,569	26,541,791	36,176,477	29,359,113
Net lease and hire purchase receivables after five years [Note 31 (f) (iii)]	201,101	79,859	230,664	83,321
	49,239,824	42,700,875	56,620,960	46,467,373

31 (f) (i) Net Lease and Hire Purchase Receivables within one year

As at 31st December	Bank		Group	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Total lease and hire purchase rentals receivable within one year from the reporting date	23,835,689	20,603,880	27,400,770	22,235,958
Unearned lease and hire purchase income	(5,423,811)	(4,426,156)	(6,646,807)	(5,088,254)
Impairment allowance for lease and hire purchase receivables	(284,724)	(98,499)	(540,144)	(122,765)
	18,127,154	16,079,225	20,213,819	17,024,939

31 (f) (ii) Net Lease and Hire Purchase Receivables from one to five years

As at 31st December	Bank		Group	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Total lease and hire purchase rentals receivables from one to five years from the reporting date	37,034,577	31,154,423	44,029,757	34,916,033
Unearned lease and hire purchase income	(5,725,452)	(4,429,822)	(7,455,724)	(5,356,348)
Impairment allowance for lease and hire purchase receivables	(397,556)	(182,810)	(397,556)	(200,572)
	30,911,569	26,541,791	36,176,477	29,359,113

Notes to the Financial Statements

31 FINANCIAL ASSETS AT AMORTISED COST - LOANS AND ADVANCES TO CUSTOMERS (Contd.)

31 (f) (iii) Net Lease and Hire Purchase Receivables after five years

As at 31st December	Bank		Group	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Total lease and hire purchase rentals receivable after five years from the reporting date	220,606	86,800	252,265	90,533
Unearned lease and hire purchase income	(16,919)	(6,453)	(19,015)	(6,724)
Impairment allowance for lease and hire purchase receivables	(2,586)	(488)	(2,586)	(488)
	201,101	79,859	230,664	83,321

Impairment allowance for lease and hire purchase receivables are included in the stage wise movement for impairment presented in Note 31 (e) (i) to the financial statement

32 FINANCIAL ASSETS AT AMORTISED COST - DEBT AND OTHER INSTRUMENTS/FINANCIAL INVESTMENTS - LOANS AND RECEIVABLES

Accounting Policy

Policy applicable from 1st January 2018

From 1st January 2018, the Bank measures other financial assets at amortised cost if both of the following conditions are met:

- The financial asset is held within a business model with the objective to hold financial assets in order to collect contractual cash flows
- The contractual terms of the financial asset give rise on specified dates to cash flows that are Solely Payments of Principal and Interest (SPPI) on the principal amount outstanding. These conditions are explained in detail in Note 3.4.2 and 3.4.3 to the financial statements. These assets are tested for impairment in accordance with the criteria given in Note 31 (b) to the financial statements.

Policy applicable prior to 1st January 2018

Before 1st January 2018, financial investments - loans and receivables, included non-derivative financial investments with fixed or determinable payments that were not quoted in an active market, other than those:

- That the Bank intended to sell immediately or in the near term
- That the Bank, upon initial recognition, designated as at FVPL or as available-for-sale
- For which the Bank may not recover substantially all of its initial investment, other than because of credit deterioration, which were designated as available-for-sale.

As at 31st December	2018 Rs 000	2017 Rs 000
Sri Lanka development bonds - Bank [Note 32 (c)]	123,137,095	100,214,581
Sri Lanka sovereign bonds - Bank [Note 32 (d)]	26,097,301	8,629,476
Foreign government bonds - Bank [Note 32 (e)]	65,892	57,839
Quoted debentures - Bank [Note 32 (f)]	12,130,405	13,354,991
Total financial assets at amortised cost – debt and other instruments/financial investments - loans and receivables - Bank	161,430,693	122,256,887
Less : Allowance for impairment assets at amortised cost – debt and other instruments/financial investments - loans and receivables - Bank	(1,285,013)	(57,839)
Stage 1	(1,130,825)	-
Stage 2	(88,296)	-
Stage 3	(65,892)	(57,839)
Net financial assets at amortised cost – debt and other instruments/financial investments - loans and receivables - Bank	160,145,680	122,199,048
Government of Sri Lanka treasury bills - Subsidiaries [Note 32 (g)]	1,861,790	-
Quoted debentures - Subsidiaries [Note 32 (h)]	3,559,570	2,525,510
Other loans and receivables held by subsidiaries [Note 32 (i)]	773,091	773,091
Total financial assets at amortised cost – debt and other instruments/financial investments - loans and receivables - Subsidiaries	6,194,452	3,298,601
Total financial assets at amortised cost – debt and other instruments/financial investments - loans and receivables - Group	167,625,144	125,555,488
Less : Allowance for impairment on fassets at amortised cost – debt and other instruments/financial investments - loans and receivables - Group	(1,803,161)	(523,817)
Stage 1	(1,131,503)	-
Stage 2	(88,296)	-
Stage 3	(583,362)	(523,817)
Net financial assets at amortised cost – debt and other instruments/financial investments - loans and receivables - Group	165,821,983	125,031,671

Notes to the Financial Statements

32 FINANCIAL ASSETS AT AMORTISED COST - DEBT AND OTHER INSTRUMENTS (Contd.)

32 (a) Analysis

As at 31st December	Bank		Group	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
By Collateralization				
Pledged as collateral	-	-	-	-
Unencumbered	160,145,680	122,199,048	165,821,983	125,031,671
Total	160,145,680	122,199,048	165,821,983	125,031,671
By Currency				
Sri Lankan Rupee	12,040,381	13,354,991	17,716,684	16,187,614
United States Dollar	148,105,299	108,844,057	148,105,299	108,844,057
Total	160,145,680	122,199,048	165,821,983	125,031,671

32 (b) Movement in Impairment during the year - 2018

As at 31st December	Bank 2018 Rs 000	Group 2018 Rs 000
Stage 1		
Opening balance as at 1st January 2018	498,056	498,056
Net impairment charge for the year	632,769	633,447
Write-offs during the year	-	-
Other movements	-	-
Closing balance as at 31st December 2018	1,130,825	1,131,503
Stage 2		
Opening balance as at 1st January 2018	-	-
Net impairment charge for the year	88,296	88,296
Write-offs during the year	-	-
Other movements	-	-
Closing balance as at 31st December 2018	88,296	88,296
Stage 3		
Opening balance as at 1st January 2018	57,839	523,817
Net impairment charge for the year	8,053	59,545
Write-offs during the year	-	-
Other movements	-	-
Closing balance as at 31st December 2018	65,892	583,362

32 (c) Sri Lanka Development Bonds Held by the Bank

As at 31st December	2018 Rs 000	2017 Rs 000
Year of Maturity		
2018	-	13,987,225
2020	63,731,602	53,324,591
2021	20,121,068	17,320,171
2022	28,030,947	15,582,594
2023	11,253,478	-
Total Sri Lanka development bonds - Bank	123,137,095	100,214,581

32 (d) Sri Lanka Sovereign Bonds Held by the Bank

As at 31st December	2018 Rs 000	2017 Rs 000
Year of Maturity		
2019	6,293,901	5,226,414
2021	4,124,112	3,403,062
2023	6,365,578	-
2025	2,213,628	-
2026	5,059,144	-
2028	2,040,938	-
Total Sri Lanka sovereign bonds - Bank	26,097,301	8,629,476

32 (e) Foreign Government Bonds Held by the Bank

As at 31st December	2018 Rs 000	2017 Rs 000
Year of Maturity		
2042*	65,892	57,839
Total foreign government bonds - Bank	65,892	57,839

*These bonds were issued by the Government of Greece and have been classified as stage 3 for Expect Credit Loss (ECL) computation. Bank has recognised an ECL provision amounting to Rs. 65.89 Mn (2017 - Rs. 57.84 Mn) in respect of this investment.

32 (f) Quoted Debentures Held by the Bank

As at 31st December	2018		2017	
	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	500,616	5,000,000	500,616
Access Engineering PLC				
(10.25% debentures redeemable on 18th November 2020)	15,000,000	1,518,956	15,000,000	1,518,534
Alliance Finance Company PLC				
(9.35% debentures redeemable on 29th December 2019)	3,000,000	328,050	3,000,000	328,050
Central Finance PLC				
(9.52% debentures redeemable on 01st June 2020)	2,000,000	219,040	2,000,000	219,040
Commercial Leasing & Finance PLC				
(9.75% debentures redeemable on 21st July 2020)	10,000,000	1,097,500	10,000,000	1,097,500
DFCC Bank PLC				
(9.10% debentures redeemable on 10th June 2020)	5,000,000	525,430	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
Lanka Orix Leasing Company PLC				
(9% debentures redeemable on 24th November 2019)	5,000,000	511,342	5,000,000	511,342
LB Finance PLC				
(14% debentures redeemed on 28th November 2018)	-	-	4,408,600	446,102

Notes to the Financial Statements

32 FINANCIAL ASSETS AT AMORTISED COST - DEBT AND OTHER INSTRUMENTS (Contd.)

As at 31st December	2018		2017	
	No of Debentures	Carrying Value Rs 000	No of Debentures	Carrying Value Rs 000
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 redeemed on 05th November 2018)	-	-	418,650	42,539
MTD Walkers PLC				
(10.25% debentures redeemable on 30th September 2020)	5,000,000	512,918	5,000,000	512,918
Nawaloka Hospitals PLC				
(14.15% debentures redeemed on 30th September 2018)	-	-	1,860,000	192,634
Orient Finance PLC				
(9.05% debentures redeemable on 26th December 2019)	2,500,000	261,405	2,500,000	261,405
People's Leasing and Finance PLC				
(9.625% debentures redeemed on 23rd September 2018)	-	-	201,200	22,057
(9.95% debentures redeemable on 12th November 2020)	20,000,000	2,026,715	20,000,000	2,026,715
(12.60% debentures redeemable on 16th November 2021)	20,000,000	2,031,759	20,000,000	2,031,759
Sanasa Development Bank PLC *				
(9.6% debentures redeemed on 31st December 2018)	9,433,700	989,024	9,433,700	989,024
Senkadagala Finance PLC				
(13.75% debentures redeemable on 09th November 2020)	3,000,000	305,877	3,000,000	305,877
Singer (Sri Lanka) PLC				
(8.60% debentures redeemed on 07th June 2018)	-	-	5,000,000	521,677
Siyapatha Finance PLC				
(13.5% debentures redeemable on 20th September 2020)	3,000,000	311,318	3,000,000	311,318
Quoted Debentures - Bank		12,130,405		13,354,991

* Settlement proceeds received on 9th January 2019.

32 (g) Government of Sri Lanka Treasury Bills Held by Subsidiaries

As at 31st December	2018	2017
	Rs 000	Rs 000
Year of Maturity		
2019	1,861,790	-
	1,861,790	-

32 (h) Quoted Debentures Held by Subsidiaries

As at 31st December	2018		2017	
	No of Debentures	Carrying Value Rs 000	No of Debentures	Carrying Value Rs 000
Abans PLC				
(14.50% debentures redeemed on 20th December 2018)	-	-	550,000	59,020
(09.00% debentures redeemable on 26th December 2019)	450,000	45,168	450,000	47,097
		45,168		106,117

As at 31st December	2018		2017	
	No of Debentures	Carrying Value Rs 000	No of Debentures	Carrying Value Rs 000
Access Engineering PLC				
(10.25% debentures redeemable on 18th November 2020)	1,250,000	126,835	1,250,000	126,509
		126,835		126,509
Bank of Ceylon				
(08.00% debentures redeemable on 21st September 2019)	140,000	14,310	140,000	14,310
(13.25% debentures redeemable on 29th December 2021)	400,000	45,329	400,000	45,329
		59,639		59,639
Central Finance Company PLC				
(14.75% debentures redeemed on 17th June 2018)	-	-	29,000	30,078
		-		30,078
Commercial Bank of Ceylon PLC				
(12.00% debentures redeemable on 27th October 2021)	289,500	29,559	289,500	29,559
(12.25% debentures redeemable on 27th October 2026)	135,700	13,861	135,700	13,861
(12.50% Debentures redeemable on 22nd July 2028)	1,192,800	125,857	-	-
(12.00% Debentures redeemable on 22nd July 2023)	577,800	60,838	-	-
		230,115		43,420
Commercial Credit and Finance PLC				
(10.50% debentures redeemable on 01st June 2020)	1,100,000	112,911	1,100,000	112,911
(10.40% debentures redeemable on 10th December 2020)	1,000,000	100,598	1,000,000	100,598
		213,509		213,509
Commercial Leasing and Finance PLC				
(9.75% debentures redeemable on 21st July 2020)	600,000	65,850	600,000	65,850
		65,850		65,850
DFCC Bank PLC				
(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	100,000	10,173
(12.75% debentures redeemable on 09th June 2023)	700,000	71,272	700,000	71,272
(13.00% Debentures redeemable on 29th March 2025)	500,000	54,933	-	-
(12.60% Debentures redeemable on 29th March 2023)	1,400,000	153,387	-	-
		332,445		124,125
HDFC Bank				
(15.50% debentures redeemed on 23rd October 2018)	-	-	600,000	69,300
		-		69,300
Hemas Holdings PLC				
(11.00% debentures redeemable on 29th April 2019)	557,900	57,350	557,900	57,433
		57,350		57,433
Hayleys PLC				
(12.50% Debentures redeemable on 31st July 2023)	3,300,000	347,291	-	-
		347,291		-
Lanka Orix Leasing Company PLC				
(09.00% debentures redeemable on 24th November 2019)	550,000	56,248	550,000	56,248
		56,248		56,248
LB Finance PLC				
(15.00% debentures redeemed on 28th November 2018)	-	-	851,000	97,865
(12.75% debentures redeemable on 11th December 2022)	170,000	17,119	170,000	17,119
		17,119		114,984

Notes to the Financial Statements

32 FINANCIAL ASSETS AT AMORTISED COST - DEBT AND OTHER INSTRUMENTS (Contd.)

As at 31st December	2018		2017	
	No of Debentures	Carrying Value Rs 000	No of Debentures	Carrying Value Rs 000
Lion Brewery (Ceylon) PLC				
(14.00% debentures redeemed on 17th June 2018)	-	-	38,400	39,770
				39,770
Mercantile Investment & Finance PLC				
(10.50% debentures redeemed on 05th November 2018)	-	-	114,100	11,597
				11,597
Merchant Bank of Sri Lanka & Finance PLC				
(17.50% debentures redeemed on 27th March 2018)	-	-	112,600	13,230
(16.70% debentures redeemed on 27th March 2018)	-	-	112,600	11,730
(08.75% debentures redeemable on 12th November 2019)	150,000	15,660	150,000	15,660
(09.00% debentures redeemable on 12th November 2019)	410,000	44,690	410,000	44,690
		60,350		85,310
National Development Bank PLC				
(13.00% debentures redeemed on 19th December 2018)	-	-	125,900	13,415
(13.40% debentures redeemed on 19th December 2018)	-	-	84,200	9,496
(09.40% debentures redeemable on 24th June 2020)	217,200	18,030	217,200	16,727
(09.40% debentures redeemable on 24th June 2020)	253,000	28,099	253,000	28,099
(13.90% debentures redeemable on 19th December 2023)	187,500	21,409	187,500	21,409
		67,538		89,146
Nations Trust Bank PLC				
(13.00% debentures redeemed on 19th December 2018)	-	-	331,500	35,322
(12.65% debentures redeemable on 08th December 2021)	357,400	36,396	357,400	36,396
(12.80% debentures redeemable on 08th December 2021)	210,200	21,411	210,200	21,411
(13.00% Debentures redeemable on 20th April 2023)	1,550,000	169,077	-	-
		226,884		93,129
Nawaloka Hospitals PLC				
(14.15% debentures redeemed on 30th September 2018)	-	-	550,000	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				
(17.00% debentures redeemed on 26th March 2018)	-	-	300,000	35,100
(09.625% debentures redeemed on 23rd September 2018)	-	-	59,400	6,512
(09.60% debentures redeemable on 12th November 2019)	450,000	45,580	450,000	45,580
(09.95% debentures redeemable on 12th November 2020)	290,000	29,387	290,000	29,387
(12.60% Debentures redeemable on 16th November 2021)	500,000	50,777	500,000	50,777
(12.80% Debentures redeemable on 18th April 2023)	653,600	71,251	-	-
		196,995		167,356
Richard Pieris and Company PLC				
(11.00% debentures redeemed on 16th May 2018)	-	-	124,000	12,744
(11.25% debentures redeemable on 16th May 2019)	408,800	42,094	408,800	42,258
		42,094		55,002

As at 31st December	2018		2017	
	No of Debentures	Carrying Value Rs 000	No of Debentures	Carrying Value Rs 000
Sampath Bank PLC				
(13.40% debentures redeemed on 04th December 2018)	-	-	363,400	41,210
(08.25% debentures redeemable on 14th December 2019)	750,000	81,187	750,000	81,188
(09.90% debentures redeemable on 18th November 2020)	1,642,200	166,400	1,642,200	166,180
(12.50% debentures redeemable on 21st December 2022)	800,000	80,525	800,000	80,274
(12.50% debentures redeemable on 20th March 2023)	2,000,000	207,615		
		535,727		368,852
Seylan Bank PLC				
(15.50% debentures redeemed on 21st February 2018)	-	-	900,000	101,963
(08.60% debentures redeemable on 22nd February 2019)	300,000	32,644	300,000	32,644
(08.75% debentures redeemable on 23rd December 2020)	500,000	54,483	500,000	54,483
(13.00% debentures redeemable on 15th July 2021)	215,800	22,879	215,800	22,879
(12.85% Debentures redeemable on 29th March 2023)	2,500,000	258,185	-	-
		368,191		211,969
Singer (Sri Lanka) PLC				
(12.00% debentures redeemable on 28th September 2021)	800,000	82,472	-	-
		82,472		-
Siyapatha Finance PLC				
(08.90% debentures redeemable on 24th December 2019)	1,000,000	108,900	1,000,000	108,900
(13.50% debentures redeemable on 20th September 2021)	244,200	25,341	244,200	25,341
		134,241		134,241
Sri Lanka Telecom PLC				
(12.75% Debentures redeemable on 19th April 2028)	1,443,800	148,523	-	-
		148,523		-
Softlogic Finance PLC				
(10.00% debentures redeemable on 29th August 2019)	303,900	31,156	303,900	31,156
		31,156		31,156
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		3,559,570		2,525,510

32 (i) Other Loans and Receivables Held by Subsidiaries

As at 31st December	2018	2017
	Carrying Value Rs 000	Carrying Value Rs 000
Other loans and receivables	773,091	773,091
	773,091	773,091

*These investments have been categorised as "stage 3" for Expected Credit Loss (ECL) computation. Accordingly an ECL provision of Rs 517.47 Mn (2017 - Rs. 465.98 Mn) has been recognised for these investments.

33 FINANCIAL ASSETS MEASURED AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME/ FINANCIAL INVESTMENTS - AVAILABLE-FOR-SALE

Accounting Policy

Policy applicable from 1st January 2018

With the adoption of SLFRS 9 - "Financial Instruments" financial assets are classified as fair value through other comprehensive income when both of the following conditions are met:

- The instrument is held within a business model, the objective of which is achieved by both collecting contractual cash flows and selling financial assets
- The contractual terms of the financial asset meet the SPPI test

These instruments comprise of assets that had previously been classified as financial investments available for-sale under LKAS 39.

FVOCI debt instruments are subsequently measured at fair value with gains and losses arising due to changes in fair value recognised in OCI. Interest income and foreign exchange gains and losses on account of such investments are recognised in profit or loss. 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. On derecognition, cumulative gains or losses previously recognised in OCI are reclassified from OCI to profit or loss.

Equity instruments at FVOCI

Upon initial recognition, the Bank occasionally makes an irrevocable election to classify some of its equity investments as equity instruments at FVOCI when those meet the definition of Equity under LKAS 32 Financial Instruments: Presentation and are not held for trading. Such classification is determined on an instrument-by-instrument basis.

Gains and losses on these equity instruments are never recycled to profit or loss. Dividends are recognised in profit or loss as other operating income when the right of the payment has been established, except when the Bank benefits from such proceeds as a recovery of part of the cost of the instrument, in which case, such gains are recorded in OCI. Equity instruments at FVOCI are not subject to an impairment assessment.

Policy applicable prior to 1st January 2018

Prior to 1st January 2018, Bank recognised equity and debt securities as available-for-sale investments in accordance with LKAS 39 - "Financial Instruments - recognition and Measurement". 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, financial investments available-for-sale are subsequently measured at fair value.

Unrealised gains and losses were recognised directly in equity via 'other comprehensive income' in the 'available-for-sale reserve'. When the investment was disposed of, the cumulative gain or loss previously recognised in equity was recognised in the statement of profit or loss in 'net gain from financial investments'. Where the Bank held more than one investment in the same security, they were deemed to be disposed of on a first in first out basis. Interest earned whilst holding available-for-sale financial investments was reported as 'interest income' using the Effective Interest Rate (EIR). Dividends earned whilst holding available-for-sale financial investments were recognised in the statement of profit or loss as 'net gain from financial investments' when the right to receive the dividend has been established. The losses arising from impairment of such investments were recognised in the statement of profit or loss in 'impairment losses on financial investments' and were removed from the 'available-for-sale reserve'.

Impairment of Financial Investments - Available-for-sale

For available-for-sale financial investments, the Group assessed at each reporting date whether there was an objective evidence that an investment is impaired.

In case of debt instruments classified as available-for-sale, the Group assessed 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. 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 was based on the reduced carrying amount and accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income was recorded as part of interest income as 'financial investments - available-for-sale'. If, in a subsequent period, the fair value of a debt instrument increased 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 the case of equity investments classified as available-for-sale, objective evidence also included a 'significant' or 'prolonged' decline in the fair value of the investment below its cost. Where there was 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 was removed from equity and recognised in the statement of profit or loss. Impairment losses on equity investments not reversed through the statement of profit or loss, increases in the fair value after impairment were recognised in 'other comprehensive income'.

As at 31st December	Fair Value	
	2018 Rs 000	2017 Rs 000
Quoted shares - Bank [Note 33 (b)]	3,981,142	4,912,813
Quoted units - Bank [Note 33 (c)]	240,000	276,300
Unquoted shares - Bank [Note 33 (d)]	24,780	25,405
Unquoted units - Bank [Note 33 (e)]	372,373	418,646
Government of Sri Lanka treasury bonds - Bank [Note 33 (f)]	46,435,837	55,254,516
Government of Sri Lanka treasury bills - Bank [Note 33 (g)]	18,382,857	34,516,140
Total financial assets at fair value through other comprehensive income/financial investments - available-for-sale [Note 33 (a)]	69,436,989	95,403,820
Government of Sri Lanka treasury bonds - Subsidiaries [Note 33 (h)]	6,555,839	6,031,354
Government of Sri Lanka treasury bills - Subsidiaries [Note 33 (i)]	-	217,307
Quoted shares - Subsidiaries [Note 33 (j)]	-	78,074
Unquoted shares - Subsidiaries [Note 33 (k)]	12,430	12,430
Total financial assets at fair value through other comprehensive income/financial investments - available-for-sale - Subsidiaries	6,568,269	6,339,165
Total financial assets at fair value through other comprehensive income/financial investments - available for sale - Group [Note 33 (a)]	76,005,258	101,742,985

33 (a) Analysis

As at 31st December	Bank		Group	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
By collateralisation				
Pledged as collateral	17,536,743	5,698,021	17,536,743	5,698,021
Unencumbered	51,900,246	89,705,799	58,468,515	96,044,964
Total	69,436,989	95,403,820	76,005,258	101,742,985
By Currency				
Sri Lankan Rupee	69,436,989	95,403,820	76,005,258	101,742,985
Total	69,436,989	95,403,820	76,005,258	101,742,985

Notes to the Financial Statements

33 FINANCIAL ASSETS MEASURED AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME (Contd.)

33 (b) Quoted Shares Held by the Bank

As at 31st December	2018			2017		
	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
DFCC Bank	32,396,140	942,651	3,012,841	32,396,140	942,651	4,017,122
National Development Bank PLC	6,133,969	901,502	656,335	4,445,523	719,458	606,814
Nations Trust Bank PLC	3,799,827	390,842	311,966	3,703,543	383,236	288,877
Total quoted shares - Bank		2,234,995	3,981,142		1,950,986	4,912,813

33 (c) Quoted Units in Unit Trusts Held by the Bank

As at 31st December	2018			2017		
	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
Namal Acuity Value Fund	3,000,000	150,000	240,000	3,000,000	150,000	276,300
Total quoted units in unit trusts - Bank		150,000	240,000		150,000	276,300

33 (d) Unquoted Shares Held by the Bank

As at 31st December	2018			2017		
	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
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	-
		60,886	24,780		61,511	25,405

33 (e) Unquoted Units in Unit Trusts Held by the Bank

As at 31st December	2018			2017		
	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	372,373	19,455,327	400,000	418,646
Total unquoted units in unit trusts - Bank		400,000	372,373		400,000	418,646

33 (f) Government of Sri Lanka Treasury Bonds Held by the Bank

As at 31st December	2018		2017	
	Cost of Investment Rs 000	Fair Value Rs 000	Cost of Investment Rs 000	Fair Value Rs 000
Year of Maturity				
2018	-	-	10,261,100	10,338,205
2019	16,376,141	16,313,567	16,421,382	16,516,167
2020	3,034,845	2,976,543	3,025,896	3,026,043
2021	17,438,724	17,561,979	17,346,557	18,277,287
2022	274,514	261,929	277,520	274,881
2023	5,281,088	5,012,742	3,272,324	3,256,113
2024	2,571,244	2,624,983	2,557,000	2,788,274
2025	1,777,171	1,684,094	760,594	777,546
Total government of Sri Lanka treasury bonds - Bank	46,753,727	46,435,837	53,922,373	55,254,516

33 (g) Government of Sri Lanka Treasury Bills Held by the Bank

As at 31st December	2018		2017	
	Cost of Investment Rs 000	Fair Value Rs 000	Cost of Investment Rs 000	Fair Value Rs 000
Year of Maturity				
2018	-	-	34,376,903	34,516,140
2019	18,392,709	18,382,857	-	-
Total government of Sri Lanka treasury bills - Bank	18,392,709	18,382,857	34,376,903	34,516,140

Notes to the Financial Statements

33 FINANCIAL ASSETS MEASURED AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME (Contd.)

33 (h) Government of Sri Lanka Treasury Bonds Held by Subsidiaries

As at 31st December	2018		2017	
	Cost of Investment Rs 000	Fair Value Rs 000	Cost of Investment Rs 000	Fair Value Rs 000
Year of Maturity				
2018	-	-	116,389	125,139
2019	602,024	622,322	550,781	572,601
2020	303,517	322,661	373,472	404,315
2021	1,122,017	1,119,541	1,246,550	1,315,968
2022	600,125	592,627	646,373	672,016
2023	799,327	802,298	303,373	326,326
2024	531,280	549,056	715,959	805,374
2025	104,077	96,168	-	-
2026	461,154	455,993	469,765	528,254
2027	152,790	150,676	-	-
2028	363,440	354,249	48,755	56,005
2029	135,191	108,803	135,191	119,712
2030	1,044,036	960,725	717,582	741,448
2033	102,404	100,345	-	-
2044	143,435	112,417	143,435	131,221
2045	222,302	207,958	222,302	232,975
Total government of Sri Lanka treasury bonds - Subsidiaries	6,687,119	6,555,839	5,689,927	6,031,354

33 (i) Government of Sri Lanka Treasury Bills Held by Subsidiaries

As at 31st December	2018		2017	
	Cost of Investment Rs 000	Fair Value Rs 000	Cost of Investment Rs 000	Fair Value Rs 000
2018	-	-	213,602	217,307
Total government of Sri Lanka treasury bills - Subsidiaries	-	-	213,602	217,307

33 (j) Quoted Shares Held by Subsidiaries

As at 31st December	2018			2017		
	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)	-	-	-	249,355	12,347	13,964
Sampath Bank PLC	-	-	-	37,831	6,834	11,943
Central Finance Company PLC	-	-	-	151,743	11,464	14,006
Sector Total	-	-	-		30,645	39,913
Diversified Holdings						
Melstacorp Limited	-	-	-	39,532	2,343	2,352
Sector Total	-	-	-		2,343	2,352
Manufacturing						
Tokyo Cement Company (Lanka) PLC	-	-	-	249,602	10,692	16,474
Royal Ceramic Lanka PLC	-	-	-	50,000	6,067	5,725
Sector Total	-	-	-		16,759	22,199
Land and Property						
Overseas Reality (Ceylon) PLC	-	-	-	773,335	19,640	13,610
Sector Total	-	-	-		19,640	13,610
Total quoted shares - Subsidiaries	-	-	-	-	69,387	78,074

Shares held as "Financial Investments - available for Sale" by the subsidiaries as at 1st January 2018 have been reclassified as "Financial assets recognised through profit or loss".

33 (k) Unquoted Shares Held by Subsidiaries

As at 31st December	2018			2017		
	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	-
Total unquoted shares - Subsidiaries		51,122	12,430		51,122	12,430

Notes to the Financial Statements

34 FINANCIAL INVESTMENTS - HELD-TO-MATURITY

Accounting Policy

Policy applicable prior to 1st January 2018

Prior to 1st January 2018, Group classified 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 at fair value through profit or loss or as available-for-sale as held-to-maturity investments.

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	2017
	Rs 000
Government of Sri Lanka treasury bills - Subsidiaries [Note 34 (a)]	1,385,143
Government of Sri Lanka treasury bonds - Subsidiaries [Note 34 (b)]	180,460
Total financial investments - Held-to-maturity - Group	1,565,603

34 (a) Government of Sri Lanka Treasury Bills Held by Subsidiaries

As at 31st December	2017
Year of Maturity	Rs 000
2019	1,385,143
Total government of Sri Lanka treasury bills - Subsidiaries	1,385,143

34 (b) Government of Sri Lanka Treasury Bonds Held by Subsidiaries

As at 31st December	2017
Year of Maturity	Rs 000
2019	180,460
Total government of Sri Lanka treasury bonds - Subsidiaries	180,460

Financial investments held by the subsidiaries till maturity under LKAS 39 - "Financial Instruments - Recognition and Measurement" were classified as "Financial assets at amortised cost-debt and other instruments" as at 1st January 2018 with the transition to SLFRS 9 - "Financial Instruments"

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 such change, 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.

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 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 statement of profit or loss. The Bank's investment in joint venture is carried at cost.

35 (a) Investment in Unquoted Joint Venture - Bank

As at 31st December	Principal Activity	Principal Place of Business	% Holding	2018		2017		
				Cost of Investment Rs 000	Fair Value Rs 000	% Holding	Cost of Investment Rs 000	Fair Value Rs 000
Acuity Partners (Pvt) Ltd	Investment banking	Sri Lanka	50	755,000	2,139,339	50	755,000	1,801,401
Total				755,000			755,000	

Bank received Rs 33.22 Mn of dividend income from Acuity Partners (Pvt) Ltd for the year ended 31st December 2018 (2017 : Rs 33.22 Mn).

Notes to the Financial Statements

35 INVESTMENT IN JOINT VENTURE (Contd.)

35 (b) Investment in Unquoted Joint Venture - Group

As at 31st December	2018 Rs 000	2017 Rs 000
Investment in joint venture (at cost) as at 1st January	755,000	755,000
Group's share of joint venture profit as at 1st January	1,046,401	807,944
Group's share of net assets of joint venture company as at 1st January	1,801,401	1,562,944
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)	1,689,263	1,450,806
Additional investment during the year	-	-
Share of profit of joint venture (net of income tax) (Note 20)	303,092	175,616
Share of other comprehensive income of equity accounted joint venture	67,539	(21,417)
Deemed disposal gain through joint venture	527	117,478
Dividend received during the year	(33,220)	(33,220)
Group's share of net assets of joint venture company as at 31st December	2,027,201	1,689,263

35 (c) Summarised Financial Position of Joint Venture - Acuity Partners (Pvt) Ltd and its Subsidiaries

As at 31st December	2018 Rs 000	2017 Rs 000
Current assets	7,055,525	5,241,692
Non-current assets	10,133,199	9,299,826
Current liabilities	(9,450,958)	(7,688,029)
Non-current liabilities	(1,039,126)	(1,025,766)
Non controlling interest	(2,419,964)	(2,224,925)
Equity	4,278,676	3,602,798
Group carrying amount of the investment	2,139,339	1,801,401
Share of unrealised profit on disposal of investments	(112,138)	(112,138)
Group carrying amount of the investment - Net	2,027,201	1,689,263

35 (d) Summarised statement of profit or loss of Joint Venture - Acuity Partners (Pvt) Ltd and its Subsidiaries

As at 31st December	2018 Rs 000	2017 Rs 000
Revenue	1,388,061	1,269,861
Administration and distribution expenses	(514,302)	(402,619)
Finance cost	(179,970)	(248,500)
Profit from operations	693,789	618,742
VAT and NBT on financial services	(20,116)	(3,622)
Profit before tax	673,673	615,120
Income tax expenses	222,753	(50,240)
Profit for the year	896,426	564,880
Other comprehensive income	303,198	(69,456)
Total comprehensive income for the year	1,199,624	495,424
Non controlling interest	(458,364)	(187,025)
Total comprehensive income for the year	741,260	308,399
Group's share of comprehensive income for the year	370,630	154,200

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.

The Bank's investments in subsidiaries are carried at cost.

Notes to the Financial Statements

36 INVESTMENT IN SUBSIDIARIES (Contd.)

36 (a) Investment in Subsidiary - Quoted

As at 31st December	Principal Activity	Principal Place of Business	% Holding	2018		2017		Fair Value Rs 000
				Cost of Investment Rs 000	Fair Value Rs 000	% Holding	Cost of Investment Rs 000	
HNB Assurance PLC								
(29,993,000 shares)	Insurance	Sri Lanka	60	384,285	3,959,076	60	384,285	2,174,493
Total quoted subsidiaries				384,285			384,285	

36 (b) Investment in Subsidiary - Unquoted

As at 31st December	Principal Activity	Principal Place of Business	% Holding	2018		2017		Fair Value Rs 000
				Cost of Investment Rs 000	Fair Value Rs 000	% Holding	Cost of Investment Rs 000	
Sithma Development (Pvt) Ltd								
(206,000,000 ordinary shares)	Property development	Sri Lanka	100	1,973,000	6,989,540	100	1,973,000	8,515,460
HNB Finance Ltd								
(724,904,118 ordinary shares)	Micro-finance	Sri Lanka	42.16	660,000	1,822,615	42.16	660,000	1,802,063
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 Finance Ltd

Bank holds a stake of 51% in the voting rights of Prime Grameen Micro Finance Ltd (subsequently rebranded as HNB 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 Finance Ltd, Bank's holding in the said company is 42.16%.

36 (c) Subsidiary Held through HNB Assurance PLC

As at 31st December	Principal Activity	Principal Place of Business	% Holding	2018		2017		
				Cost of Investment Rs 000	Fair Value Rs 000	% Holding	Cost of Investment Rs 000	
HNB General Insurance Limited								
(115,000,000 ordinary shares)	General Insurance	Sri Lanka	100	1,150,000		100	1,150,000	
				1,150,000			1,150,000	

36 (d) Non-Controlling Interests (NCI) in Subsidiaries

Subsidiary	% of Ownership Interest held by NCI	Share of % of Voting Rights held by NCI	Total Comprehensive Income of NCI for the Year Ended 31st December		NCI as at 31st December		Dividends Paid to NCI	
			2018	2017	2018	2017	2018	2017
			Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
HNB Assurance PLC	40.00	40.00	1,024,771	309,523	2,199,263	1,295,931	120,000	100,000
HNB Finance Ltd	57.84	49.00	484,239	517,618	2,473,947	2,352,772	89,514	99,461
			1,509,010	827,141	4,673,210	3,648,703	209,514	199,461

36 (e) Summarised Financial Information of Subsidiaries

	HNB Assurance PLC		Sithma Development (Pvt) Ltd		HNB Finance Ltd	
	2018	2017	2018	2017	2018	2017
As at 31st December	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Assets	22,274,327	18,648,935	10,240,586	10,142,140	29,808,927	25,486,912
Liabilities	16,530,116	14,852,436	3,251,037	1,626,680	25,485,836	21,212,569
Equity	5,744,211	3,796,499	6,989,549	8,515,460	4,323,091	4,274,343
For the year ended 31st December	2018	2017	2018	2017	2018	2017
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Revenue	9,616,851	8,305,789	1,003,030	987,209	7,825,581	7,295,792
Profit after tax	2,702,302	909,752	291,056	527,872	847,776	1,084,647
Total comprehensive income	2,672,372	935,040	(1,526,155)	527,872	860,387	1,123,753
For the year ended 31st December	2018	2017	2018	2017	2018	2017
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Cash flows from operating activities	1,519,051	1,509,809	536,932	639,616	(3,992,953)	3,176,020
Cash flows from investing activities	(1,080,246)	(1,385,046)	(354,860)	24,964	2,232,353	(3,862,606)
Cash flows from financing activities	(300,000)	(250,000)	290,300	(590,000)	2,082,511	(322,130)

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 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.

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.

Classes of Asset	% per annum
Hatton National Bank PLC	
Freehold buildings (Refer Note 37 (a))	2.5
Sithma Development (Pvt) Ltd	
Freehold buildings	
HNB Tower	1
Others	2.5
Plant, Machinery and equipment integral to freehold buildings referred to above	20

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 it is considered as owner-occupied from the perspective of the Group and adjustments are made for consolidation purposes.

As at 31st December	Bank		Group	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Cost				
Balance as at 1st January	347,684	458,229	1,271,501	1,156,300
Transferred to property, plant and equipment [Note 37 (b) iii]	-	(196,344)	15	-
Transferred from property, plant and equipment [Note 37 (b) ii]	-	83,400	-	75,259
Improvements during the year	-	2,399	-	39,942
Balance as at 31st December	347,684	347,684	1,271,516	1,271,501
Accumulated depreciation				
Balance as at 1st January	20,220	54,270	124,937	102,000
Transferred to property, plant and equipment [Note 37 (b) iii]	-	(35,666)	-	-
Charge for the year [Note 18]	1,646	1,616	39,107	22,937
Balance as at 31st December	21,866	20,220	164,044	124,937
Net book value as at 31st December	325,818	327,464	1,107,472	1,146,564

Notes to the Financial Statements

37 INVESTMENT PROPERTIES (Contd.)

37 (a) Valuation of Investment Properties - Bank

	Building sq.ft	Land Perches	Cost / Carrying Amount As at 31st December 2018			Fair Value As at 31st December 2018			Fair Value as at 31st December 2017
			Land (Cost) Rs 000	Building (Net Book Value) Rs 000	Total Rs 000	Land Rs 000	Building Rs 000	Total Rs 000	Total Rs 000
23 & 23 1/1, Independence Avenue, Colombo 7 [Note 37 (b) i]	10,645	105.10	37,081	43,968	81,049	-	-	942,000	816,525
479, T B Jayah Mawatha, Colombo 10 [Note 37 (b) ii]	Land	112.96	126,480	-	126,480	2,118,000	-	2,118,000	1,694,400
21, 21A, 23 & 25, Janadhipathi Mawatha, Colombo 1 [Note 37 (b) ii]	Land	26.62	34,889	-	34,889	665,500	-	665,500	532,400
451, Kandy Road, Kegalle (Note 37(b)iii)	Land	61.70	83,400	-	83,400	154,250	-	154,250	154,250
			281,850	43,968	325,818	2,937,750	-	3,879,750	3,197,575

37 (b) Valuation of Investment Properties - Group

	Building sq.ft	Land Perches	Cost / Carrying Amount As at 31st December 2018			Fair Value As at 31st December 2018			Fair Value as at 31st December 2017
			Land (Cost) Rs 000	Building (Net Book Value) Rs 000	Total Rs 000	Land Rs 000	Building Rs 000	Total 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	43,968	81,049	-	-	942,000	816,525
Through the Subsidiary Sithma Development Pvt) Ltd									
21, 21A, 23 & 25, Janadhipathi Mawatha, Colombo 1 [Note 37 (b) ii]	41,688	-	-	74,692	74,692	-	421,243	421,243	338,500
451, Kandy Road, Kegalle [Note 37 (b) ii]	16,000	-	-	93,964	93,964	-	143,658	143,658	138,830

	Building sq.ft	Land Perches	Cost / Carrying Amount As at 31st December 2018			Fair Value As at 31st December 2018			Fair Value as at 31st December 2017
			Land (Cost) Rs 000	Building (Net Book Value) Rs 000		Land Rs 000	Building Rs 000		Total Rs 000
				Total Rs 000	Total Rs 000		Total Rs 000		
Through the Subsidiary HNB Finance Ltd Note 37 (b) iv]									
249, Stanley Thilekaratne Mawatha, Pagoda, Nugegoda	24,952	39.60	151,063	387,540	538,603	271,523	547,477	819,000	819,000
Vihara Road, Rankewatte, Matale	Land	15.00	9,000	-	9,000	9,750	-	9,750	9,750
44/1, Service Road, Puttalam	Land	25.60	12,800	-	12,800	16,000	-	16,000	16,000
465/1, Old Police Station Road, Kahathuduwa, Polgasowita	20,494	182.59	49,008	68,392	117,400	52,152	69,648	121,800	121,800
67/1, Mahinda Place, Kirulapone, Colombo 5	5,786	8.00	25,267	86,197	111,464	33,785	96,215	130,000	130,000
06, Abaya Place, 7th Lane, Anuradapura	Land	13.52	20,000	-	20,000	25,700	-	25,700	25,700
10/11, Galle Road, Moratuwa	Land	23.00	34,500	-	34,500	41,400	-	41,400	41,400
Adampodaivayal, Adampodaimalaikadu, Trincomalee	Land	724.00	14,000	-	14,000	16,500	-	16,500	16,500
			352,719	754,753	1,107,472	466,810	2,220,241	2,687,051	2,474,005

37 (b) i Valued as a condominium property

37 (b) ii Lands 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 out 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. Further, the land situated at No. 451, Kandy Road, Kegalle was also leased out to Sithma Development (Pvt) Ltd in 2017, resulting in a transfer from property, plant and equipment to investment properties.

37 (b) iii As at 31st December 2016, building situated at No 10, Sri Uttarananda Mw, Colombo 03 was classified as an investment property in the statement of financial position of the Bank since it was leased out to HNB Assurance PLC and Royal Ceramics Lanka PLC. However, during 2017 these tenants vacated the premises and the Bank commenced occupation of this building since July 2017. Accordingly, the said building was transferred to property, plant and equipment during the year 2017.

37 (b) iv These properties are held by the subsidiary of the Bank, HNB 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.

Notes to the Financial Statements

37 INVESTMENT PROPERTIES (Contd.)

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 4,188,000
		- Years since 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 18,750,000
21, 21A, 23 & 25, Janadhipathi Mawatha, Colombo 01	Mr. J.M.J. Fernando	Market comparable method	
		- Rate per perch for land	Rs 25,000,000
451, Kandy Road, Kegalle	Mr. N.M. Jayathilake	- Rate per perch for land	Rs. 2,750,000

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.M.J. Fernando	Income approach	
		- Estimated rent per month	Rs 4,188,000
		- Years since purchase	25
		- Outgoing expenses as a percentage of gross annual rent	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
451, Kandy Road, Kegalle	Mr. N.M. Jayathilake	Depreciated replacement cost basis	
		- Rate per Sq.ft for building	Rs 6,500 - Rs 8,500

Property	Name of professional Valuer	Method of valuation and significant unobservable inputs	Range of estimates for unobservable inputs
Through the subsidiary -			
HNB Finance Ltd			
No.249, Stanley Thilekerathna Mawatha, Pagoda, Nugegoda	Mr. R.S. Wijesuriya	Income approach	
		- Estimated rent per month	Rs 2,496,787
		- Discount Rate	20%
Vihara Road, Rakewatta, Matale	Mr. R.S. Wijesuriya	Market comparable method	
		- Rate per perch for land	Rs 650,000
No.44/1, Service Road, Puttalam	Mr. R.S. Wijesuriya	Market comparable method	
		- Rate per perch for land	Rs 625,000
No.465/1, Old Police Station Road, Kahathduwa, Polgasowita	Mr. R.S. Wijesuriya	Income approach	
		- Estimated rent per month	Rs 452,540
		- Discount rate	20%
No. 67/1, Mahinda Place, Kirulapone, Colombo 05	Mr. R.S. Wijesuriya	Income approach	
		- Estimated rent per month	Rs 450,000
		- Discount rate	20%
No. 06, Abaya Place, 7th Lane, Anuradapura	Mr. R.S. Wijesuriya	Market comparable method	
		- Rate per perch for land	Rs 1,900,000
No. 10/11, Galle Road, Katubedda, Moratuwa	Mr. R.S. Wijesuriya	Market comparable method	
		- Rate per perch for land	Rs 1,800,000
Adampodaivayal, Adampodaimlaikadu, Trincomalee	Mr. R.S. Wijesuriya	Market comparable method	
		- Rate per perch for land	Rs 22,700

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.

- Income approach

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 those 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, those 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 a property changes from owner-occupied to investment property, the property is re-measured to fair value and reclassified as an 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.

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 and major plant and machinery 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.

Notes to the Financial Statements

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	2018 Total	2017 Total
	Note 38 (c)	Note 38 (a)						
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Cost / valuation as at 1st January	1,678,033	14,838,402	3,993,180	5,335,995	127,917	27,388	26,000,915	21,554,841
Accumulated depreciation adjustment on revaluation	-	(170,910)	-	-	-	-	(170,910)	(148,110)
Revaluation surplus	-	2,868,193	-	-	-	-	2,868,193	2,981,379
Net impairment (charge) / reversal (Note 15)	-	40,501	-	-	-	-	40,501	64,178
Additions and improvements	83,016	53,991	879,413	381,824	41,830	112,887	1,553,961	1,712,689
Disposals during the year	(50,479)	-	(144,604)	(161,988)	-	-	(357,071)	(277,006)
Transferred from investment properties	-	-	-	-	-	-	-	196,344
Transferred to investment properties	-	-	-	-	-	-	-	(83,400)
Transferred from capital work-in-progress	6,826	13,288	-	33,740	-	(53,854)	-	-
Cost / valuation as at 31st December	1,717,396	17,643,465	4,727,989	5,589,571	169,747	86,421	29,934,589	26,000,915
Accumulated depreciation as at 1st January	1,410,532	-	2,842,633	3,714,515	127,915	-	8,095,595	7,609,839
Accumulated depreciation adjustment on revaluation	-	(170,910)	-	-	-	-	(170,910)	(148,110)
Charge for the year [Note 18 (b)]	101,097	170,910	349,090	436,414	3,331	-	1,060,842	871,178
Transferred from investment properties	-	-	-	-	-	-	-	35,666
Disposals during the year	(50,479)	-	(144,468)	(160,361)	-	-	(355,308)	(272,978)
Accumulated depreciation as at 31st December	1,461,150	-	3,047,255	3,990,568	131,246	-	8,630,219	8,095,595
Net book value as at 31st December 2018 as at 31st December 2018	256,246	17,643,465	1,680,734	1,599,044	38,501	86,421	21,304,370	
Net book value as at 31st December 2017 as at 31st December 2017	267,501	14,838,402	1,150,547	1,621,480	2	27,388	-	17,905,320

The Bank/Group revalued its freehold land and buildings during 2018. The details relating to revaluation of freehold land and buildings are given in Note 38 (b).

Group	Leasehold Buildings	Freehold Land and Buildings	Computer Equipment	Equipment Furniture and Fixtures	Motor Vehicles	Capital Work-in Progress	2018 Total	2017 Total
	Note 38 (c)	Note 38 (a)						
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Cost / valuation as at 1st January	1,678,033	29,978,691	4,371,008	8,011,823	147,836	27,711	44,215,102	38,732,946
Accumulated depreciation adjustment on revaluation	-	(212,893)	-	-	-	-	(212,893)	(192,106)
Revaluation surplus	-	7,468,463	-	-	-	-	7,468,463	4,146,677
Net Impairment (charge) / reversal (Note 15)	-	40,501	-	-	-	-	40,501	64,178
Additions and improvements	83,016	53,991	925,385	467,534	41,830	136,507	1,708,263	1,888,965
Disposals during the year	(50,479)	-	(165,641)	(183,676)	-	-	(399,796)	(350,299)
Transferred to investment properties (Note 37 (b) ii)	-	-	-	-	-	-	-	(75,259)
Transferred from capital work-in-progress	6,826	13,288	-	33,740	-	(53,854)	-	-
Cost / valuation as at 31st December	1,717,396	37,342,041	5,130,752	8,329,421	189,666	110,364	52,819,640	44,215,102
Accumulated depreciation as at 1st January	1,410,532	228,333	3,068,406	4,727,915	144,882	-	9,580,068	8,888,712
Accumulated depreciation adjustment on revaluation	-	(212,893)	-	-	-	-	(212,893)	(192,106)
Charge for the year [Note 18 (b)]	101,097	325,334	398,657	598,811	6,472	-	1,430,371	1,224,138
Disposals during the year	(50,479)	-	(163,415)	(181,138)	-	-	(395,032)	(340,676)
Accumulated depreciation as at 31st December	1,461,150	340,774	3,303,648	5,145,588	151,354	-	10,402,514	9,580,068
Net book value as at 31st December 2018	256,246	37,001,267	1,827,104	3,183,833	38,312	110,364	42,417,126	
Net book value as at 31st December 2017	267,501	29,750,358	1,302,602	3,283,908	2,954	27,711	-	34,635,034

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

	Land 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 2018 Net Book Value Rs 000	As at 31st December 2017 Net Book Value Rs 000
Akkaraipattu Branch								
14, Main Street, Akkaraipattu.	19.32	10,080	72,450	70,550	143,000	-	143,000	136,000
Ambalangoda Branch								
94/1, New Galle Road, Ambalangoda.	29.90	14,469	119,500	30,500	150,000	-	150,000	118,500
Anuradhapura Branch								
30, Maithripala Senanayake Mawatha, Anuradhapura.	58.99	9,510	112,000	32,800	144,800	-	144,800	138,000
Badulla Branch								
15, 15 1/1, Udayaraja Mawatha, Badulla.	27.75	5,629	106,838	38,162	145,000	-	145,000	138,000
Bambalapitiya Branch								
285, Galle Road, Colombo 04.	20.00	16,170	380,000	87,000	467,000	-	467,000	374,000
Boraesgamuwa Branch								
24, Maharagama Road, Boraesgamuwa.	29.55	5,432	125,587	32,413	158,000	-	158,000	131,000
Borella Branch								
53/1, D S Senanayake Mawatha, Colombo 08.	28.00	10,102	315,000	107,000	422,000	-	422,000	348,000
Centre of Aspirations								
90, Vinayankara Mawatha, Colombo 10.	249.00	10,250	3,311,700	71,300	3,383,000	-	3,383,000	2,660,000
Centralised Operations								
10, Sri Uttarananda Mawatha, Colombo 3	40.00	57,197	880,000	450,270	1,330,270	-	1,330,270	1,046,000
City Office								
16, Janadhipathi Mawatha, Colombo 1.	84.00	44,807	1,848,000	98,000	1,946,000	-	1,946,000	1,555,900
Chavakachcheri Branch								
170, Kandy Road, Chavakachcheri .	20.40	5,557	31,670	21,330	53,000	-	53,000	51,000
Dambulla Branch								
700B, Anuradhapura Road, Dambulla.	100.00	7,456	200,000	43,000	243,000	-	243,000	183,000
Fruithill Bungalow								
No 295/6, Dimbula Road, Hatton.	53.08	4,277	20,175	19,825	40,000	-	40,000	37,000
Galle Branch								
3, Wakwella Road, Galle.	13.68	7,920	95,000	35,000	130,000	-	130,000	108,000
Gampaha Branch								
148, Colombo Road,	25.00	16,682	93,750	168,250	262,000	-	262,000	246,000

	Land 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 2018 Net Book Value Rs 000	As at 31st December 2017 Net Book Value Rs 000
Gampaha.								
Gampola Branch								
142, Kandy Road,	17.05	12,825	65,643	101,357	167,000	-	167,000	159,000
Gampola.								
Grandpass Branch								
182, St Joseph Street, Colombo 14.	24.00	11,220	168,000	102,000	270,000	-	270,000	221,000
Gunasinghapura Stores								
11, Mohandiram's Road, Colombo 12.	48.30	6,022	301,000	27,000	328,000	-	328,000	279,000
Ja-Ela Branch								
73, Old Negombo Road, Kanuwana, Ja-Ela.	19.00	3,766	30,400	13,500	43,900	-	43,900	42,500
Jaffna Metro Branch								
177 & 179, Ponnampalam Road, Jaffna.	61.36	30,694	276,000	415,000	691,000	-	691,000	558,385
Kahawatte Branch								
772 A, Main Street, Kahawatte.	16.14	3,298	32,000	26,000	58,000	-	58,000	47,500
Kalmunai Branch								
30A, Batticaloa Road, Kalmunai.	25.10	6,123	80,320	44,680	125,000	-	125,000	117,000
Kandy Branch								
1, Dalada Veediya, Kandy.	58.00	26,821	720,625	214,375	935,000	-	935,000	885,000
Kuliyapitiya Branch								
225, Main Street, Kuliyapitiya.	32.08	4,500	25,560	16,673	42,233	-	42,233	44,900
Kurunegala Branch								
6, St. Anne's Street, Kurunegala.	36.25	17,970	163,125	113,013	276,138	-	276,138	250,828
Mount Bungalow								
16, Mount Road, Hatton.	160.09	5,074	44,025	19,975	64,000	-	64,000	60,000
Mannar Branch								
68, Main Street, Mannar.	23.00	5,866	12,650	20,000	32,650	-	32,650	31,200
Marawila Branch								
534, Colombo Road, Marawila.	43.80	7,217	34,800	25,900	60,700	-	60,700	57,550
Maskeliya Branch								
7/11, New Town, Maskeliya.	20.32	8,277	32,512	57,488	90,000	-	90,000	86,000
Matara Branch								
58D, Esplanade Road, Matara.	26.00	7,242	78,000	44,000	122,000	-	122,000	96,000

Notes to the Financial Statements

38 PROPERTY, PLANT AND EQUIPMENT (Contd.)

	Land 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 2018 Net Book Value Rs 000	As at 31st December 2017 Net Book Value Rs 000
Minuwangoda Branch								
41, Samarakkody Road, Minuwangoda.	20.51	3,452	45,000	30,650	75,650	-	75,650	67,500
Managers' Bungalow								
295, Dimbula Road, Hatton.	42.20	1,976	15,825	10,175	26,000	-	26,000	25,000
Mount Lavinia Branch								
605, Galle Road, Mount Lavinia.	22.66	11,350	124,300	84,400	208,700	-	208,700	174,000
Negombo Branch								
18, Rajapakse Broadway, Negombo.	8.88	5,450	19,536	19,800	39,336	-	39,336	37,260
Negombo Metro								
201, Colombo Road, Negombo.	51.98	28,081	133,029	217,971	351,000	-	351,000	324,000
Nittambuwa Branch								
22, Kandy Road, Nittambuwa.	55.69	10,411	139,225	140,275	279,500	-	279,500	272,500
Nochchiyagama Branch *								
10, Puttalam Road, Nochchiyagama.	-	8,652	-	25,000	25,000	-	25,000	24,500
Nugegoda Branch								
181, High Level Road, Nugegoda.	16.50	11,096	82,500	77,500	160,000	-	160,000	153,000
Nugegoda Branch								
190,190/1, High Level Road, Nugegoda.	39.65		297,375	177,625	475,000	-	475,000	386,895
Nuwara Eliya Branch / Bungalow								
42, Queen Elizabeth Drive, Nuwara Eliya.	149.03	12,929	656,508	103,492	760,000	-	760,000	737,000
Panchikawatte Branch								
168, Panchikawatta Road, Colombo 10.	22.55	16,366	225,500	119,463	344,963	-	344,963	284,000
Pettah Branch								
149-151, Main Street, Colombo 11.	13.03	11,460	293,175	99,825	393,000	-	393,000	321,000
Pettah Metro **								
88, Main Street, Colombo 11.	-	3,708	-	106,400	106,400	-	106,400	92,000
Polonnaruwa Branch *								
467, Main Street, Kaduruwela, Polonnaruwa.	-	9,882	-	57,500	57,500	-	57,500	56,884
Pussellawa Branch								
510, Nuwara Eliya Road, Pussellawa.	14.30	4,785	30,030	36,970	67,000	-	67,000	63,000
Ratnapura Branch								
21 & 23, Senanayake Mawatha, Ratnapura.	43.40	18,777	140,000	175,325	315,325	-	315,325	247,800

	Land 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 2018 Net Book Value Rs 000	As at 31st December 2017 Net Book Value Rs 000
Sea Street Branch								
60, Sea Street, Colombo 11.	6.93	9,608	129,937	56,463	186,400	-	186,400	152,000
Trincomalee Branch								
59, Ehamparam Road, Trincomalee.	31.75	9,156	82,550	52,450	135,000	-	135,000	129,000
Vavuniya Branch *								
43, Inner Circular Road, Vavuniya.	-	9,032	-	26,000	26,000	-	26,000	25,300
Wattala Branch								
270, 270/1, Negombo Road, Wattala.	53.00	8,579	265,000	65,000	330,000	-	330,000	269,000
Welimada Branch								
35, Nuwara Eliya Road, Welimada.	14.37	9,909	51,732	78,268	130,000	-	130,000	125,000
Wellawaya Branch								
70, Kumaradasa Mawatha, Wellawaya.	26.60	5,873	22,500	23,500	46,000	-	46,000	28,500
Wellawatte Branch								
100 & 102, Galle Road, Colombo 06.	36.05	16,082	630,875	152,125	783,000	-	783,000	637,000
Total freehold land and buildings			13,160,927	4,482,538	17,643,465	-	17,643,465	14,838,402

* Buildings constructed on state land given on lease ** Condominium property

	Land 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 2018 Net Book Value Rs 000	As at 31st December 2017 Net Book Value Rs 000
479 T B Jayah Mawatha, Colombo 10 [Note 37 (b) ii]	112.96	535,147	2,118,000	15,881,331	17,999,331	324,279	17,675,052	13,408,906
Janadhipathi Mawatha, Colombo 1 [Note 37 (b) ii]	26.62	-	665,500	-	665,500	-	665,500	532,400
451, Kandy Road, Kegalle	61.7	-	154,250	-	154,250	-	154,250	154,250
94 96/1, Kandy Rd, Kurunagela	7.05	5,755	21,100	70,622	91,722	1,722	90,000	86,800
46/A, Thangalle Rd, Hambanthota	9.26	2,113	6,606	11,678	18,284	284	18,000	18,000
677, William Gopallawa Mw, Kandy	9.26	5,400	22,147	57,556	79,703	1,403	78,300	78,000
168, Nawala Rd , Nugegoda	25.9	30,887	153,244	536,542	689,786	13,086	676,700	633,600
Total freehold land and buildings			3,140,847	16,557,729	19,698,576	340,774	19,357,802	14,911,956
Total freehold land and buildings - Group			16,301,774	21,040,267	37,342,041	340,774	37,001,267	29,750,358

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 results of the revaluation carried out in 2018.

	Range of Estimates for Unobservable Inputs	Net book value before revaluation of		Revalued amount of		Revaluation Gain/(Loss) Recognised on	
		Land	Buildings	Land	Buildings	Land	Buildings
		Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Akkaraipattu Branch 14, Main Street, Akkaraipattu.	Rs.3,750,000 p.p	67,788	66,056	72,450	70,550	4,662	4,494
Ambalangoda Branch 94/1, New Galle Road, Ambalangoda.	Rs.4,000,000 p.p Rs.7,000 to Rs.8,500 p. sq.ft	97,000	20,509	119,500	30,500	22,500	9,991
Anuradhapura Branch 30, Maithripala Senanayake, Mawatha, Anuradhapura.	Rs.1,100,000 to Rs.2,950,000 p.p Rs.3,650 to Rs.5,000 p. sq.ft	106,500	30,340	112,000	32,800	5,500	2,460
Badulla Branch 15, 15 1/1, Udayaraja Mawatha, Badulla.	Rs.3,850,000 p.p Rs.2,500 to Rs. 7,000 p.sq.ft	104,063	34,015	106,838	38,162	2,775	4,147
Bambalapitiya Branch 285, Galle Road, Colombo 4.	Rs.19,000,000 p.p Rs.12,000 p. sq.ft	300,000	71,660	380,000	87,000	80,000	15,340
Boralessgamuwa Branch 24, Maharagama Road, Boralessgamuwa.	Rs.4,250,000 p.p Rs.4,500 to Rs.8,500 p. sq.ft	103,425	26,289	125,587	32,413	22,162	6,124
Borella Branch 53/1, D S Senanayake Mawatha, Borella.	Rs.11,250,000 p.p Rs.2,750 to Rs.14,000 p. sq.ft	252,000	91,475	315,000	107,000	63,000	15,525
Centre of Aspiration 90, Vinayalankara Mawatha. Colombo 10.	Rs.14,000,000 p.p Rs.8,500 p. sq.ft	2,602,050	57,060	3,311,700	71,300	709,650	14,240
Chavakachcheri Branch 170, Kandy Road, Chavakachcheri	Rs.1,000,000 p.p Rs.3,000 to Rs.4,500 p. sq.ft	35,420	15,193	31,670	21,330	(3,750)	6,137
City Office 16, Janadhipathi Mawatha, Colombo 1.	Rs.22,000,000 p.p Rs.3,000 to Rs.10,000 p. sq.ft	1,470,000	83,160	1,848,000	98,000	378,000	14,840
Dambulla Branch 700B, Anuradhapura Road, Dambulla.	Rs.1,000,000 to Rs.3,000,000 p.p Rs.8,000 to Rs.8,500 p. sq.ft	140,000	41,222	200,000	43,000	60,000	1,778
Fruithill Bungalow No 295/6, Dimbula Road, Hatton.	Rs.375,000 p.p Rs.5,750 p. sq.ft	18,829	17,305	20,175	19,825	1,346	2,520
Galle Branch 3, Wakwella Road, Galle.	Rs.7,000,000 p.p Rs.5,500 to Rs.8,000 p. sq.ft	78,000	29,211	95,000	35,000	17,000	5,789
Gampaha Branch 148, Colombo Road, Gampaha.	Rs.3,750,000 p.p Rs.8,500 to Rs.16,000 p. sq.ft	75,000	162,898	93,750	168,250	18,750	5,352
Gampola Branch 142, Kandy Road, Gampola.	Rs.3,850,000 p.p Rs. 7,000 p. sq.ft	63,938	92,541	65,642	101,357	1,704	8,816
Grandpass Branch 182, St Joseph Street, Colombo 14.	Rs.7,000,000 p.p Rs.12,500 p. sq.ft	132,000	85,404	168,000	102,000	36,000	16,596
Gunasinghepura Stores 11, Mohandiram's Road, Colombo 12.	Rs.7,000,000 p.p Rs.2,500 to Rs.6,500 p. sq.ft	255,480	22,400	301,000	27,000	45,520	4,600
Ja-Ela Branch 73,Old Negombo Road, Kanuwana, Ja-Ela	Rs.1,600,000 p.p Rs.2,600 to Rs.4,650 p. sq.ft	28,500	13,410	30,400	13,500	1,900	90
Jaffna Metro Branch 177 & 179, Ponnampalam Road, Jaffna.	Rs.4,500,000 p.p Rs.12,500 p. sq.ft	276,000	275,797	276,000	415,000	-	139,203
Kahawatte Branch 772 A, Main Street, Kahawatte.	Rs.2,000,000 p.p Rs.4,500 to Rs.8,000 p. sq.ft	26,500	20,000	32,000	26,000	5,500	6,000
Kalmunai Branch 30A, Batticaloa Road, Kalmunai.	Rs.3,200,000 p.p Rs.7,000 p. sq.ft	75,300	40,593	80,320	44,680	5,020	4,087

	Range of Estimates for Unobservable Inputs	Net book value before revaluation of		Revalued amount of		Revaluation Gain/(Loss) Recognised on	
		Land	Buildings	Land	Buildings	Land	Buildings
		Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Kandy Branch 1, Dalada Veediya, Kandy.	Rs.12,500,000 p.p Rs.7,000 to Rs.8,000 p.sq.ft	691,800	184,302	720,625	214,375	28,825	30,073
Kuliyapitiya Branch 225, Main Street, Kuliyapitiya.	Rs.450,000 to Rs.900,000 p.p Rs.4,750 p. sq.ft	28,510	16,906	25,560	16,672	(2,950)	(234)
Kurunegala Branch 6, St. Anne's Street, Kurunegala.	Rs.4,500,000 p.p Rs.4,000 to Rs.9,500 p. sq.ft	145,000	105,263	163,125	107,875	18,125	2,612
Mount Bungalow No 16, Mount Road, Hatton.	Rs.275,000 p.p Rs.4,750 p. sq.ft	40,023	19,174	44,025	19,975	4,002	801
Mannar Branch 68, Main Street, Mannar.	Rs.550,000 p.p Rs.2,800 to Rs.3,600 p. sq.ft	11,500	18,776	12,650	20,000	1,150	1,224
Marawila Branch 534, Colombo Road, Marawila.	Rs.525,000 to Rs.1,100,000 p.p Rs.500 to Rs.4,500 p. sq.ft	32,150	24,206	34,800	25,900	2,650	1,694
Maskeliya Branch 7/11, New Town, Maskeliya.	Rs.1,600,000 p.p Rs.6,000 to Rs.7,000 p. sq.ft	30,480	53,005	32,512	57,488	2,032	4,483
Matara Branch 58D, Esplanade Road, Matara.	Rs.3,000,000 p.p Rs.5,000 to Rs.8,000 p. sq.ft	58,500	36,356	78,000	44,000	19,500	7,644
Minuwangoda Branch 41, Samarakkody Road, Minuwangoda.	Rs.2,200,000 p.p Rs.2,850 to Rs.6,250 p. sq.ft	41,020	25,453	45,000	30,650	3,980	5,197
Manager Bungalow 295, Dimbula Road, Hatton.	Rs.375,000 p.p Rs.4,000 p. sq.ft	14,769	9,744	15,825	10,175	1,056	431
Mount Lavinia Branch 605, Galle Road, Mount Lavinia.	Rs.5,500,000 p.p Rs.12,000 p. sq.ft	101,970	68,655	124,300	84,400	22,330	15,745
Negombo Branch 18, Rajapakse Broadway, Negombo.	Rs.2,200,000 p.p Rs.850 to Rs.5,050 p. sq.ft	17,760	19,586	19,536	19,800	1,776	214
Negombo Metro Building 201, Colombo Road, Negombo.	Rs.2,500,000 p.p Rs.2,500 to Rs.9,525 p. sq.ft	113,467	201,389	133,029	217,971	19,562	16,582
Nittambuwa Branch 22, Kandy Road, Nittambuwa.	Rs.2,500,000 p.p Rs.12,000 to Rs.18,000 p. sq.ft	128,101	137,539	139,225	140,275	11,124	2,736
Nochchiyagama Branch* 10, Puttalam Road, Nochchiyagama.	Rs 1,500 to Rs.4,550 p. sq.ft	-	24,160	-	25,000	-	840
Nugegoda Branch 181, High Level Road, Nugegoda.	Rs 5,000,000 p.p Rs.10,000p. sq.ft	82,500	67,144	82,500	77,500	-	10,356
Nugegoda Branch 190,190/1, High Level Road, Nugegoda	Rs.7,500,000 p.p Rs.2,500 to Rs.12,500 p. sq.ft	237,900	155,943	297,375	177,625	59,475	21,682
Nuwara Eliya Branch / Bungalow 42, Queen Elizabeth Drive, Nuwara Eliya.	Rs.3,600,000 to Rs.5,600,000 p.p Rs.7,000 p. sq.ft	641,605	91,635	656,508	103,492	14,903	11,857
Panchikawatta Branch 168, Panchikawatta Road, Colombo 10.	Rs.10,000,000 p.p Rs.12,000 p. sq.ft	180,400	99,071	225,500	119,500	45,100	20,429
Pettah Branch 149-151, Main Street, Colombo 11.	Rs.22,500,000 p.p Rs.12,500 p. sq.ft	234,540	82,396	293,175	99,825	58,635	17,429
Pettah Metro ** 88, Main Street, Colombo 11.	Rs.28,700 p.sq.ft	-	87,912	-	106,400	-	18,488
Polonnaruwa Branch * 467, Main Street, Kaduruwela, Polonnaruwa.	Rs.7,000 to Rs.7,750 p. sq.ft	-	54,381	-	57,500	-	3,119

Notes to the Financial Statements

38 PROPERTY, PLANT AND EQUIPMENT (Contd.)

	Range of Estimates for Unobservable Inputs	Net book value before revaluation of		Revalued amount of		Revaluation Gain/(Loss) Recognised on	
		Land	Buildings	Land	Buildings	Land	Buildings
		Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Pussellawa Branch 510, Nuwara Eliya Road, Pussellawa.	Rs.2,100,000 p.p Rs.7,000 p. sq.ft	28,600	32,910	30,030	36,970	1,430	4,060
Ratnapura Branch 21 & 23, Senanayake Mawatha, Ratnapura.	Rs.3,500,000 p.p Rs.1,800 to Rs.10,500 p. sq.ft	110,023	135,299	140,000	175,000	29,977	39,701
Sea Street Branch 60, Sea Street, Colombo 11.	Rs.18,750,000 p.p Rs.12,000 p. sq.ft	103,950	46,040	129,937	56,462	25,987	10,422
Trincomalee Branch 59, Ehampraram Road, Trincomalee.	Rs.2,600,000 p.p Rs.6,750 to Rs.8,500 p. sq.ft	79,375	51,320	82,550	52,450	3,175	1,130
Vavuniya Branch * 43, Inner Circular Road, Vavuniya.	Rs.1,550 to Rs. 4,600 p. sq.ft	-	24,226	-	26,000	-	1,774
Wattala Branch 270, 270/1, Negombo Road, Wattala.	Rs.5,000,000 p.p Rs.1,500 to Rs.12,000 p. sq.ft	212,000	54,488	265,000	65,000	53,000	10,512
Welimada Branch 35, Nuwara Eliya Road, Welimada.	Rs.3,600,000 p.p Rs.7,000 p. sq.ft	50,295	71,243	51,732	78,268	1,437	7,025
Wellawaya Branch 70, Kumaradasa Mawatha, Wellawaya.	Rs.850,000 p.p Rs.3,500 to Rs.5,000 p. sq.ft	7,500	20,053	22,500	23,500	15,000	3,447
Wellawatte Branch 100 & 102, Galle Road, Wellawatte.	Rs.17,500,000 p.p Rs.2,000 to Rs.13,000 p. sq.ft	504,700	126,813	630,875	152,125	126,175	25,312
Centralised Operations Building 10, Sri Uttarananda Mawatha, Colombo 3	Rs.22,000,000 p.p Rs.16,500 p. sq.ft	700,000	351,188	880,000	450,270	180,000	99,082
		10,936,231	3,793,114	13,160,926	4,477,110	2,224,695	683,996

* 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.

38 (c) Leasehold Buildings

As at 31st December	Bank				Group			
	2018			2017	2018			2017
	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	422,752	399,644	23,108	51,289	422,752	399,644	23,108	51,289
06 - 10 years	1,215,683	985,069	230,614	205,374	1,215,683	985,069	230,614	205,374
11 - 15 years	68,429	65,965	2,464	9,525	68,429	65,965	2,464	9,525
16 - 20 years	10,532	10,473	59	1,313	10,532	10,473	59	1,313
Total	1,717,396	1,461,150	256,246	267,501	1,717,396	1,461,151	256,245	267,501

38 (d) Temporarily Idle Property, Plant and Equipment - Bank

There was no temporarily idle property, plant and equipment as at 31st December 2018.

38 (e) Compensation from Third Parties for Property, Plant and Equipment - Bank

No compensation was received 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 to the financial statements.

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 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.

(c) 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.

Notes to the Financial Statements

39 INTANGIBLE ASSETS AND GOODWILL (Contd.)

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 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	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Cost				
Balance as at 1st January	3,282,946	3,001,205	3,941,542	3,574,214
Additions and improvements during the year	382,546	281,741	497,025	367,328
Balance as at 31st December	3,665,492	3,282,946	4,438,567	3,941,542
Accumulated amortisation				
Balance as at 1st January	2,467,565	2,211,557	2,703,713	2,393,945
Amortisation for the year [Note 18 (b)]	292,274	256,008	356,990	309,768
Balance as at 31st December	2,759,839	2,467,565	3,060,703	2,703,713
Net book value as at 31st December	905,653	815,381	1,377,864	1,237,829

39 (a) Analysis of Intangible Assets

As at 31st December	Bank		Group	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Computer Software	905,653	815,381	1,154,923	1,014,888
Goodwill *	-	-	122,941	122,941
License	-	-	100,000	100,000
	905,653	815,381	1,377,864	1,237,829

*Goodwill amounting to Rs 122.94 Mn has been recognised in respect of acquisition of HNB Finance Ltd.

As at 31st December 2018, the Bank carried out an impairment assessment on the goodwill recognised, on acquisition of HNB 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 of 21.8% 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	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Deposits and prepayments	1,403,156	1,492,547	1,204,283	1,241,578
Items held for use	191,269	111,304	191,269	111,304
Items in transit	4,421	26,950	4,421	26,950
Receivable from pension fund	1,347,519	1,719,510	1,347,519	1,719,510
Un-amortised cost on staff loans	4,776,496	4,192,733	4,866,069	4,273,500
VAT recoverable	162,795	167,013	162,795	167,013
Other debtors	6,696,019	3,444,909	8,568,880	5,570,091
Allowance for impairment	(71,724)	(71,724)	(71,724)	(71,724)
	14,509,951	11,083,242	16,273,512	13,038,222

Notes to the Financial Statements

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	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Call and time deposits	19,119,913	711,220	19,119,913	711,220
Foreign bank borrowings	44,218,622	49,055,803	44,218,622	49,055,803
Local bank borrowings	9,241,534	8,303,649	9,724,962	8,304,543
Refinance borrowings	4,912,513	4,392,825	4,912,513	4,392,825
	77,492,582	62,463,497	77,976,010	62,464,391

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 price is treated as interest expense and is accrued over the life of the agreement using the Effective Interest Rate (EIR).

As at 31st December	Bank		Group	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Securities sold under repurchase agreements				
with banks	11,085,279	-	11,085,279	-
with customers	5,593,667	5,064,360	5,593,667	5,064,360
	16,678,946	5,064,360	16,678,946	5,064,360

43 FINANCIAL LIABILITIES AT AMORTISED COST - DUE TO DEPOSITORS

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	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Local currency deposits	640,481,101	576,571,392	658,722,191	593,887,005
Foreign currency deposits	159,494,256	124,947,905	159,319,771	124,883,046
	799,975,357	701,519,297	818,041,962	718,770,051

43 (a) Analysis of Due to Customers

43 (a) i By Product

Current account deposits	44,941,127	39,167,863	44,454,697	38,624,655
Savings deposits	231,640,593	209,750,730	233,914,101	211,701,591
Time deposits	518,589,325	449,772,985	534,868,852	465,616,086
Certificates of deposit	407,482	955,609	407,482	955,609
Margin deposits	4,396,830	1,872,110	4,396,830	1,872,110
	799,975,357	701,519,297	818,041,962	718,770,051

43 (a) ii By Currency

Sri Lankan Rupees	640,481,101	576,571,392	658,722,191	593,887,005
United States Dollars	127,753,141	97,560,173	127,578,656	97,496,110
Great Britain Pounds	10,070,160	8,531,315	10,070,160	8,531,315
Euros	15,121,219	13,218,377	15,121,219	13,217,581
Australian Dollars	5,330,914	4,669,614	5,330,914	4,669,614
Other currencies	1,218,822	968,426	1,218,822	968,426
	799,975,357	701,519,297	818,041,962	718,770,051

Notes to the Financial Statements

44 DIVIDENDS PAYABLE

Details of dividends declared for the year after the reporting date are given in Note 23 (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".

As at 31st December	Bank		Group	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Balance as at 1st January	975,371	1,007,075	986,880	1,015,463
Final cash dividends declared in the prior year	-	1,596,426	209,514	1,795,887
Interim cash dividends declared during the year o/a of previous year	2,540,528	-	2,540,528	-
Interim cash dividends declared during the year	738,976	732,745	738,976	732,745
Transfer to retained earning	(39,229)	(22,856)	(39,229)	(22,856)
Dividends paid during the year	(3,220,884)	(2,338,019)	(3,427,201)	(2,534,359)
Balance as at 31st December	994,812	975,371	1,009,468	986,880

45 FINANCIAL LIABILITIES AT AMORTISED COST - 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	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Refinance borrowings	726,203	851,195	726,203	851,195
Foreign borrowings	24,167,952	26,406,811	24,167,952	26,406,811
	24,894,155	27,258,006	24,894,155	27,258,006

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.

As at 31st December								Bank		Group	
	Colombo Stock Exchange Listing	Interest Payment Frequency	Face Value Rs 000	Interest Rate	Repayment Terms	Issue Date	Maturity Date	As at 31.12.2018 Rs 000	As at 31.12.2017 Rs 000	As at 31.12.2018 Rs 000	As at 31.12.2017 Rs 000
(i) Year of issuance 2013	Listed	Annually	2,000,000	8.00%	10 Years	30th Aug 2013	29th Aug 2023	1,646,483	1,587,729	1,623,715	1,565,774
(ii) Year of issuance 2014	Listed	Semi Annually	2,757,240	7.75%	5 Years	15th Dec 2014	15th Dec 2019	2,757,240	2,864,961	2,725,993	2,832,750
		Semi Annually	84,040	8.33%	10 Years	15th Dec 2014	15th Dec 2024	84,040	87,569	63,999	66,729
(iii) Year of issuance 2011	Not Listed	Monthly	665,000 (1 Yr Avg TB rate)		20 Years	01st Apr 2011	31st Mar 2040	-	-	616,293	570,705
Total debt securities issued								4,487,763	4,540,259	5,030,000	5,035,958
Due within one year								2,811,596	165,606	2,776,314	160,331
Due after one year								1,676,167	4,374,653	2,253,686	4,875,627
Total debt securities issued								4,487,763	4,540,259	5,030,000	5,035,958

HNB Assurance PLC, subsidiary of the Bank has invested Rs 74 Mn in debt securities issued by the Bank.

* Debt securities issued by HNB 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	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Subordinated debentures [Note 47 (a)]	17,670,496	21,977,327	17,370,791	21,732,662
Subordinated loan [Note 47 (b)]	4,559,455	3,831,934	4,559,455	3,831,934
	22,229,951	25,809,261	21,930,246	25,564,596

47 (a) Subordinated Debentures

As at 31st December	Colombo Stock Exchange Listing	Interest Payment Frequency	Face Value Rs 000	Interest Rate	Repayment Terms	Issue Date	Maturity Date	Bank		Group	
								As at 31.12.2018 Rs 000	As at 31.12.2017 Rs 000	As at 31.12.2018 Rs 000	As at 31.12.2017 Rs 000
(i) Year of issuance 2006	Listed	At maturity	514,345	11.00%	15 Year	1st Apr 2006	31st Mar 2021	406,901	366,598	378,479	340,992
			1,362,800	11.25%	18 Year	1st Apr 2006	31st Mar 2024	778,998	700,268	778,998	700,268
(ii) Year of issuance 2007	Listed	Annually	700,000	16.75%	15 Year	1st Aug 2007	31st Jul 2022	758,625	758,625	758,623	758,625
(iii) Year of issuance 2011	Listed	Semi Annually	2,000,000	11.50%	10 Year	5th Sep 2011	4th Sep 2021	2,000,000	2,115,945	2,000,000	2,115,945
(iv) Year of issuance 2013	Listed	Annually	4,000,000	14.00%	5 Year	13th Jun 2013	12th Jun 2018	-	4,309,918	-	4,262,142
(v) Year of issuance 2016	Listed	Annually	7,000,000	11.25%	5 Year	28th Mar 2016	28th Mar 2021	7,599,795	7,599,795	7,328,513	7,328,512
			2,000,000	11.75%	5 Year	1st Nov 2016	1st Nov 2021	2,039,274	2,039,274	2,039,274	2,039,274
			4,000,000	13.00%	7 Year	1st Nov 2016	1st Nov 2023	4,086,904	4,086,904	4,086,904	4,086,904
(vi) Year of issuance 2013	Not Listed	Monthly	100,000	17.50%	5 Year	17th Jun 2013	16th Jun 2018	-	-	-	100,000
Total subordinated debentures								17,670,496	21,977,327	17,370,791	21,732,662
Due within one year								784,598	5,210,461	755,106	5,267,636
Due after one year								16,885,898	16,766,866	16,615,685	16,465,026
Total subordinated debentures								17,670,496	21,977,327	17,370,791	21,732,662

Subsidiaries of the Bank, HNB Assurance PLC and HNB Finance Ltd have invested Rs 136.9 Mn and Rs 162.7 Mn respectively, 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	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Current tax	9,184,814	3,974,624	9,559,852	4,066,087
	9,184,814	3,974,624	9,559,852	4,066,087

49 DEFERRED TAX

As at 31st December	Bank		Group	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Deferred tax liabilities [Note 49 (a)]	6,286,779	6,497,772	12,353,486	9,145,091
Deferred tax assets [Note 49 (b)]	(4,477,881)	(1,415,136)	(6,521,813)	(1,835,808)
	1,808,898	5,082,636	5,831,673	7,309,283

49 (a) Deferred Tax Liabilities**49 (a) i Deferred Tax Liabilities on Other Temporary Differences**

As at 31st December	Bank				Group			
	2018		2017		2018		2017	
	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	23,206,330	6,497,772	8,561,212	2,397,139	29,915,883	8,376,446	9,607,700	2,690,155
Originating during the year								
Recognised / (realised) in the statement of profit or loss	(1,822,607)	(510,330)	977,971	273,830	(1,157,707)	(324,158)	1,075,786	301,217
Recognised in OCI								
revaluation surplus recognised on buildings	639,746	179,129	519,011	145,323	11,098,350	3,107,538	3,994,648	1,118,502
revaluation surplus recognised on land	2,228,447	623,962	9,839,275	2,754,997	2,269,301	799,679	11,904,706	3,333,318
government securities	(1,799,121)	(503,754)	3,308,861	926,483	(1,828,721)	(512,042)	3,333,043	933,254
Balance as at 31st December	22,452,795	6,286,779	23,206,330	6,497,772	40,297,106	11,447,463	29,915,883	8,376,446

Notes to the Financial Statements

49 DEFERRED TAX (Contd.)

49 (a) ii Deferred Tax Liabilities on Undistributed Profits of Subsidiaries

As at 31st December	Bank				Group			
	2018		2017		2018		2017	
	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	-	-	-	-	5,490,293	768,644	3,962,820	396,282
Originating during the year								
Effect of withholding tax rate change	-	-	-	-			-	158,516
Recognised in the statement of profit or loss	-	-	-	-	981,279	137,379	1,527,473	213,846
Balance as at 31st December	-	-	-	-	6,471,572	906,023	5,490,293	768,644
Total deferred tax liabilities (Note 49)	22,452,795	6,286,779	23,206,330	6,497,772	46,768,678	12,353,486	35,406,172	9,145,091

49 (b) Deferred Tax Assets

As at 31st December	Bank				Group			
	2018		2017		2018		2017	
	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	5,054,057	1,415,136	7,734,914	2,165,776	6,556,456	1,835,808	8,077,356	2,261,660
Opening balance adjustment day 1	3,893,146	1,090,081			4,539,432	1,271,041		
Originating during the year								
Recognised / (realised) in the statement of Profit or loss	7,045,229	1,972,664	(2,680,857)	(750,640)	12,217,836	3,420,787	(1,537,104)	(430,389)
Recognised in OCI	-	-			(20,796)	(5,823)	16,204	4,537
Balance as at 31st December (Note 49)	15,992,432	4,477,881	5,054,057	1,415,136	23,292,928	6,521,813	6,556,456	1,835,808

49 (c) Recognised Deferred Tax Assets and Liabilities

49 (c) i Recognised Deferred Tax Assets / (Liabilities) - Bank

	Statement of Financial Position As at 31st December		Statement of Profit or Loss For the year ended 31st December		Other Comprehensive Income For the year ended 31st December	
	2018	2017	2018	2017	2018	2017
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Accelerated depreciation for tax purposes						
- Property, plant and equipment	(627,425)	(624,621)	(2,805)	(108,778)	-	-
- Intangible assets	(192,424)	(120,308)	(72,116)	17,452	-	-
- Assets on leasing business	(1,507,878)	(2,093,129)	585,251	(182,504)	-	-
Revaluation of government securities	92,983	(410,771)	-	-	503,754	(926,481)
Capital gain on land revaluation	(3,378,962)	(2,754,997)	-	-	(623,965)	(2,754,997)
Revaluation of freehold buildings	(673,074)	(493,946)	-	-	(179,129)	(145,323)
Temporary difference on allowance for impairment	4,477,882	1,415,136	1,972,664	(750,640)	-	-
	(1,808,898)	(5,082,636)	2,482,994	(1,024,470)	(299,340)	(3,826,801)

49 (c) ii Recognised Deferred Tax Assets / (Liabilities) - Group

Deferred tax assets and liabilities are attributable to the following.

	Statement of Financial Position As at 31st December		Statement of Profit or Loss For the year ended 31st December		Other Comprehensive Income For the year ended 31st December	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Accelerated depreciation for tax purposes						
Property, plant and equipment	(902,745)	(844,056)	(58,694)	(165,673)	-	-
Intangible assets	(192,424)	(120,308)	(72,116)	17,452	-	-
Assets on leasing business	(1,675,082)	(2,131,958)	454,761	(153,000)	-	-
Revaluation of government securities	97,612	(414,430)	-	-	512,042	(933,251)
Capital gain on land revaluation	(6,269,336)	(3,333,318)	-	-	(799,679)	(3,333,318)
Revaluation of freehold buildings	(2,509,581)	(1,532,380)	-	-	(3,107,538)	(1,137,191)
Undistributed profits of subsidiaries and joint ventures	(906,021)	(768,640)	(137,379)	(372,358)	-	-
Unutilised tax losses	1,290,918	153,524	-	94,383	-	-
Temporary difference on allowance for impairment	5,234,985	1,682,283	3,420,994	(524,772)	(5,823)	4,537
	(5,831,674)	(7,309,283)	3,607,566	(1,103,968)	(3,400,998)	(5,399,223)

49 (d) Unrecognised tax losses - Subsidiaries

The cumulative unrecognised tax loss of HNB Assurance PLC (company) from its life business as per Section 92 of inland Revenue Act No. 10 of 2006 amounted to Rs. 5,195 Mn as at 31st March 2018. However, as per Section 67 of the new Inland Revenue Act No 24 of 2017 which is effective from 1st April 2018, the company incurs a taxable income. The new act allows the 100% deduction of taxable income against the tax losses incurred whereas the previous act limited the set off only upto 35% of the total statutory income. Transitional provisions of the new Act, allows the claim such brought forward tax losses against taxable income for a period of 6 years with effect from 1st April 2018. Based on the assessment of future taxable profits of the company, the said total tax loss can be claimed within the period specified in the transitional provisions. Accordingly, the company recognised a net deferred tax asset of Rs. 1,280.40 Mn during the year in respect of the said tax loss.

HNB General Insurance Ltd, subsidiary of HNB Assurance PLC also recorded a deferred tax asset amounting to Rs 24.4 Mn (2017 - Rs. 59.1 Mn) for net temporary differences. The Group does not have unrecognised deferred tax as at the reporting date.

In 2017 the company recognised a deferred tax asset in respect of the unutilised tax losses up to the extent of the deferred tax liability arising from temporary differences in the company.

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 discount rate as specified by the Insurance Regulatory Commission of Sri Lanka. 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 cash flows, interest rate applied is based on the management's 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 2018 was carried out by Mr. Hassan Scott Odierno, of M/S Actuarial Partners Consulting Sdn Bhd.

The life fund stands at Rs 12,256.68 Mn as at 31st December 2018 (2017 : Rs 10,915.86 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 31st January 2019.

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 recognised 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 year. 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.

51 INSURANCE PROVISION - GENERAL (Contd.)

As at 31st December	2018	2018	2017	2017
	Rs 000	Rs 000	Rs 000	Rs 000
Unearned premium				
Gross		2,102,101		1,956,581
Reinsurance		(307,405)		(364,130)
Net		1,794,696		1,592,451
Deferred acquisition expenses		-		-
Reserve for title insurance		49,582		34,840
Unexpired risk reserve		-		-
		1,844,278		1,627,291
Claims outstanding - gross	550,126		663,854	
Claims incurred but not reported - gross	130,691	680,817	93,763	757,617
Total		2,525,095		2,384,908

52 OTHER LIABILITIES

As at 31st December	Bank		Group	
	2018	2017	2018	2017
	Rs 000	Rs 000	Rs 000	Rs 000
Cheques sent on clearing	44,004	36,342	44,004	36,342
Bills payable	1,164,254	1,574,872	1,164,254	1,574,872
Items in transit	14,772	43,438	14,772	43,438
Refundable deposits and advances	-	-	47,535	12,211
Balance held o/a of pension fund	8,789	13,618	8,789	13,618
Balance held o/a of Widows', Widowers' and Orphans' Pension Fund (WW&OP)	4,168	1,215	4,168	1,215
Balance held o/a of Employees' Provident Fund (EPF)	-	8,152	-	8,152
Liability for EPF interest rate guarantee [Note 53 (b)]	70,170	58,952	70,170	58,952
Liability for leave accrual plan [Note 53 (c)]	126,448	118,563	126,448	118,563
Provision for gratuity benefits	-	-	358,161	321,157
Payable to vendors for lease equipment	816,619	708,827	816,619	708,827
Impairment allowance for off-balance sheet credit exposures	1,275,924	-	1,275,924	-
Other creditors	3,383,763	3,156,917	5,013,945	4,461,889
	6,908,911	5,720,896	8,944,789	7,359,236

Notes to the Financial Statements

52 OTHER LIABILITIES (Contd.)

52 (a) Movement in Impairment for off balance sheet credit exposure during the year - 2018

As at 31st December	Bank 2018 Rs 000	Group 2018 Rs 000
Stage 1		
Opening balance as at 1st January 2018	623,967	623,967
Net impairment charge for the year	147,613	147,613
Write-offs during the year	-	-
Other movements	-	-
Closing balance as at 31st December 2018	771,580	771,580
Stage 2		
Opening balance as at 1st January 2018	102,614	102,614
Net impairment charge for the year	127,450	127,450
Write-offs during the year	-	-
Other movements	-	-
Closing balance as at 31st December 2018	230,064	230,064
Stage 3		
Opening balance as at 1st January 2018	180,389	180,389
Net impairment charge for the year	93,891	93,891
Write-offs during the year	-	-
Other movements	-	-
Closing balance as at 31st December 2018	274,280	274,280
Total impairment allowance for off balance sheet credit exposures	1,275,924	1,275,924

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.

(a) Pension Fund

The Bank operates an approved pension fund to facilitate the following payments for permanent staff of the Bank:

(a) i 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.

(a) ii 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.

(a) iii 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.

(b) 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.

Notes to the Financial Statements

53 EMPLOYEE RETIREMENT BENEFITS (Contd.)

(c) Gratuity Obligation - Group Companies

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. Provision for gratuity benefits of group companies is given in Note 52 to the financial statements.

(d) 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.

(e) 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.

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.

(a) Employees' Trust Fund

The Bank and the Group contribute 3% of the salary of each employee to the Employees' Trust Fund.

(b) 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 above.

53 (a) Pension Fund - Bank

An actuarial valuation of the pension fund was carried out as at 31st December 2018 by Mr M Poopalanathan, AIA, M/s Actuarial and Management Consultants (Pvt) Ltd, a firm of professional actuaries. The valuation method used by the actuary 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 contributed 2.96% of the pensionable salary to the pension fund in respect of all employees in 2018 (2017 8.3%)

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	2018	2017
	Rs 000	Rs 000
Present value of funded obligation [Note 53 (a) iii]	15,076,495	14,338,923
Total present value of obligations	15,076,495	14,338,923
Fair value of plan assets [Note 53 (a) ii]	(16,424,014)	(16,058,433)
Present value of net surplus	(1,347,519)	(1,719,510)
Recognised asset for defined benefit obligations	(1,347,519)	(1,719,510)

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 1,347.52 Mn from the pension fund as the present value of the reduction in future contributions.

53 (a) ii Fair Value of Plan Assets consists of the following

As at 31st December	2018	2017
	Rs 000	Rs 000
Equity securities and debentures	1,930,294	2,453,469
Government securities	4,368,411	5,163,492
Balance with Hatton National Bank PLC	115,318	6,340
Fixed deposits	10,097,460	8,383,617
Others	(87,469)	51,515
	16,424,014	16,058,433

53 (a) iii Movement in the Present Value of Defined Benefit Obligations

As at 31st December	2018	2017
	Rs 000	Rs 000
Liability for defined benefit obligations as at 1st January	14,338,923	12,543,413
Current service cost	611,349	587,759
Interest on obligation	1,534,265	1,551,620
Actuarial (gains) / losses	(422,043)	322,131
Benefits paid by the plan	(985,999)	(666,000)
Liability for defined benefit obligations as at 31st December	15,076,495	14,338,923

53 (a) iv Movement in Fair Value of Plan Assets

As at 31st December	2018	2017
	Rs 000	Rs 000
Fair value of plan assets as at 1st January	16,058,433	14,499,380
Expected return on plan assets	1,718,253	1,793,573
Contributions paid into plan	156,281	394,309
Benefits paid by the plan	(985,999)	(666,000)
Actuarial gains / (losses)	(522,954)	37,171
Fair value of plan assets as at 31st December	16,424,014	16,058,433

Notes to the Financial Statements

53 EMPLOYEE RETIREMENT BENEFITS (Contd.)

53 (a) v Net Interest on Defined Benefit Asset

For the year ended 31st December	2018 Rs 000	2017 Rs 000
Interest on obligation	1,534,265	1,551,620
Expected return of plan assets	(1,718,253)	(1,793,573)
Net interest on defined benefit asset	(183,988)	(241,953)

53 (a) vi Actuarial Gains and Losses Recognised in Other Comprehensive Income

For the year ended 31st December	2018 Rs 000	2017 Rs 000
Actuarial gains / (losses) on present value of defined benefit obligations	422,043	(322,131)
Actuarial gains / (losses) on fair value of plan assets	(522,954)	37,171
Actuarial gains / (losses) recognised during the year	(100,911)	(284,960)

53 (a) vii Actuarial Assumptions

For the year ended 31st December	2018 Rs 000	2017 Rs 000
Discount rate	11.45%	10.70%
Expected return on plan assets as at 1st January	10.70%	12.37%
Future salary increment rate	10.50%	9.75%
Future pension increments	Nil	Nil
Increase in cost of living allowance	10.70%	9.75%
Normal retirement age	55 years	55 years
Mortality	1967-70 Mortality Table issued by the Institute of Actuaries	1967-70 Mortality Table issued by the Institute of Actuaries

The average duration of the pension fund obligation is 30 years as at 31st December 2018 (2017 - 30 years).

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 2018.

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%		1,275,830	1,275,830
-1%		(1,531,489)	(1,531,489)
	1%	(924,121)	(924,121)
	-1%	825,504	825,504

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.

Actuarial assumptions

As at 31st December	2018 Rs 000	2017 Rs 000
Discount rate	10.00%	9.95%
Long term interest rate to credit the fund	10.00%	10.00%
Liability for EPF interest rate guarantee		
As at 31st December	2018 Rs 000	2017 Rs 000
Present value of obligation as at 1st January	58,952	57,434
Provision made during the year (Note 16)	11,218	1,518
Present value of obligation as at 31st December (Note 52)	70,170	58,952

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.

Actuarial assumptions

As at 31st December	2018 Rs 000	2017 Rs 000
Discount rate	11.45%	10.70%
Future salary increase	10.50%	9.75%
Liability for leave accrual plan		
As at 31st December	2018 Rs 000	2017 Rs 000
Present value of obligation as at 1st January	118,563	114,885
Provision made during the year (Note 16)	7,885	3,678
Present value of obligation as at 31st December (Note 52)	126,448	118,563

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 741 Mn and that the fair value of the fund assets is Rs 1,823 Mn resulting in a past service surplus of Rs 1,082 Mn (2017 : Rs 919 Mn) in the Widows', Widowers' and Orphans' Pension Scheme as at 31st December 2018.

No contribution is made by the Bank and the members' contribution during the period amounted to Rs 92.01 Mn.

Notes to the Financial Statements

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

As at 31st December	2018 Rs 000	2017 Rs 000
Voting ordinary shares		
Balance as at 1st January	25,900,025	12,338,734
Issue of shares under ESOP	31,442	143,110
Transfer from ESOP reserve *	11,478	47,516
Issue of shares through scrip dividend	706,515	1,044,073
Issue of shares through rights issue**	-	12,326,592
Balance as at 31st December	26,649,460	25,900,025
Non-voting ordinary shares		
Balance as at 1st January	5,509,094	3,001,424
Issue of shares under ESOP	4,708	20,568
Transfer from ESOP reserve *	1,446	6,390
Issue of shares through scrip dividend	173,318	262,093
Issue of shares through rights issue**	-	2,218,619
Balance as at 31st December	5,688,566	5,509,094
Stated capital as at 31st December	32,338,026	31,409,119

54 (b) Reconciliation of Number of Shares

As at 31st December	2018 Rs 000	2017 Rs 000
Voting ordinary shares		
Balance as at 1st January	392,304,558	330,756,782
Issue of shares under ESOP	221,160	998,013
Issue of shares through scrip dividend	2,925,530	4,519,797
Issue of shares through rights issue**	-	56,029,966
Balance as at 31st December	395,451,248	392,304,558
Non-voting ordinary shares		
Balance as at 1st January	96,249,132	83,058,692
Issue of shares under ESOP	42,788	203,031
Issue of shares through scrip dividend	907,421	1,310,462
Issue of shares through rights issue**	-	11,676,947
Balance as at 31st December	97,199,341	96,249,132
Total number of shares as at 31st December	492,650,589	488,553,690

* 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.

**At the Extra Ordinary General Meeting held on 5th July 2017, shareholders approved a resolution to issue 56,029,966 voting shares and 14,093,547 non-voting shares by way of a rights issue to the existing shareholders of the Bank in the proportion of one new ordinary share for every six ordinary shares (1 : 6) held as at the end of trading on 5th July 2017. These shares were to be issued at an issue price of Rs 220/- per each ordinary voting share and at an issue price of Rs 190/- per each ordinary non-voting share. Accordingly, Bank raised Rs 14.5 Bn through the issue of 56,029,966 voting shares and 11,676,947 non-voting shares.

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.

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 were recognised and measured in terms of SLFRS 2.

All options were to be settled by physical delivery of shares.

54 (c) i Employee Share Option Plan (Equity-Settled Share Based Payment Scheme)

As at 31st December	2018		2017	
	Weighted Average Exercise Price Rs	Number of Options	Weighted Average Exercise Price Rs	Number of Options
Outstanding as at 1st January	135.94	578,579	136.07	1,853,575
No of options granted in 2018 due to scrip dividend announced in 2017	-	-	135.68	48,457
No of options granted in 2018 due to scrip dividend announced in 2018	-	-	135.67	12,332
Exercised during the year	136.96	(263,948)	136.28	(1,201,044)
Expired during the year	135.08	(314,631)	134.66	(134,741)
Outstanding as at 31st December	-	-	135.94	578,579
Exercisable as at 31st December	-	-	135.94	578,579

The weighted average share price at the date of exercise, for share options exercised during the year ended 31st December 2018 was Rs. 244.12 for voting shares and Rs. 187.51 for non-voting shares (2017: Rs 233.92 for voting shares and Rs 194.10 for non-voting shares).

Notes to the Financial Statements

55 STATUTORY RESERVE FUND

As at 31st December	Bank		Group	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Balance as at 1st January	5,460,000	4,560,000	5,460,000	4,560,000
Transfers during the year	800,000	900,000	800,000	900,000
Balance as at 31st December	6,260,000	5,460,000	6,260,000	5,460,000

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

As at 31st December	Bank		Group	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Balance as at 1st January	15,193,585	9,524,236	18,082,284	12,821,116
Day 1 impact from the application of SLFRS 9	(4,042,519)	-	(4,225,558)	-
Profit for the year	15,518,203	16,466,790	17,254,618	15,946,989
Other comprehensive income for the year	(100,911)	(284,960)	(90,611)	(290,818)
Transfer to other reserves	(6,680,509)	(6,877,144)	(6,680,509)	(6,877,144)
Dividends	(4,159,336)	(3,635,337)	(4,159,336)	(3,635,337)
Deemed disposal gain through joint venture	-	-	528	117,478
Balance as at 31st December	15,728,513	15,193,585	20,181,416	18,082,284

57 OTHER RESERVES

57 (a) 2018

	Bank			Group		
	Opening Balance As at 1st January 2018 Rs 000	Movement/ Transfers Rs 000	Closing Balance As at 31st December 2018 Rs 000	Opening Balance As at 1st January 2018 Rs 000	Movement/ Transfers Rs 000	Closing Balance As at 31st December 2018 Rs 000
Capital reserve [Note 57 (c)]	8,725,542	2,065,452	10,790,994	19,433,829	3,560,681	22,994,510
Available for sale reserve [Note 57 (d)]	4,166,167	(4,166,167)	-	4,207,731	(4,207,731)	-
General reserve [Note 57 (e)]	43,100,000	6,000,000	49,100,000	43,100,000	6,000,000	49,100,000
Fair value reserve [Note 57 (f)]	-	1,536,439	1,536,439	-	1,537,723	1,537,723
ESOP reserve [Note 57 (g)]	93,186	(93,186)	-	93,186	(93,186)	-
Life policy holder reserve fund [Note 57 (h)]	-	-	-	223,271	(421,074)	(197,803)
Restricted Regulatory Reserve [Note 57 (i)]	-	-	-	-	381,156	381,156
Exchange Equalization Reserve [Note 57 (j)]	-	-	-	-	66,368	66,368
	56,084,895	5,342,538	61,427,433	67,058,017	6,823,937	73,881,954

57 (b) 2017

	Bank			Group		
	Opening Balance As at 1st January 2017 Rs 000	Movement/ Transfers Rs 000	Closing Balance As at 31st December 2017 Rs 000	Opening Balance As at 1st January 2017 Rs 000	Movement/ Transfers Rs 000	Closing Balance As at 31st December 2017 Rs 000
Capital reserve [Note 57 (c)]	8,644,483	81,059	8,725,542	19,771,905	(338,076)	19,433,829
Available for sale reserve [Note 57 (d)]	1,701,257	2,464,910	4,166,167	1,741,535	2,466,196	4,207,731
General reserve [Note 57 (e)]	37,100,000	6,000,000	43,100,000	37,100,000	6,000,000	43,100,000
ESOP reserve [Note 57 (g)]	147,092	(53,906)	93,186	147,092	(53,906)	93,186
Life policy holder reserve fund [Note 57 (h)]	-	-	-	(191,131)	414,402	223,271
	47,592,832	8,492,063	56,084,895	58,569,401	8,488,616	67,058,017

57 (c) Capital Reserve

As at 31st December	Bank		Group	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Balance as at 1st January	8,725,542	8,644,483	19,433,829	19,771,905
Revaluation during the year	2,868,546	2,981,379	7,468,816	4,110,702
Deferred tax effect on revaluation of freehold land and buildings	(803,094)	(2,900,320)	(3,908,135)	(4,448,778)
Balance as at 31st December	10,790,994	8,725,542	22,994,510	19,433,829

Capital reserve relates to revaluation surplus that resulted from the revaluation of freehold land and buildings carried out in 1989, 1993, 2007, 2012, 2015, 2016, 2017 and 2018.

57 (d) Available-for-sale Reserve

As at 31st December	Bank		Group	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Balance as at 1st January	4,166,167	1,701,257	4,207,731	1,741,535
Transferred to fair value reserve	(4,166,167)	3,308,142	(4,207,731)	3,331,781
Net amount transferred to profit or loss	-	83,249	-	64,958
Deferred tax effect	-	(926,481)	-	(930,543)
Balance as at 31st December	-	4,166,167	-	4,207,731

The available for sale reserve which comprised of the cumulative net change in fair value of available-for-sale financial investments recognised under LKAS 39 "Financial Instruments: Recognition and Measurement" was transferred to fair value reserve with the implementation of SLFRS 9 "Financial Instruments".

Notes to the Financial Statements

57 OTHER RESERVES (Contd.)

57 (e) General Reserve

As at 31st December	Bank		Group	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Balance as at 1st January	43,100,000	37,100,000	43,100,000	37,100,000
Transfer during the year	6,000,000	6,000,000	6,000,000	6,000,000
Balance as at 31st December	49,100,000	43,100,000	49,100,000	43,100,000

General reserve comprises of the amounts appropriated by the Board of Directors as a general banking reserve.

57 (f) Fair Value Reserve

As at 31st December	Bank		Group	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Balance as at 1st January	-	-	-	-
Day 1 impact from the application of SLFRS 9	4,035,701	-	4,058,756	-
Balance as at 1st January 2018 - restated	4,035,701	-	4,058,756	-
Net change in fair value during the year	(2,499,262)	-	(2,521,033)	-
Balance as at 31st December	1,536,439	-	1,537,723	-

The fair value reserve comprises of net change in fair value of financial assets - fair value through other comprehensive income.

57 (g) ESOP Reserve

As at 31st December	Bank		Group	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Balance as at 1st January	93,186	147,092	93,186	147,092
Transfer to stated capital	(93,186)	(53,906)	(93,186)	(53,906)
Balance as at 31st December	-	93,186	-	93,186

ESOP reserve consisted of the liabilities recognised on account of ESOP allocations granted in 2012 and 2013. With the expiry of all remaining options during the year, the outstanding value in ESOP reserve was transferred to retained earnings.

57 (h) Life Policy Holder Reserve Fund

As at 31st December	Group	
	2018 Rs 000	2017 Rs 000
Balance as at 1st January	223,271	(191,131)
Day 1 impact from the application of SLFRS 9	(4,507)	-
Balance as at 1st January 2018 - restated	218,764	(191,131)
Transfer to / (from) life policy holder reserve fund	(416,567)	414,402
Balance as at 31st December	(197,803)	223,271

57 (i) Restricted Regulatory Reserve

As at 31st December	Group	
	2018 Rs 000	2017 Rs 000
Balance as at 1st January	-	-
Transfer to / (from) Restricted Regulatory Reserve	381,156	-
Balance as at 31st December	381,156	-

Restricted regulatory reserve – HNB Assurance PLC “Company”

The Insurance Regulatory Commission of Sri Lanka (IRC SL) will consider the distribution of One-Off Surplus when the RBC rules are revised. The distribution of one-off surplus to shareholders as dividends shall remain restricted until a Company develops appropriate policies and procedures for effective management of its business, as listed below, Further these policies should be approved by the Board of Directors of the Company and must also comply with any relevant guidance issued by IRC SL from time to time.

57 (j) Exchange Equalization Reserve

As at 31st December	Group	
	2018 Rs 000	2017 Rs 000
Balance as at 1st January	-	-
Transfer to / (from) exchange equalization reserve	66,368	-
Balance as at 31st December	66,368	-

58 NON-CONTROLLING INTERESTS

As at 31st December	Group	
	2018 Rs 000	2017 Rs 000
Subsidiaries		
HNB Assurance PLC	2,199,263	1,295,931
HNB Finance Ltd	2,473,947	2,352,772
Total	4,673,210	3,648,703

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 Group 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 Group 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 Group also form part of commitments of the Group. 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 Group.

All discernible risks are accounted for in determining the amount of all known liabilities. The Group's share of any contingencies and capital commitments of a subsidiary or joint venture for which the Group 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 Group'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	2018 Rs 000	2017 Rs 000
Documentary credit	29,760,771	28,291,149
Guarantees	141,352,517	124,389,833
Acceptances	19,065,908	17,913,826
Bills for collection	14,407,921	10,952,695
Forward exchange contracts		
Forward exchange sales	38,199,566	24,743,007
Forward exchange purchases	85,271,103	77,923,587
Cheques sent on clearing	7,604,740	5,358,110
Commitments for unutilised facilities - direct	175,446,454	165,822,760
Commitments for unutilised facilities - indirect	252,105,256	142,969,759
Total - Bank	763,214,236	598,364,726

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 365 Mn.

As at 31st December	Bank		Group	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Approved and contracted but not provided for	327,759	473,413	327,759	473,413
Approved and not contracted for	37,027	263,470	37,027	263,470
	364,786	736,883	364,786	736,883

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	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Less than 1 year	410,094	1,163,762	618,961	1,331,417
1-5 years	861,005	1,370,318	1,178,252	1,775,442
6-10 years	194,825	235,663	227,111	278,109
11-15 years	13,702	30,458	17,229	33,158
Above 15 years	3,859	8,660	9,796	13,700
	1,483,485	2,808,861	2,051,349	3,431,826

Notes to the Financial Statements

59 CONTINGENT LIABILITIES AND COMMITMENTS (Contd.)

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 230.9 Mn on VAT on Financial Services (relating to 2003, 2004 and 2012) and assessments to the value of Rs 324.4 Mn on VAT on Non-Financial turnover (relating to the taxable period ended 30/06/2015, 30/09/2015 and 31/12/2015) and assessment to the value of Rs 14.4Mn on NBT on Non - Financial turnover (relating to the taxable period ended 31/03/2016 and 30/06/2016) received by the Bank are outstanding and have been duly appealed.

59 (e) ii Tax assessments against group entity - HNB Assurance PLC (Company)

Assessments to the value of Rs 21.99 Mn on VAT on Reinsurance Claims and Commissions (relating to Y/A 2010/11) and assessment to the value of Rs 31.6 Mn on VAT on Financial services (relating to 2014) and assessments to the value of Rs 432 Mn on Income tax (relating to Y/A 2011/12, 2012/13, 2013/14, 2014/15 and 2015/16) 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.

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	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Short term employment benefits				
Board of Directors and other KMP's	111,548	153,631	118,971	158,748

60 (b) ii Transactions, Arrangements and Agreements involving Key Management Personnel (KMPs) and their Close Family Members (CFMs)**Statement of Financial Position-Bank**

For the year ended 31st December	Closing Balance		Average Balance	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Assets				
Financial assets at amortised cost - loans and advances	167,018	103,198	141,408	92,856
	167,018	103,198	141,408	92,856
Liabilities				
Debt securities issued and subordinated term debts	10,000	10,000	10,000	10,000
Financial liabilities at amortised cost - due to depositors	505,142	349,983	471,893	274,022
	515,142	359,983	481,893	284,022

Commitments and Contingencies

As at 31st December	Closing Balance	
	2018 Rs 000	2017 Rs 000
Commitments for unutilised facilities		
Direct	40,629	55,300
	40,629	55,300

Statement of Profit or Loss - Bank

For the year ended 31st December	2018 Rs 000	2017 Rs 000
Interest income	13,427	9,400
Interest expenses	37,457	24,433

Details of ESOPs granted to KMP are given below.

	2018 Rs 000	2017 Rs 000
Number of options exercised during the year	53,415	50,528
Number of options remaining as at 31st December	-	53,415

Number of shares held by KMP

As at 31st December	2018	2017
Voting	234,835	202,757
Non-Voting	55,007	43,765

Cash dividends paid to KMP amount to Rs.1,502,946 in 2018 (2017 - Rs. 994,146)

Notes to the Financial Statements

60 RELATED PARTY DISCLOSURES (Contd.)

60 (b) iii Transactions, Arrangements and Agreements with Entities which are Controlled and/or Jointly Controlled by the KMP or their Close Family Members (CFMs)

Statement of Financial Position - Bank

As at 31st December	Closing Balance		Average Balance	
	2018	2017	2018	2017
	Rs 000	Rs 000	Rs 000	Rs 000
Assets				
Financial assets at amortised cost - loans and advances	22,066	19,292	21,168	10,149
	22,066	19,292	21,168	10,149
Liabilities				
Financial liabilities at amortised cost - due to depositors	24,324	25,870	24,863	26,203
	24,324	25,870	24,863	26,203

Commitments and contingencies

As at 31st December	Closing Balance	
	2018	2017
	Rs 000	Rs 000
Guarantees	68,450	68,220
Commitments for unutilised facilities		
Direct	20,735	9,961
Indirect	92,850	7,160
	182,035	85,341

Statement of Profit or Loss - Bank

For the year ended 31st December	2018	2017
	Rs 000	Rs 000
Interest income	2,781	1,351
Interest expenses	2,617	2,453

Number of shares held

As at 31st December	2018	2017
	Voting	1,847

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

As at 31st December	Closing Balance		Average Balance	
	2018	2017	2018	2017
	Rs 000	Rs 000	Rs 000	Rs 000
Assets				
Financial assets at amortised cost - loans and advances	3,036,597	1,434,582	2,240,923	521,660
Other assets	484,057	491,058	492,378	492,370
	3,520,654	1,925,640	2,733,301	1,014,030
Liabilities				
Securities sold under repurchase agreements	-	-	-	165,940
Debt securities issued and subordinated term debt	327,230	385,644	341,304	385,644
Financial liabilities at amortised cost - due to depositors	1,963,988	2,058,743	1,707,751	2,111,916
	2,291,218	2,444,387	2,049,055	2,663,500

Commitments and contingencies

As at 31st December	Closing Balance	
	2018	2017
	Rs 000	Rs 000
Guarantees	18,790	-
Commitments for unutilised facilities		
Direct	347,700	50,000
	366,490	50,000

Statement of Profit or Loss - Bank

For the year ended 31st December	2018	2017
	Rs 000	Rs 000
Interest income	355,351	120,713
Interest expenses	167,592	195,552
Other income	530,684	2,045,062
Other expenses	753,485	776,283
Other transactions		
Expenses reimbursed to the bank	35,865	38,186
Expenses reimbursed by the bank	77,056	87,252
Insurance claims received	26,046	17,389

60 (c) ii Transactions with the Joint Venture

Statement of Financial Position - Bank

As at 31st December	Closing Balance		Average Balance	
	2018	2017	2018	2017
	Rs 000	Rs 000	Rs 000	Rs 000
Assets				
Financial assets at amortised cost - loans and advances	246,623	295,313	288,873	367,137
	246,623	295,313	288,873	367,137
Liabilities				
Financial liabilities at amortised cost - due to depositors	164,573	79,806	80,717	68,644
Securities sold under repurchase agreements	4,750	24,520	15,830	43,940
	169,323	104,326	96,547	112,584

Commitments and contingencies

As at 31st December	Closing Balance	
	2018	2017
	Rs 000	Rs 000
Letter of Guarantees	1,150	1,150
Commitments for unutilised facilities		
Direct	3,630,000	3,503,440
	3,631,150	3,504,590

Notes to the Financial Statements

60 RELATED PARTY DISCLOSURES (Contd.)

Statement of Profit or Loss - Bank

For the year ended 31st December	2018	2017
	Rs 000	Rs 000
Interest income	37,647	47,677
Interest expenses	2,072	4,756
Other income	39,855	38,512
Other expenses	-	5,809

60 (d) Transactions with Post Employment Benefit Plans of the Bank

Statement of Financial Position - Bank

As at 31st December	Closing Balance		Average Balance	
	2018	2017	2018	2017
	Rs 000	Rs 000	Rs 000	Rs 000
Liabilities				
Financial liabilities at amortised cost - due to depositors	7,908,686	13,738,149	6,275,164	12,923,095
Debt securities issued and subordinated term debts	683,429	683,429	683,429	683,429
Securities sold under repurchase agreements	-	120,000	180,010	154,290
	8,592,115	14,541,578	7,138,603	13,760,814
Equity				
Stated capital	50,574	49,060	50,574	49,060
	50,574	49,060	50,574	49,060

Statement of profit or loss - Bank

For the year ended 31st December	2018	2017
	Rs 000	Rs 000
Interest expenses	822,045	1,834,342
Other transactions		
Dividends paid	6,728	6,663
Contributions made	1,245,503	1,444,572

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 2018 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 2018, 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

As at 31st December	Closing Balance		Average Balance	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Assets				
Balances with Central Bank of Sri Lanka	33,907,057	38,610,940	37,154,660	35,827,909
Reverse repurchase agreements	-	-	-	3,267,000
Financial assets at amortised cost - debt and other instruments/ Financial investments - loans and receivables	152,163,773	112,962,588	135,782,001	110,066,929
Financial assets measured at fair value through other comprehensive income/financial investments - available for sale	64,818,694	89,770,656	69,334,205	87,902,951
Financial assets recognised through profit or loss	1,286	-	965	-
Financial assets at amortised cost - loans and advances	61,087,504	57,814,676	57,861,600	55,347,797
Placements with banks	1,828,500	2,145,500	9,371,291	7,291,071
	313,806,814	301,304,360	309,504,722	299,703,657
Liabilities				
Financial liabilities at amortised cost - due to depositors	18,637,401	16,961,213	17,033,222	15,688,298
Due to banks	4,507,749	3,373,786	9,747,322	8,470,844
Debt securities issued	9,656,977	10,358,942	9,656,977	10,358,942
Securities sold under repurchase agreements	4,307,910	1,871,493	6,632,640	5,555,350
Financial liabilities at amortised cost - other borrowings	5,157,896	5,182,279	5,246,552	5,276,660
Taxation	9,271,714	3,974,624	6,795,734	6,194,366
	51,539,647	41,722,337	55,112,447	51,544,460

Commitments and contingencies

As at 31st December	Closing Balance	
	2018 Rs 000	2017 Rs 000
Forward foreign exchange contracts		
Sales	1,828,500	12,371,250
Purchases	14,536,575	-
Documentary credit	98,830	233,540
Guarantee	5,162,530	4,375,860
Commitments for unutilised facilities		
Direct	33,042,904	26,242,162
Indirect	4,209,870	2,724,140

Statement of profit or loss - Bank

For the year ended 31st December	2018	2017
	Rs 000	Rs 000
Interest income	21,652,272	20,652,218
Interest expenses	2,197,740	2,351,803
Other income	68,529	15,260
Impairment charge / (reversal) for loans and other losses	(75,227)	3,177,168
Tax expenses (income tax, financial services VAT, NBT, DRL)	16,285,559	9,580,397

Number of Shares held by Government

As at 31st December	2018	2017
Voting	62,429,239	61,108,285
Non voting	1,755,411	1,512,980

Cash dividends paid to Government related entities amounts to Rs. 626.74 Mn in 2018 (2017 - Rs. 454.4 Mn)

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 2018 was Rs. 673.56 Mn (2017 - Rs. 542.63 Mn).

Recurrent Related Party Transactions

In accordance with CSE rules there are no recurrent related party transactions which in aggregate exceeds more than 10% of the gross revenue of the Group, other than the transactions carried out with Government of Sri Lanka and Employees Provident Fund of HNB.

Notes to the Financial Statements

61 MATURITY ANALYSIS

61 (a) As at 31st December 2018

	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	25,141,890	-	25,141,890	24,966,831	-	24,966,831
Placements with banks	3,292,733	-	3,292,733	6,276,715	2,229,540	8,506,255
Balances with central banks	-	33,907,057	33,907,057	-	33,907,057	33,907,057
Reverse repurchase agreements	90,094	-	90,094	1,168,764	-	1,168,764
Derivative financial instruments	4,507,576	-	4,507,576	4,507,576	-	4,507,576
Financial assets recognised through profit or loss						
- Measured at fair value	100,342	-	100,342	264,420	-	264,420
Financial assets at amortised cost						
- loans and advances	377,891,401	371,157,419	749,048,820	389,256,321	381,006,679	770,263,000
financial assets at amortised cost						
- debt and other instruments	11,480,318	148,665,362	160,145,680	14,240,283	151,581,700	165,821,983
Financial assets measured at fair value through other comprehensive income	35,804,321	33,632,668	69,436,989	36,439,073	39,566,185	76,005,258
Investment in joint venture	-	755,000	755,000	-	2,027,201	2,027,201
Investment in subsidiaries	-	3,017,285	3,017,285	-	-	-
Investment properties	-	325,818	325,818	-	1,107,472	1,107,472
Property, plant and equipment	-	21,304,370	21,304,370	-	42,417,126	42,417,126
Intangible assets and goodwill	-	905,653	905,653	-	1,377,864	1,377,864
Other assets	7,648,451	6,861,500	14,509,951	9,309,836	6,963,676	16,273,512
Total assets	465,957,126	620,532,132	1,086,489,258	486,429,818	662,184,684	1,148,614,319
LIABILITIES						
Due to banks	59,584,261	17,908,321	77,492,582	59,684,355	18,291,655	77,976,010
Derivative financial instruments	2,519,172	-	2,519,172	2,519,172	-	2,519,172
Securities sold under repurchase agreements	16,678,946	-	16,678,946	16,678,946	-	16,678,946
Financial liabilities at amortised cost						
- due to depositors	776,660,753	23,314,604	799,975,357	786,054,955	31,987,007	818,041,962
Dividends payable	994,812	-	994,812	1,009,468	-	1,009,468
Financial liabilities at amortised cost						
- due to other borrowers	7,902,892	16,991,263	24,894,155	7,902,892	16,991,263	24,894,155
Debt securities issued	2,811,596	1,676,167	4,487,763	2,743,555	2,286,445	5,030,000
Current tax liabilities	9,184,814	-	9,184,814	9,559,852	-	9,559,852
Deferred tax liabilities	-	1,808,898	1,808,898	-	5,831,673	5,831,673
Insurance provision - life	-	-	-	149,366	12,107,320	12,256,686
Insurance provision - general	-	-	-	2,525,095	-	2,525,095
Other provisions	3,559,925	-	3,559,925	4,081,659	-	4,081,659
Other liabilities	6,577,486	331,425	6,908,911	8,216,618	728,171	8,944,789
Subordinated term debts	774,556	21,455,395	22,229,951	611,842	21,318,404	21,930,246
Total shareholders' equity	-	115,753,972	115,753,972	-	132,661,396	132,661,396
Non-controlling interests	-	-	-	-	4,673,210	4,673,210
Total liabilities	887,249,213	199,240,045	1,086,489,258	901,737,775	246,876,543	1,148,614,319
Maturity gap	(421,292,087)	421,292,087		(415,307,957)	415,307,957	
Cumulative gap	(421,292,087)			(415,307,957)		

61 (b) As at 31st December 2017

	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	21,739,800	-	21,739,800	21,924,898	-	21,924,898
Placements with banks	3,182,377	-	3,182,377	8,536,426	1,133,699	9,670,125
Balances with Central Bank of Sri Lanka	-	38,610,940	38,610,940	-	38,610,940	38,610,940
Reverse repurchase agreements	-	-	-	772,002	-	772,002
Derivative financial instruments	615,357	-	615,357	615,357	-	615,357
Financial assets recognised through profit or loss	120,486	-	120,486	266,538	-	266,538
Loans and receivables to customers	280,107,227	358,994,834	639,102,061	293,093,769	362,519,169	655,612,938
Financial investments - loans and receivables	17,433,697	104,765,351	122,199,048	18,149,411	106,882,260	125,031,671
Financial investments - available-for-sale	46,375,466	49,028,354	95,403,820	46,717,913	55,025,072	101,742,985
Financial investments - held-to-maturity	-	-	-	1,565,603	-	1,565,603
Investment in joint venture	-	755,000	755,000	-	1,689,263	1,689,263
Investments in subsidiaries	-	3,017,285	3,017,285	-	-	-
Investment properties	-	327,464	327,464	-	1,146,564	1,146,564
Property, plant and equipment	-	17,905,320	17,905,320	-	34,635,034	34,635,034
Intangible assets and goodwill	-	815,381	815,381	-	1,237,829	1,237,829
Other assets	4,301,735	6,781,507	11,083,242	6,241,524	6,796,698	13,038,222
Total assets	373,876,145	581,001,436	954,877,581	397,883,441	609,676,528	1,007,559,969
Liabilities						
Due to banks	25,681,363	36,782,134	62,463,497	25,682,257	36,782,134	62,464,391
Derivative financial instruments	1,305,900	-	1,305,900	1,305,900	-	1,305,900
Securities sold under repurchase agreements	5,064,360	-	5,064,360	5,064,360	-	5,064,360
Financial liabilities at amortised cost – due to depositors	686,612,698	14,906,599	701,519,297	694,660,070	24,109,981	718,770,051
Dividends payable	975,371	-	975,371	986,880	-	986,880
Financial liabilities at amortised cost – other borrowings	6,692,296	20,565,710	27,258,006	6,692,296	20,565,710	27,258,006
Debt securities issued	165,606	4,374,653	4,540,259	170,720	4,865,238	5,035,958
Current tax liabilities	3,974,624	-	3,974,624	4,066,087	-	4,066,087
Deferred tax liabilities	-	5,082,636	5,082,636	-	7,309,283	7,309,283
Insurance provision - life	-	-	-	115,037	10,800,821	10,915,858
Insurance provision - general	-	-	-	2,384,908	-	2,384,908
Other provisions	3,015,875	-	3,015,875	3,416,332	-	3,416,332
Other liabilities	5,357,924	362,972	5,720,896	6,554,532	804,704	7,359,236
Subordinated term debts	5,217,113	20,592,148	25,809,261	5,169,338	20,395,258	25,564,596
Shareholders' funds	-	108,147,599	108,147,599	-	125,658,123	125,658,123
Total liabilities	744,063,130	210,814,451	954,877,581	756,268,717	251,291,252	1,007,559,969
Maturity gap	(370,186,985)	370,186,985	-	(358,385,276)	358,385,276	-
Cumulative gap	(370,186,985)	-	-	(358,385,276)	-	-

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 eight different segments (corporate, retail, SME, micro, treasury, real estate, insurance and NBFI) 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 corporate, retail, SME, NBFI and treasury. Real estate insurance and finance represent the operating results and financial position of the subsidiaries, Sithra Development (Pvt) Ltd, HNB Assurance PLC and HNB Finance Limited respectively.

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 income, 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 2018 or in 2017.

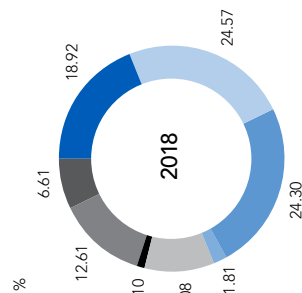
Segment information is presented in respect of the Group's business segments. The Group's primary format for segment reporting is based on business segments. The business segments are determined based on the Group's management and internal reporting structure.

	Corporate		Retail		SME		Micro		Treasury		Real Estate		Insurance		NBFI		Eliminations / Unallocated		Consolidated	
	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017
	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	Rs 000	Rs 000
Net interest income	11,301,723	9,097,794	16,307,632	14,786,976	14,058,640	12,411,495	1,209,568	861,024	5,801,428	3,925,112	(31,375)	1,883,052	1,684,689	4,364,216	4,197,541	(1,144,096)	(1,471,989)	53,636,164	45,461,267	
Foreign Exchange income	199,172	143,798	211,757	206,888	404,667	378,658	3,462	2,189	609,283	(1,501,058)	-	-	-	-	-	1,602,603	277,344	3,030,944	(492,261)	
Net fee and commission income	2,934,595	2,439,432	2,218,498	2,013,282	4,071,324	4,278,791	170,867	152,551	813,430	539,442	-	172,647	129,099	526,033	578,028	(809,444)	(1,116,219)	10,097,950	9,014,386	
Other operating income	-	-	-	-	-	-	-	-	465,027	2,065,793	982,561	965,701	7,561,152	6,492,001	239,873	(812,542)	(2,647,725)	8,349,989	7,115,643	
Total operating income	14,435,490	11,681,024	18,737,887	17,007,046	18,534,631	17,068,944	1,383,897	1,015,764	7,689,168	5,029,289	836,562	934,326	9,616,951	8,305,789	5,015,442	(1,110,817)	(4,958,899)	75,114,047	61,099,035	
Impairment charges for loans and other losses	3,284,457	3,288,539	(1,067,700)	(474,513)	6,133,121	273,267	282,560	(81,993)	688,491	102,219	-	-	1,508	(1,114)	891,795	(28,509)	7,549	9,784,052	3,926,149	
Net operating income	11,151,033	8,472,485	19,805,587	17,481,559	12,401,510	16,795,677	1,101,337	1,097,357	7,000,677	4,927,070	836,562	934,326	9,615,343	8,306,903	4,123,647	(1,082,308)	(4,966,138)	65,329,995	57,172,886	

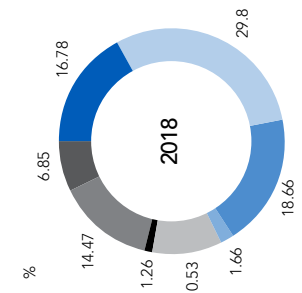
	Corporate		Retail		SME		Micro		Treasury		Real Estate		Insurance		NIFI		Eliminations / Unrealized		Consolidated		
	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017	
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	
Profit from Operation	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	26,163,212	22,927,396
Share of profit of Joint venture	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	303,092	175,616
Income tax expenses	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(7,316,842)	(6,361,616)
Non - controlling interest	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(1519,688)	(794,407)
Net Profit for the year attributable to equity holders of the parent	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	17,635,774	15,946,989
Segment assets	358,189,322	295,887,582	136,504,776	239,988,582	209,195,260	27,290,808	21,677,050	226,287,172	207,945,670	10,240,586	10,142,140	22,274,327	18,648,935	29,888,927	25,468,912	73,539,582	80,782,381	1,146,587,118	1,005,870,706	-	-
Investment in joint venture	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	2,027,201	1,689,263	2,027,201	1,689,263	-	-
Total Assets	358,189,322	295,887,582	136,504,776	239,988,582	209,195,260	27,290,808	21,677,050	226,287,172	207,945,670	10,240,586	10,142,140	22,274,327	18,648,935	29,888,927	25,468,912	75,566,783	82,471,644	1,148,614,319	1,007,559,969	-	-
Segment liabilities	134,710,179	117,483,567	484,585,016	422,511,567	157,263,130	144,162,520	7,354,855	86,026,302	60,572,015	10,240,586	10,142,140	22,274,327	18,648,935	29,888,927	25,468,912	216,350,998	203,308,779	1,148,614,320	1,007,559,969	-	-
Total liabilities	134,710,179	117,483,567	484,585,016	422,511,567	157,263,130	144,162,520	7,354,855	86,026,302	60,572,015	10,240,586	10,142,140	22,274,327	18,648,935	29,888,927	25,468,912	216,350,998	203,308,779	1,148,614,320	1,007,559,969	-	-

* Business of HNB Finance Limited

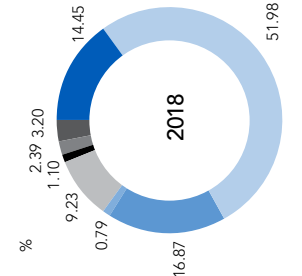
Total operating income



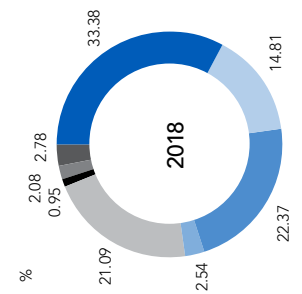
Net operating income



Segment liabilities



Segment assets



● Corporate ● Retail ● SME ● Micro ● Treasury ● Real Estate ● Insurance ● Finance

Notes to the Financial Statements

63 NET ASSETS VALUE PER ORDINARY SHARE

As at 31st December	Bank		Group	
	2018 Rs 000	2017 Rs 000	2018 Rs 000	2017 Rs 000
Amount used as the numerator:				
Equity holders funds (Rs 000)	115,753,971	108,147,599	132,661,396	122,009,420
Number of ordinary shares used as the denominator:				
Total number of shares*	492,651	492,387	492,651	492,387
Net assets value per share (Rs)	234.96	219.64	269.28	247.79

*Number of shares used in net assets value per ordinary share calculation of 2017 has been adjusted by the number of shares issued as scrip dividends in 2018.

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 23 (a).

65 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 132 for the statement of the Directors' Responsibility for Financial Reporting.

Statement of Profit or Loss in US Dollars

For the year ended 31st December	Bank		Group	
	2018 US\$ 000	2017 US\$ 000	2018 US\$ 000	2017 US\$ 000
Gross income	663,691	693,605	756,088	781,463
Interest income	591,222	627,572	637,072	678,031
Less : Interest expenses	331,011	368,849	343,738	381,383
Net interest income	260,211	258,723	293,334	296,648
Fee and commission income	52,178	54,914	56,779	60,212
Less: Fee and commission expenses	774	688	1,554	1,391
Net fee and commission income	51,404	54,226	55,225	58,821
Net interest, fee and commission income	311,615	312,949	348,559	355,469
Net loss from trading	(1,950)	(24,217)	(2,171)	(24,115)
Net gain from financial assets	1,178	1,384	1,192	1,613
Net insurance premium income	-	-	40,644	41,281
Net gains on derecognition of financial assets	-	-	395	-
Net other operating income	21,063	33,952	22,177	24,441
Total operating income	331,906	324,068	410,796	398,689
Less: Impairment charge for loans and other losses	50,820	19,807	53,510	25,619
Net operating income	281,086	304,261	357,286	373,070
Less : Operating expenses				
Personnel expenses	54,690	57,857	67,218	71,232
Benefits, claims and underwriting expenditure	-	-	31,060	35,797
Other expenses	66,043	69,754	78,501	80,964
Total operating expenses	120,733	127,611	176,779	187,993
Operating profit before Value Added Tax (VAT), Nation Building Tax (NBT) and Debt Recovery Levy (DRL) on financial services	160,353	176,650	180,507	185,077
Less: Value Added Tax (VAT) , Nation Building Tax (NBT) and Debt Recovery Levy (DRL) on financial services	34,833	32,766	37,423	35,469
Operating profit after Value Added Tax (VAT), Nation Building Tax (NBT) and Debt Recovery Levy (DRL) on financial services	125,520	143,884	143,084	149,608
Share of profit of joint venture (net of income tax)	-	-	1,658	1,146
PROFIT BEFORE INCOME TAX	125,520	143,884	144,742	150,754
Less: Income tax expense	40,652	36,433	40,015	41,511
PROFIT FOR THE YEAR	84,868	107,451	104,727	109,243
Profit attributable to:				
Equity holders of the Bank	84,868	107,451	96,449	104,059
Non-controlling interests	-	-	8,278	5,184
PROFIT FOR THE YEAR	84,868	107,451	104,727	109,243
Earnings per share				
Basic earnings per ordinary share (\$)	0.17	0.22	0.20	0.22
Diluted earnings per ordinary share (\$)	0.17	0.22	0.20	0.22
Dividend per share				
Dividend per share: Gross (\$)	0.06*	0.06	0.06*	0.06

Exchange rate of US\$ 1 was Rs 182.85 as at 31st December 2018 (Rs 153.25 as at 31st December 2017)

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.

Statement of Comprehensive Income in US Dollars

For the year ended 31st December	Bank		Group	
	2018 US\$ 000	2017 US\$ 000	2018 US\$ 000	2017 US\$ 000
PROFIT FOR THE YEAR	84,868	107,451	104,727	109,243
Other comprehensive income that will not be reclassified to profit or loss in subsequent periods				
Change in fair value of investments in equity instruments designated at fair value through other comprehensive income	(6,584)	-	(6,584)	-
Remeasurement of post-employment benefit obligations	(552)	(1,859)	(421)	(1,905)
Revaluation of freehold land and buildings	15,688	19,454	40,847	27,058
Share of other comprehensive income of joint venture	-	-	6	-
Less: Tax expense relating to items that will not be reclassified to profit or loss	(4,392)	(18,925)	(21,400)	(29,142)
Total other comprehensive income that will not be reclassified to profit or loss	4,160	(1,330)	12,448	(3,989)
Other comprehensive income that will be reclassified to profit or loss in subsequent periods				
Debt instruments at fair value through other comprehensive income :				
Net losses on investments in debt instruments measured at fair value through other comprehensive income	(9,839)	-	(11,966)	-
Reclassification of net gains on derecognition of debt instruments at fair value through other comprehensive income to statement of profit or loss	-	-	(394)	-
Transfer from life policy holder reserve fund	-	-	2,278	-
Share of profits of joint ventures	-	-	363	-
Less: Tax expense relating to items that will be reclassified to profit or loss	2,755	-	2,800	-
Available-for-sale financial assets:				
Net change in fair value during the year	-	21,586	-	24,781
Transfer to life policy holder reserve fund	-	-	-	(2,704)
Net amount transferred to profit or loss (available-for-sale financial assets)	-	543	-	344
Less: Tax expense relating to items that will be reclassified to profit or loss	-	(6,046)	-	(6,090)
Share of other comprehensive income of equity accounted joint venture	-	-	-	(140)
Total other comprehensive income that will be reclassified to profit or loss	(7,084)	16,083	(6,919)	16,191
OTHER COMPREHENSIVE INCOME FOR THE YEAR, NET OF TAX	(2,924)	14,753	5,529	12,202
TOTAL COMPREHENSIVE INCOME FOR THE YEAR, NET OF TAX	81,944	122,204	110,256	121,445
Total comprehensive income attributable to:				
Equity holders of the Bank	81,944	122,204	102,003	116,048
Non-controlling interests	-	-	8,253	5,397
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	81,944	122,204	110,256	121,445

Exchange rate of US\$ 1 was Rs 182.85 as at 31st December 2018 (Rs 153.25 as at 31st December 2017)

The statement of other 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.

* Calculated on interim dividend paid and final dividend proposed, which is to be approved at the Annual General Meeting.

Statement of Financial Position in US Dollars

As at 31st December	Bank		Group	
	2018 US\$ 000	2017 US\$ 000	2018 US\$ 000	2017 US\$ 000
ASSETS				
Cash and cash equivalents	137,500	141,858	136,543	143,066
Placements with banks	18,008	20,766	46,520	63,100
Balances with Central Bank of Sri Lanka	185,436	251,947	185,436	251,947
Reverse repurchase agreements	493	-	6,392	5,038
Derivative financial instruments	24,652	4,015	24,652	4,015
Financial assets recognised through profit or loss - measured at fair value	549	786	1,446	1,739
Financial assets at amortised cost - loans and advances	4,096,521	4,170,323	4,212,540	4,278,062
Financial assets at amortised cost - debt and other instruments / Financial investments - loans and receivables	875,831	797,384	906,874	815,867
Financial assets measured at fair value through other comprehensive income /Financial investments - available for sale	379,748	622,537	415,670	663,902
Financial investments - held to maturity	-	-	-	10,216
Investment in joint venture	4,129	4,926	11,087	11,023
Investment in subsidiaries	16,501	19,689	-	-
Investment properties	1,782	2,137	6,057	7,482
Property, plant and equipment	116,513	116,837	231,978	226,003
Intangible assets and goodwill	4,953	5,321	7,536	8,077
Other assets	79,354	72,321	88,999	85,078
Total assets	5,941,970	6,230,847	6,281,730	6,574,615
LIABILITIES				
Due to banks	423,804	407,592	426,448	407,598
Derivative financial instruments	13,777	8,521	13,777	8,521
Securities sold under repurchase agreements	91,217	33,046	91,217	33,046
Financial liabilities at amortised cost - due to depositors	4,375,036	4,577,614	4,473,842	4,690,180
Dividends payable	5,441	6,365	5,521	6,440
Financial liabilities at amortised cost - other borrowings	136,145	177,866	136,145	177,866
Debt securities issued	24,543	29,626	27,509	32,861
Current tax liabilities	50,231	25,936	52,282	26,532
Deferred tax liabilities	9,893	33,166	31,893	47,695
Insurance provision - life	-	-	67,031	71,229
Insurance provision - general	-	-	13,810	15,562
Other provisions	19,469	19,679	22,322	22,293
Other liabilities	37,785	37,330	48,919	48,021
Subordinated term debts	121,575	168,413	119,936	166,816
Total liabilities	5,308,916	5,525,154	5,530,652	5,754,660
EQUITY				
Stated capital	176,855	204,953	176,855	204,953
Statutory reserve fund	34,236	35,628	34,236	35,628
Retained earnings	86,019	99,142	110,371	117,992
Other reserves	335,944	365,970	404,058	437,573
Total shareholders' equity	633,054	705,693	725,520	796,146
Non-controlling interests	-	-	25,558	23,809
Total equity	633,054	705,693	751,078	819,955
Total equity and liabilities	5,941,970	6,230,847	6,281,730	6,574,615
Contingent liabilities and commitments	4,173,991	3,904,501	4,173,991	3,904,501
Net assets value per share (\$)	1.28	1.43	1.47	1.62

Exchange rate of US\$ 1 was Rs 182.85 as at 31st December 2018 (Rs 153.25 as at 31st December 2017)

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.

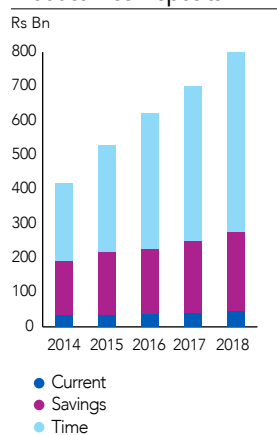
Analysis of Deposits

	2014	2015	2016	2017	2018
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Analysis of total deposits					
Local currency deposits	352,732,715	438,253,261	522,168,609	576,571,392	640,481,101
Foreign currency deposits	66,594,408	88,872,920	101,326,360	124,947,905	159,494,256
	419,327,123	527,126,181	623,494,969	701,519,297	799,975,357

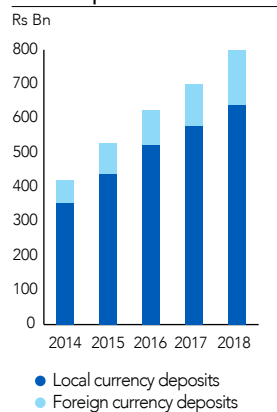
Product wise analysis of deposits

Current	32,608,645	33,958,697	36,675,800	39,167,863	44,941,127
Savings	157,946,623	184,204,894	188,845,184	209,750,730	231,640,593
Time	228,771,855	308,962,590	397,973,985	452,600,704	523,393,637
	419,327,123	527,126,181	623,494,969	701,519,297	799,975,357

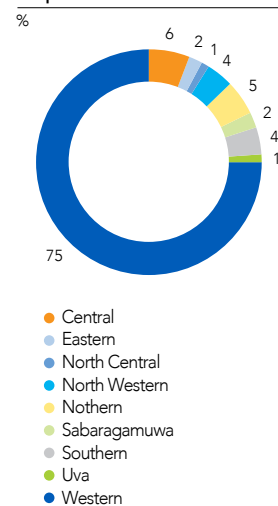
Analysis of Product-wise Deposits



Analysis of Total Deposits



Province Wise Deposits



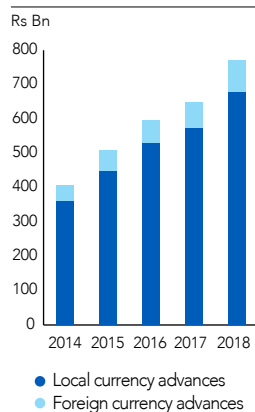
Analysis of Loans and Receivables

	2014 Rs 000	2015 Rs 000	2016 Rs 000	2017 Rs 000	2018 Rs 000
Analysis of Loans and Receivables to customers (Gross)					
Local currency advances	359,217,435	446,394,387	527,288,700	572,606,594	677,463,768
Foreign currency advances	47,714,009	63,131,080	68,225,219	76,940,473	94,228,857
Total advances (Gross)	406,931,444	509,525,467	595,513,919	649,547,067	771,692,625

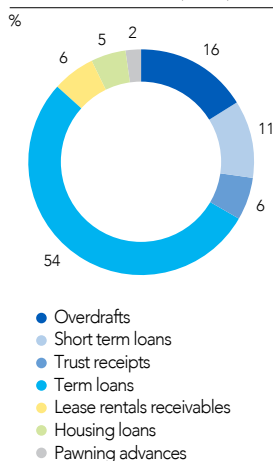
Product wise analysis of loans and receivables to customers (Gross)

Overdrafts	69,118,967	71,566,434	91,093,180	111,332,217	122,582,431
Short term loans	40,664,653	50,881,880	60,562,111	50,852,930	87,921,676
Trust receipts	17,867,491	23,669,721	24,885,713	32,738,671	49,026,148
Term loans	204,143,947	275,817,905	328,374,844	361,644,613	408,483,835
Lease rentals receivables	24,482,873	40,341,596	42,621,900	42,982,671	49,924,690
Housing loans	27,622,481	30,808,329	33,966,019	34,466,310	36,303,859
Pawning advances	23,031,032	16,439,602	14,010,152	15,529,655	17,449,986
Total	406,931,444	509,525,467	595,513,919	649,547,067	771,692,625

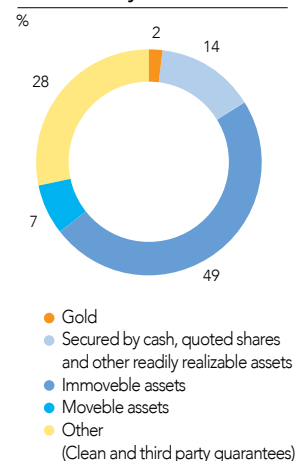
Analysis of Total Advances



Product Wise Analysis of Loans and Receivables (Gross)



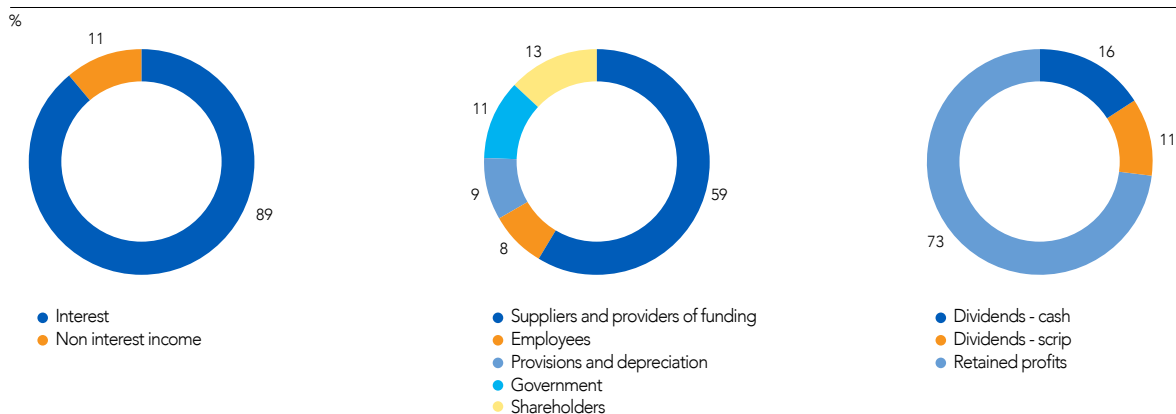
Analysis of Advances by Securities



Sources and Utilisation of Income

	2014 Rs 000	2015 Rs 000	2016 Rs 000	2017 Rs 000	2018 Rs 000
Sources of Income					
Interest	51,868,333	52,615,463	75,608,193	96,175,453	108,104,923
Non interest income	7,632,162	8,538,003	8,742,630	10,119,741	13,251,166
Total	59,500,495	61,153,466	84,350,823	106,295,194	121,356,089
Utilisation of income					
Employees					
Salaries and other payment to Staff	7,407,015	7,927,695	8,703,575	8,866,642	10,000,083
Suppliers and providers of funding					
Interest paid	26,966,826	26,279,934	41,236,605	56,526,138	60,525,342
Other expenses	6,824,410	6,967,804	8,501,199	9,419,591	10,681,770
	33,791,236	33,247,738	49,737,804	65,945,729	71,207,112
Provisions and depreciation					
Depreciation and amortisation	1,126,996	966,596	1,035,930	1,128,802	1,354,762
Impairment for loans and other losses	2,502,835	1,013,322	237,160	3,035,468	9,292,421
	3,629,831	1,979,918	1,273,090	4,164,270	10,647,183
Net Income before Government Taxes and Levies	14,672,414	17,998,115	24,636,354	27,318,553	29,501,711
Government					
Income Tax, VAT, SGT, NBT, Crop Insurance, DRL (Incl. Deferred Tax)	5,667,139	9,623,577	10,492,948	10,851,763	13,983,508
Shareholders					
Dividends - Cash	3,430,715	2,029,748	2,071,683	3,175,513	2,463,253
Retained through scrip dividend	-	1,421,200	1,451,296	977,592	1,724,277
Retained profits	5,574,559	4,923,590	10,620,427	12,313,685	11,330,673
Total	59,500,495	61,153,466	84,350,823	106,295,194	121,356,089

Sources and Utilisation of Income



Value Added Statement

	2018		2017	
	Rs 000	%	Rs 000	%
Value Added				
Income earned by providing banking services	121,138,114		107,873,629	
Cost of services	71,208,394		65,945,729	
Value added by banking services	49,929,720		41,927,900	
Non-banking income	359,018		1,920,639	
Net Gain/(loss) from trading & Financial investment	(141,043)		(3,499,074)	
Impairment for loans and other losses	(9,292,421)		(3,035,468)	
	40,855,274		37,313,997	

Value allocated to employees

Salaries, wages & other benefits	10,000,083	24.48	8,866,642	23.76
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To providers of capital

Dividends to shareholders - cash	2,463,253	6.03	3,175,514	8.51
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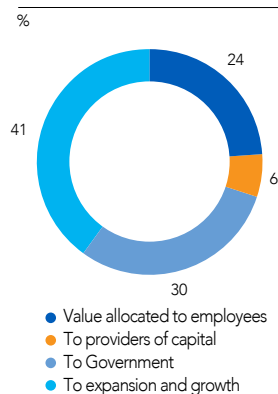
To Government

Income tax	9,916,291		4,558,951			
Value Added tax on financial services	5,003,424		4,417,660			
Debt Recovery Levy	698,721		-			
Nation building tax on financial services	667,123		603,786			
Crop insurance levy	157,000		201,630			
Local Taxes	14,835		14,838			
Stamp Duty	9,108	16,466,502	40.30	30,428	9,827,293	26.34

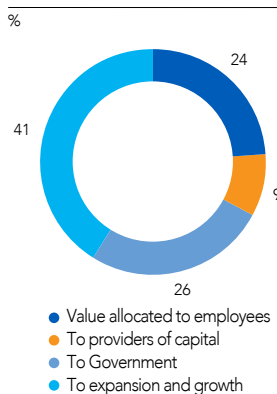
To expansion and growth

Retained income	11,330,673	27.73	12,314,169	33.00
Retained through scrip dividend	1,724,277	4.22	977,107	2.62
Depreciation & amortization	1,353,480	3.31	1,128,802	3.03
Deferred taxation	(2,482,994)	(6.08)	1,024,470	2.75
	40,855,274	100.00	37,313,997	100.00

Analysis of Value Addition 2018



Analysis of Value Addition 2017



Value Created to Stakeholders

For the year ended 31st December	2018	2017
Direct Economic value generated		
Interest Income	108,104,923	96,175,453
Fee Commission Income	9,540,862	8,415,579
Net Gain/(loss) from trading & Financial investment	(141,043)	(3,499,074)
Other operating income	3,851,347	5,203,236
Total Direct Economic value generated	121,356,089	106,295,194
Economic value distributed		
To Depositors/Debenture Holders as Interest	60,525,342	56,526,138
To Employees as Emoluments	10,000,083	8,866,642
Depreciation/ Amortisation Set Aside	1,353,480	1,128,802
Impairment charge for loans and other losses	9,292,421	3,035,468
To providers of Supplies and services	9,939,704	8,787,760
To Government as Taxation	16,466,502	9,827,293
- Income tax	9,916,291	4,558,951
- VAT and NBT on Financial Services	5,670,547	5,021,446
- Debt Recovery Levy	698,721	-
- Crop Insurance Levy	157,000	201,630
- Stamp duty and Other Local taxes	23,943	45,266
To Central Bank of Sri Lanka as Deposit insurance premium	692,980	621,468
To Shareholders as Dividends	4,187,530	4,152,621
To Community as Donation/CSR	14,258	10,363
Total Economic value distributed	112,472,300	92,956,555
Economic Value Retained	8,883,789	13,338,639

Ten Year Statistical Summary

Year ended 31st December (Rs Mn) 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018

OPERATING RESULTS

Income	38,811	34,870	37,066	51,539	61,006	59,500	61,153	84,351	106,295	121,356
Interest income	34,620	30,249	33,176	47,326	56,771	51,868	52,615	75,608	96,175	108,105
Interest expense	20,040	14,703	16,530	25,368	31,424	26,967	26,280	41,237	56,526	60,525
Non interest income	4,191	4,621	3,890	4,213	4,236	7,633	8,538	8,743	10,120	13,251
Operating expenses (Incl. financial VAT, NBT & DRL)	12,853	13,436	12,148	16,294	19,575	20,470	19,824	22,968	27,719	37,879
Profit before income tax	5,918	6,731	8,388	9,876	10,008	12,064	15,050	20,146	22,050	22,952
Income tax on profit	1,566	2,267	2,123	2,342	2,998	3,059	4,601	6,002	5,583	7,433
Profit after taxation	4,352	4,464	6,265	7,534	7,010	9,005	10,449	14,143	16,467	15,518

LIABILITIES AND SHAREHOLDERS' FUNDS

Customer deposits	210,507	239,034	291,357	341,424	387,158	419,327	527,126	623,495	701,519	799,975
Refinance borrowings	6,169	6,435	7,045	6,429	5,615	4,889	4,227	4,140	5,244	5,639
Other liabilities	38,773	42,572	42,923	50,496	66,084	87,736	128,424	154,080	134,884	163,312
Deferred tax liabilities	939	891	1,175	1,111	-	-	379	231	5,083	1,809
Shareholders' funds	23,900	30,775	37,984	46,899	51,454	60,899	65,051	77,017	108,148	115,754
Total	280,289	319,708	380,484	446,358	510,310	572,851	725,208	858,963	954,878	1,086,489

ASSETS

Loans and receivables to customers (Net)	169,639	202,253	257,198	302,761	351,965	396,277	498,342	584,413	639,102	749,049
Cash, short term funds and statutory deposits with the Central Bank of Sri Lanka	38,216	30,600	33,446	39,024	29,238	33,838	35,033	52,042	63,533	62,342
Property, plant and equipment	7,180	7,428	7,835	9,418	9,521	9,305	11,474	13,945	17,905	21,304
Deferred tax assets	-	506	314	-	768	287	-	-	-	-
Other assets	65,254	78,921	81,690	95,155	118,818	133,144	180,360	208,564	234,337	253,794
Total	280,289	319,708	380,484	446,358	510,310	572,851	725,208	858,963	954,878	1,086,489

RATIOS

Return on average shareholders funds (%)	20	16	18	18	14	16	17	20	18	14
Income growth (%)	6	(10)	6	39	18	(2)	3	38	26	14
Return on average assets (%)	1.6	1.5	1.8	1.8	1.5	1.7	1.6	1.8	1.8	1.5
Dividend cover (Times)	2.8	2.7	2.1	2.2	2.1	2.6	3.0	4.0	4.0	3.7
Property, plant and equipment to shareholders' funds (%)	30	24	21	20	19	15	18	18	17	18
Total assets to shareholders' funds (Times)	12	10	10	10	10	9	11	11	9	9
Liquid assets to liabilities (%)	29	24	22	22	23	23	24	24	24	24

SHARE INFORMATION

Market value per share (Rs)										
-Voting	170.25	399.90	151.30	148.00	147.00	194.90	210.60	225.00	249.00	214.00
-Non Voting	104.75	214.60	83.20	112.50	119.00	152.90	177.90	190.00	195.00	168.50
Earnings per share (Rs)	18.47	18.84	16.60	18.94	17.59	22.47	25.41	33.53	34.40	31.50
Earnings per share (Adjusted) (Rs) *	8.83	9.06	12.72	15.29	14.23	18.28	21.21	28.71	33.43	31.50
Price earnings ratio	9.22	21.23	9.11	7.81	8.36	8.67	8.29	6.71	7.24	6.79
Net assets per share (Adjusted) (Rs) **	48.51	62.47	77.10	95.20	104.44	123.61	132.04	156.33	219.64	234.96
Dividend per share (Rs)	6.50	7.00	7.50	8.50	8.50	8.50	8.50	8.50	8.50	8.50
Gross dividends (Rs Mn)	1,533	1,650	2,915	3,379	3,400	3,431	3,451	3,523	4,153	4,188

OTHER INFORMATION

No of employees	4,302	4,352	4,584	4,679	4,604	4,451	4,285	4,190	4,348	4,781
No of customer centres	186	205	240	247	250	249	249	251	251	250
No of student banking centres	153	159	164	166	168	168	168	150	152	155

* 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 2018

Highlighted Information is based on LKASs/SLFRSs.

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 2018 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 4,669 registered Voting Shareholders as at 31st December 2018 (2017 - 4,505) 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	2,761	643,309	0.25	41	14,461	0.01	2,802	657,770	0.17
1,001	-	10,000	1,204	3,770,577	1.49	35	117,997	0.08	1,239	3,888,574	0.98
10,001	-	100,000	467	13,850,320	5.46	23	783,153	0.56	490	14,633,473	3.71
100,001	-	1,000,000	68	17,131,282	6.76	25	10,611,603	7.53	93	27,742,885	7.03
Over		1,000,000	17	218,216,583	86.04	28	129,408,709	91.82	45	347,625,292	88.11
			4,517	253,612,071	100.00	152	140,935,923	100.00	4,669	394,547,994	100.00

ANALYSIS OF SHAREHOLDERS

Resident / Non-Resident

	31st December 2018			31st December 2017		
	No of Share holders	No of Shares	%	No of Share holders	No of Shares	%
Resident	4,517	253,612,071	64.28	4,335	247,190,674	66.26
Non-Resident	152	140,935,923	35.72	170	125,867,899	33.74
Total	4,669	394,547,994	100.00	4,505	373,058,573	100.00

Individuals / Institutions

	31st December 2018			31st December 2017		
	No of Share holders	No of Shares	%	No of Share holders	No of Shares	%
Individuals	4,343	64,760,535	16.41	4,180	63,246,273	16.95
Institutions	326	329,787,459	83.59	325	309,812,300	83.05
Total	4,669	394,547,994	100.00	4,505	373,058,573	100.00

As at 31/12/2018 the average size of holding of ordinary shareholding was 84,504 voting shares. (31/12/2017 - 82,810 voting shares)

As per the 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 2018 was 69% approximately. (64% as at 31st December 2017).

As per the rule No. 7.13.1 of the Listing Rules of the Colombo Stock Exchange, No. of shareholders, representing public holding as at 31st December 2018 - 4,648. (4,483 as at 31st December 2017).

An aggregate of 903,254 number of 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

1 SHARE INFORMATION - NON VOTING

There were 10,245 registered Non Voting Shareholders as at 31st December 2018 (2017 - 10,368) 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	6,348	2,075,665	4.05	42	13,973	0.03	6,390	2,089,638	2.15
1,001	- 10,000	3,180	9,822,504	19.15	46	164,138	0.36	3,226	9,986,642	10.27
10,001	- 100,000	534	14,145,212	27.57	17	524,903	1.14	551	14,670,115	15.09
100,001	- 1,000,000	55	15,248,380	29.73	8	2,064,733	4.50	63	17,313,113	17.81
Over	1,000,000	6	10,004,519	19.50	9	43,135,314	93.97	15	53,139,833	54.68
		10,123	51,296,280	100.00	122	45,903,061	100.00	10,245	97,199,341	100.00

2 ANALYSIS OF SHAREHOLDERS

Resident / Non-Resident

	31st December 2018			31st December 2017		
	No of Share holders	No of Shares	%	No of Share holders	No of Shares	%
Resident	10,123	51,296,280	52.77	10,235	51,712,729	53.73
Non-Resident	122	45,903,061	47.23	133	44,536,403	46.27
Total	10,245	97,199,341	100.00	10,368	96,249,132	100.00

Individuals / Institutions

	31st December 2018			31st December 2017		
	No of Share holders	No of Shares	%	No of Share holders	No of Shares	%
Individuals	9,981	32,655,031	33.60	10,093	33,291,329	34.59
Institutions	264	64,544,310	66.40	275	62,957,803	65.41
Total	10,245	97,199,341	100.00	10,368	96,249,132	100.00

As at 31/12/2018 the average size of holding of ordinary shareholding was 9,487 non-voting shares. (31/12/2017 - 9,283 non-voting shares)

As per the rule No. 7.6 (iv) of the Listing Rules of the Colombo Stock Exchange, percentage of public holding as at 31st December 2018 was 99% approximately. (99% as at 31st December 2017).

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 2018 - 10,234. (10,358 as at 31st December 2017).

3 SHARE TRADING

VOTING	2018	2017
Number of transactions	4,452	4,709
Number of shares traded (Mn)	53	27
Value of shares traded (Rs Mn)	12,339	6,608
NON VOTING	2018	2017
Number of transactions	2,923	3,302
Number of shares traded (Mn)	5	6
Value of shares traded (Rs Mn)	915	1,181

4 DIVIDENDS

	2018		2017	
1st Interim (Rs) - Cash Dividend	1.50	Paid in December 2018	1.50	Paid in December 2017
2nd Interim (Rs) - Cash Dividend	3.50	Propose to be paid in April 2019	5.00	Paid in April 2018
Final (Rs) - Scrip Dividend	3.50	Propose to be paid in April 2019	2.00	Paid in April 2018
Cash Dividend payout ratio (%)	15.87		19.28	

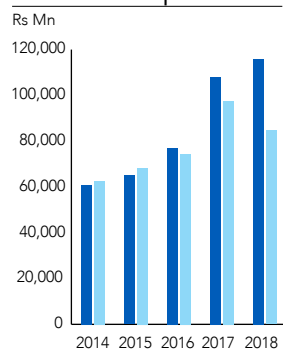
5 EARNINGS

Earnings per share (Rs)	31.50	34.40
Price earnings ratio(Times)-Voting Shares	6.79	7.24

6 MARKET VALUE

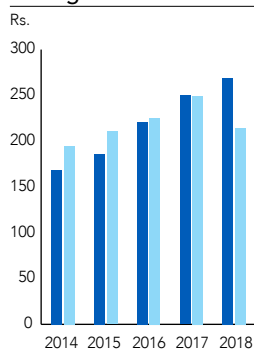
	Highest Rs.	Lowest Rs.	Year End Rs.
2014 - Voting	205.00	145.10	194.90
- Non Voting	153.20	116.60	152.90
2015 - Voting	242.00	192.00	210.60
- Non Voting	187.00	150.00	177.90
2016 - Voting	235.00	185.00	225.00
- Non Voting	202.00	165.50	190.00
2017 - Voting	271.00	220.00	249.00
- Non Voting	214.00	184.10	195.00
2018 - Voting	257.50	200.00	214.00
- Non Voting	200.00	150.00	168.50

Shareholders Funds and HNB Market Capitalisation



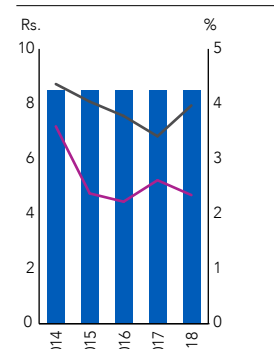
● Shareholders Funds
● HNB Market Capitalisation (Voting Shares)

Net Asset Per Share and Closing Price Per Share



● Net Asset Per Share (Group)
● Closing Price Per Share (Voting Shares)

Dividend Per Share and Dividend Yield



● Dividend Per Share
— Dividend Yield (Voting Shares)
— Cash Dividend Yield (Voting Shares)

7 MARKET CAPITALISATION (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
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
2017	108,148	97,684	2,899,290	3.37	5
2018	115,754	84,627	2,839,450	2.98	5

HNB Market Capitalization includes only Voting shares

8 PUBLIC SHAREHOLDING

	2018		2017	
	Number	%	Number	%
Number of shareholders representing the public holding (Voting)	4,648	69	4,483	64
Number of shareholders representing the public holding (Non Voting)	10,234	99	10,358	99
Compliant under Option 1 - Float Adjusted Market Capitalization (Rs. Bn)	58.4		62.5	

9 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
2017	Shares issued under ESOP		1,201,044
2017	Scrip Dividend		5,830,259
2017	Rights issue (voting @ Rs 220.00 and non voting @ Rs 190.00)	1:6	67,706,913
2018	Shares issued under ESOP		263,948
2018	Scrip Dividend		3,832,951
	Total		492,650,589

10 20 MAJOR SHAREHOLDERS (VOTING) OF THE BANK AS AT 31ST DECEMBER 2018

Name	% on total capital	% on total voting capital	No. of Shares 2018	No. of Shares 2017
1. Employees Provident Fund	7.82	9.75	38,544,738	38,259,574
2. Sri Lanka Insurance Corporation - Life Fund	6.64	8.27	32,693,132	32,451,260
3. Milford Exports (Ceylon) Limited	6.35	**7.91	31,270,422	31,039,075
4. Stassen Exports Ltd	5.50	**6.86	27,104,164	26,903,640
5. Mr.Sohli Edelji Captain	5.23	6.51	25,745,495	25,555,023
6. Sonetto Holdings Limited	3.95	4.91	19,436,026	19,292,233
7. JPMLU-Franklin Templeton Investment	3.80	4.73	18,716,484	21,428,848
8. Sri Lanka Insurance Corporation - General Fund	3.40	4.23	16,740,449	16,616,599
9. Distilleries Company of Sri Lanka PLC	2.46	**3.07	12,126,746	12,037,030
10. National Savings Bank	2.30	2.87	11,346,652	11,262,707
11. Standard Chartered Bank Singapore S/A HL Bank Singapore	1.51	1.88	7,422,269	7,367,358
12. Ms.Leesha Anne Captain	1.50	1.87	7,390,583	5,796,589
13. RBC Investor Services Bank - COELI SICAV I - Frontier Market	1.41	1.75	6,937,459	5,034,689
14. BNYM SANV-IF Ruffer Total return Fund	1.26	1.57	6,220,950	6,174,926
15. RBC Investor Services Bank - RBC Emerging Markets Small-CAP Equity Fund	1.26	1.57	6,193,418	-
16. HSBC Intl Nom Ltd-CMG First state global umbrella fun Plc-CMG First State Indian Subcontinent Fund	1.14	1.43	5,638,975	1,596,300
17. SSBT-AI Mehwar Commercial Investments LLC	1.08	1.35	5,322,971	-
18. CitiBank Newyork S/A Norges Bank Account 2	0.94	1.17	4,646,142	4,461,303
19. BNYM SA/NV Re-IF Ruffer Absolute Return Fund	0.85	1.06	4,175,684	4,144,792
20. Morgan Stanley and Co. LLC-RWC Frontier Markets Equity Master Fund	0.81	1.01	3,986,221	74,240
Sub total	59.20	73.75	291,658,980	269,496,186
* Unregistered Shares	0.18	0.23	903,254	19,245,985
Balance held by 4,649 voting shareholders (Total voting shareholders- 4,669)	20.88	26.02	102,889,014	103,562,387
Total voting shares	80.27	100.00	395,451,248	392,304,558
Shares held by 10,245 Non-voting shareholders	19.73		97,199,341	96,249,132
Total No. of Ordinary shares	100.00		492,650,589	488,553,690

* 903,254 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 17.83% 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.

11 20 MAJOR SHAREHOLDERS (NON-VOTING) OF THE BANK AS AT 31ST DECEMBER 2018

Name	% on total capital	% on total non-voting capital	No. of Shares 2018	No. of Shares 2017
1. CITI Bank Newyork S/A Norges Bank Account 2	2.05	10.39	10,094,610	8,812,130
2. UBS AG Zurich	1.75	8.86	8,616,404	8,535,961
3. JPMLU-Franklin Templeton Invest	1.42	7.21	7,010,860	6,945,406
4. BNYM SA/NV-Frontaura Global Frontier Fund LLC	1.09	5.53	5,377,000	4,408,152
5. BNYM SA/NV-Neon Liberty Lorikeet Master Fund LP	0.73	3.71	3,601,936	3,387,027
6. Akbar Brothers Pvt Ltd A/c No. 01	0.71	3.59	3,493,293	3,060,155
7. BNYM SA/NV-IF Ruffer Total Return Fund	0.63	3.20	3,112,064	3,083,010
8. BNYM SA/NV-IF Ruffer Absolute Return Fund	0.42	2.13	2,073,039	2,053,685
9. CB Europe Plc LUX S/A Dunross & Co. AB	0.41	2.08	2,018,848	2,000,000
10. Union Assurance PLC No. 1 A/c	0.31	1.56	1,516,004	1,501,851
11. Mr. Sohli Edelji Captain	0.31	1.55	1,505,120	1,491,069
12. Rubber Investment Trust Limited A/c # 01	0.27	1.36	1,318,708	1,403,493
13. BNYM SANV Re-IF Ruffer Investment Funds:IF Ruffer Pacific Fund	0.25	1.27	1,230,553	1,219,065
14. Employees Trust Fund Board	0.23	1.17	1,137,429	900,766
15. Deutsche Bank AG as Trustee for JB Vantage Value Equity Fund	0.21	1.06	1,033,965	1,024,312
16. Union Assurance PLC A/c No. 5 (Unit-linked life insurance fund-equity fund)	0.20	1.00	976,802	967,683
17. Hatton National Bank PLC A/c No. 2	0.14	0.72	699,464	692,934
18. Saboor Chatoor (Pvt) Ltd	0.13	0.68	658,500	652,000
19. JPMCB-Templeton Global Investment Trust-Templeton Frontier Markets Fund	0.13	0.66	639,704	633,732
20. The Ceylon Investment PLC A/c No. 2	0.12	0.60	580,065	727,884
Sub total	11.51	58.33	56,694,368	53,500,315
Balance held by 10,225 Non-voting shareholders (Total Non-voting shareholders-10,245)	8.22	41.67	40,504,973	42,748,817
Total Non-voting shares	19.73	100.00	97,199,341	96,249,132
Shares held by 4,669 voting shareholders	80.09		394,547,994	373,058,573
* Unregistered voting Shares	0.18		903,254	19,245,985
Total voting shares	80.27		395,451,248	392,304,558
Total No. of Ordinary shares	100.00		492,650,589	488,553,690

* 903,254 aggregate of 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 2018

These debentures have not traded during the year ended 31st December 2018

ii) Interest Rate

12 months ended 31st December

	2018				2017			
	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)	406,901	-	11.00	11.31	366,598	-	11.00	10.78
18 year Fixed Rate (11.25% p.a.) (Zero Coupon)	778,998	-	11.25	11.59	700,268	-	11.25	11.15

HNB SUBORDINATED DEBENTURES 2007

i) Market Value

12 months ended 31st December 2018

These debentures have not traded during the year ended 31st December 2018

ii) Interest Rate

12 months ended 31st December

	2018				2017			
	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 (16.75% p.a.)	758,625	16.75	16.75	11.51	758,625	16.75	16.75	11.02

HNB SUBORDINATED DEBENTURES 2011

i) Market Value

12 months ended 31st December 2018

These debentures have not traded during the year ended 31st December 2018

ii) Interest Rate

12 months ended 31st December

	2018				2017			
	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.)	2,000,000	11.50	11.83	11.35	2,115,945	11.50	11.83	10.78

Investor Relations

HNB SENIOR DEBENTURES 2013

i) Market Value

12 months ended 31st December 2018

These debentures have not traded during the year ended 31st December 2018

ii) Interest Rate

12 months ended 31st December

	2018				2017			
	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.)	1,646,483	8.00	14.25	11.51	1,587,729	8.00	14.25	10.03

HNB SENIOR DEBENTURES 2014

i) Market Value

12 months ended 31st December 2018

These debentures have not traded during the year ended 31st December 2018

ii) Interest Rate

12 months ended 31st December

	2018				2017			
	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 %
05 year Fixed Rate (7.75% p.a.)	2,757,240	7.75	7.90	11.01	2,864,961	7.75	7.90	9.26
10 year Fixed Rate (8.33% p.a.)	84,040	8.33	8.50	11.60	87,569	8.33	8.50	10.04

HNB SUBORDINATED DEBENTURES 2016 - March

i) Market Value

12 months ended 31st December 2018

	Market Value			Traded Yield		
	Highest Rs.	Lowest Rs	Last Traded Rs	Highest %	Lowest %	Last Traded %
5 year Fixed Rate (11.25% p.a.)	100.00	92.32	98.00	15.17	11.19	12.26

ii) Interest Rate

12 months ended 31st December

	2018				2017			
	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	11.31	7,599,795	11.25	11.25	9.71

HNB SUBORDINATED DEBENTURES 2016 - November

i) Market Value

12 months ended 31st December 2018

	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	100.00	100.00	12.99	12.95	12.99

5 year debentures have not traded during the year ended 31st December 2018

ii) Interest Rate

12 months ended 31st December

	2018				2017			
	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	11.49	2,039,274	11.75	11.75	9.75
7 year Fixed Rate (13.00% p.a.)	4,086,904	13.00	13.00	11.54	4,086,904	13.00	13.00	10.03

Note: HNB Senior Debenture information is listed under Debt Securities issued, Note 47 of the Financial Position.

Note: HNB Debenture information is listed under Subordinated Term Debts, Note 48 of the Financial Position.

Ratios	2018	2017
Debt to Equity Ratio (%) *	78.38	90.84
Interest Cover (Times) **	4.71	4.46
Liquidity Asset Ratio (LAR) (%)	24.40	24.06

* Debt includes Borrowings and Debentures

** Includes interest paid on Borrowings and Debentures

Independent Assurance Statement

DNV·GL

SCOPE AND APPROACH

DNV GL represented by DNV GL Business Assurance India Private Limited ('DNV GL') was engaged by Hatton National Bank PLC ('HNB' or 'the Bank', Company Registration Number PQ 82 previously PBS 613) to undertake an independent assurance of the Company's Annual Report 2018 ('the Report') in its printed format. The Report is prepared based on the International <IR> Framework ('<IR>') of the International Integrated Reporting Council ('IIRC') that is, the Guiding Principles and Content Elements. The Report uses disclosures selected from the Global Reporting Initiative's (GRI's) Sustainability Reporting Standards (GRI Standards) to bring out the various Content Elements of <IR>. The intended user of this Assurance Statement is the management of the Company. Our assurance engagement was planned and carried out in January 2019 – February 2019, for the financial year ending 31st December 2018.

We performed our work using AccountAbility's AA1000 Assurance Standard 2008 (AA1000AS) with 2018 Addendum and DNV GL's assurance methodology VeriSustainTM^[1], which is based on our professional experience, international assurance best practices including International Standard on Assurance Engagements 3000 (ISAE 3000) Revised* and the GRI reporting principles on Content and Quality.

We planned and performed our work to obtain the evidence we considered necessary to provide a basis for our assurance opinion for providing a Type 2 Moderate Level of assurance based on AA1000 AS. In doing so, we evaluated the qualitative and quantitative disclosures presented in the Report using the <IR> principles, together with HNB's protocols for how the data was measured, recorded and reported. The performance data in the agreed scope of work included the qualitative and quantitative information on non-financial performance which were disclosed in the Report prepared by HNB based on GRI Standards for the identified material topics covering economic, environmental and social performance for the activities undertaken by the Company over the reporting period 1st January 2018 to 31st December 2018.

The reporting topic boundaries of non-financial performance is based on the internal and external materiality assessment covering HNB's operations in Sri Lanka and is as set out in the Report in the section "About the Report".

We understand that the reported data on economic performance, and other financial data within the Report are based on financial disclosures and data which has been subjected to a separate independent statutory audit process and is not included in our scope of work.

RESPONSIBILITIES OF THE MANAGEMENT OF HNB AND OF THE ASSURANCE PROVIDER

The Management team of the Company have the sole accountability for the preparation of the Report and are responsible for all information disclosed in the Report as well as the processes for collecting, analysing and reporting the information presented in the Report. In performing assurance work, our responsibility is to the management of HNB; however, statement represents our independent opinion and is intended to inform the outcome of our assurance to the stakeholders of HNB.

DNV GL provides a range of other services to HNB, none of which constitute a conflict of interest with this assurance work. DNV GL was not involved in the preparation of any statement or data included in the Report except for this Assurance Statement and Management report highlighting our assessment findings for future reporting.

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 and free from any misstatements. 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 Head Office at Colombo, Sri Lanka and visited six operational branches of the Bank. We adopted a risk based approach, i.e. we concentrated our verification efforts on the issues of high material relevance to Company's power transmission and trading business, and its key stakeholders. We undertook the following activities:

- Reviewed the Company's approach to addressing the Guiding Principles and Content Elements of the <IR> Framework, including stakeholder engagement and its materiality determination process;
- Verified the value creation disclosures related to the six capitals and claims made in the Report, and assessed the robustness of the data management system, data accuracy, information flow and controls for the reported disclosures;
- Examined and reviewed documents, data and other information made available by the Company related to disclosures;

^[1] The VeriSustain protocol is available on www.dnvgl.com

* Assurance Engagements other than Audits or Reviews of Historical Financial Information.

- Conducted in-person interviews with top and senior management team of Company and other representatives, including data owners and decision-makers from different divisions and functions of the Company to validate the disclosures. We were free to choose interviewees and interviewed those with overall responsibility to deliver the Company's sustainability objectives;
- Site visits to HNB's Head Office and six branches at Matara, Galle, Hikkaduwa, Boralesgamuwa, Piliyandala and Moratumulla, to review processes and systems for preparing site level sustainability data and implementation of sustainability strategy. We were free to choose sites we visited;
- Performed sample-based reviews of the mechanisms for implementing the Company's sustainability related policies, as described in the Report;
- Performed sample-based checks of the processes for generating, gathering and managing the quantitative data and qualitative information included in the Report based on the selected GRI Standards.

During the assurance process, we did not come across limitations to the scope of the agreed assurance engagement.

OPINION AND OBSERVATIONS

On the basis of the verification undertaken, nothing has come to our attention that causes us to believe that the Report does not properly describe HNB's adherence to the criteria of reporting (Guiding Principles and Content Elements) related to the <IR> framework, representation of the material topics, business model, disclosures on value creation through six capitals, related strategies and management approach and chosen topic-specific disclosures from the GRI Standards for identified material topics. Without affecting our assurance opinion, we also provide the following observations.

AA1000 ACCOUNTABILITY PRINCIPLES STANDARD (2018)

Inclusivity

The participation of stakeholders in developing and achieving an accountable and strategic response to Sustainability

The Report identifies investors, customers, employees, business partners, government and the community as HNB's significant stakeholders. Stakeholder concerns are responded to within the Report, through explanations of the value delivered to the key stakeholders. The outcomes from the stakeholder engagement exercise are used as an input for the Bank's materiality determination process, strategic planning and in understanding

areas for allocating the Bank's resources towards enhancing the value of its identified capitals. Nothing has come to our attention to suggest that the Report does not meet the requirements related to the Principle of Inclusivity.

Materiality

The process of determining the issues that is most relevant to an organization and its stakeholders

The Report describes the Bank's process of materiality assessment and identifying material issues. The materiality of topics identified by the Bank through the five-part materiality test in 2017 were reviewed using based on inputs such as global and peer issues, and operating context, and twelve material topics were prioritized and identified for reporting. Nothing has come to our attention to suggest that the Report does not meet the requirements related to the Principle of Materiality.

Responsiveness

The extent to which an organization responds to stakeholder issues

The Company has established formal and informal processes to respond to stakeholder concerns and feedback. These processes have been established both. The Report fairly brings out the strategies and management approach related to identified key material topics, as well as disclosures including business model, policies, management systems and governance mechanism. Nothing has come to our attention to suggest that the Report does not meet the requirements related to the Principle of Responsiveness.

Impact

The level to which an organisation monitors, measures and is accountable for how its actions affect its broader ecosystems

HNB has processes in place for monitoring and measuring the effects of its performance on the environment, society, and key stakeholders. The Report adequately describes how various impacts due to the identified material topics create and change value for the Bank and its key stakeholders through appropriate performance metrics and information. Nothing has come to our attention to suggest that the Report does not meet the requirements related to the Principle of Impact.

Specific Evaluation of the Information on Sustainability Performance

We consider the methodology and process for gathering information developed by HNB 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; personnel responsible could demonstrate the origin and interpretation of the data and its reliability. Nothing has come to our attention to suggest that the Report does not present a faithful description of the reported non-financial disclosures for the reporting period.

Reliability

The accuracy and comparability of information presented in the report, as well as the quality of underlying data management systems

The Report has disclosed HNB's non-financial performance using selected GRI Topic Specific Standards for the identified qualitative and quantitative disclosures. The majority of data and information verified at the Head Office and sampled sites were found to be accurate. Some of the data inaccuracies identified during the verification process were found to be attributable to transcription, interpretation and aggregation errors. These identified errors were communicated and subsequently corrections made in the reported data and information. Nothing has come to our attention to suggest that the Report does not meet the requirements related to the Principle of Reliability.

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 brought out the disclosure requirements of <IR> including the value creation through six capitals, business model, strategy, management approach, monitoring systems and sustainability performance indicators considering the scope and boundary of its reporting, covering the Bank's operations in Sri Lanka. Nothing has come to our attention to suggest that the Report does not meet the requirements related to the Principle of Completeness.

Neutrality

The extent to which a report provides a balanced account of an organization's performance, delivered in a neutral tone

The Report discloses non-financial issues, challenges and performance in a fairly neutral tone, in terms of content and presentation, and had also considered the sustainability context and external environment in bringing out its value creation perspective on six capitals during the reporting period. Nothing has come to our attention to suggest that the Report does not meet the requirements related to the Principle of Neutrality.

For and on behalf of DNV GL AS
Bengaluru, India
20th February 2019



KIRAN RADHAKRISHNAN
Lead Verifier,
DNV GL Business Assurance India
Private Limited, India.



NANDKUMAR VADAKEPATTH
Assurance Reviewer,
Head - Regional Sustainability Operations,
DNV GL Business Assurance India Private
Limited, India



AA1000
Licensed Assurance Provider
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DNV GL Business Assurance India Private Limited is part of DNV GL – Business Assurance, a global provider of certification, verification, assessment and training services, helping customers to build sustainable business performance. www.dnvgl.com

Annexure

APPLICATION OF <IR> GUIDING PRINCIPLES

This report is prepared in accordance with the Integrated reporting Framework and has applied the following guiding principles:

IR Guiding Principle	How we have complied
Strategic focus and future orientation	<p>The strategic focus and future orientation is derived by the management team considering inputs from diverse sources including our risk management process and evaluation of external environment.</p> <p>Our Bank strategy related to key material topics are presented on page 36 and our future plans are given in all business line reviews and the Chairman's and Managing Director/CEO's messages on pages 10 and 14 respectively.</p>
Connectivity of information	<p>We have provided links to other reports for additional and supporting information related to identified material topics. The Business Model on page 34 provides an overview of our business operations and interactions between capitals, business lines, risks and opportunities and value delivered to stakeholders.</p>
Stakeholder relationships	<p>We have a process of stakeholder identification and engagement and details of stakeholder engagement and relationship management is discussed and signposted on page 38.</p>
Materiality	<p>The process for determining materiality is based on identifying relevant matters and evaluating importance based in <IR> framework and is described on page 39.</p>
Conciseness	<p>We have made every effort to present relevant material information, including organisational context, strategy, governance, performance and prospects in a concise and effective manner.</p>
Reliability & Completeness	<p>We have established an internal and external process of evaluating our nonfinancial disclosures Further external auditors have provided assurance on financial statements as given page 133., and non-financial disclosures related to the integrated reporting framework has been assured by DNV GL and their Independent assurance statement is given on page 135.</p>
Consistency & Comparability	<p>We have provided possible comparable information on a consistent basis for the benefit of stakeholders to understand our performance trends. Where there has been a departure in computation or measurement criteria or restatements, same has been indicated in the relevant segment.</p>

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.

ACCRUAL 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 uncollectability.

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.

COMPREHENSIVE INCOME

The change in equity of a business enterprise during a period from non-owner sources. This includes all changes in equity during a period except those resulting from investments by owners and distributions to the owners. Comprehensive income equals net income plus other comprehensive income.

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 system of internal controls and procedures 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.

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.

DEMINIMIS

Features that could impact the cash flows of a financial asset by a de minimis amount both on a period by period basis and cumulatively.

DEPRECIATION

The process of systematically allocating the cost of long - lived (tangible) assets to the periods during which the assets are expected to provide economic benefits.

DILUTED EARNINGS PER SHARE

The earnings per share that would result if all dilutive securities were converted into common shares.

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.

DIVIDEND PAYOUT RATIO

It is the percentage of earnings paid to shareholders in dividends.

DOCUMENTARY LETTERS OF CREDIT

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.

Glossary of Financial / Banking Terms

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

The first date that a share trades without the (i.e. "ex") dividend

EXERCISE PRICE

The fixed price at which an option holder can buy or sell the underlying.

EXPECTED CREDIT LOSSES (ECL)

Expected credit losses are a probability – weighted estimate of credit losses over the expected life of the financial instrument.

12 MONTH EXPECTED CREDIT LOSSES (12mECL)

The portion of life time expected credit losses that represent the expected credit losses resulting from default events of a financial instrument that are possible within 12 months after the reporting date.

EXPOSURE AT DEFAULT (EAD)

Gross carrying amount of financial instruments subject to impairment calculation.

F

FAIR VALUE

The amount at which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transactions. It is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants.

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.

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.

FORWARD-LOOKING INFORMATION

Incorporation of macroeconomic scenarios into the impairment calculations.

G

GOODWILL

An intangible asset that represents the excess of the purchase price of an acquired company over the value of the net assets acquired.

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 of unfavourable price movements (interest rate, foreign exchange rate, commodity prices, etc.). A hypothetical combination of the derivative and its underlying that eliminates risk.

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.

LIFE TIME EXPECTED CREDIT LOSSES (LtECL)

The expected credit losses that result from all possible default events over the expected life of a financial instrument.

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.

Glossary of Financial / Banking Terms

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.

NON – GENUINE

A cash flow characteristic that affects the instrument's contractual cash flows only on the occurrence of an event that is extremely rare, highly abnormal and very unlikely to occur.

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 benefits 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)

A profitability ratio calculated as 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.

SOLELY PAYMENTS OF PRINCIPAL AND INTEREST TEST (SPPI)-

Classification decision for non- equity financial assets under SLFRS 9.

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 cost 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 | <ul style="list-style-type: none"> • Kundasale • Kurunduwatte • Nawalapitiya • Peradeniya • Pilimathalawa • Rikillagaskada | Nuwara Eliya - 08 |
| <ul style="list-style-type: none"> • Akurana • Digana • Galaha • Gampola • Geliyoa • Kandy • Kandy City Centre (Extension Office) • Katugastota | <ul style="list-style-type: none"> • Bogawanthalawa • Ginigathhena • Hatton • Maskeliya • Nuwara Eliya • Pussellawa • Ragala • Thalawakele | |
| | Matale - 03 | |
| | <ul style="list-style-type: none"> • Dambulla • Galewela • Matale | |

EASTERN PROVINCE - 25

- | | | |
|--|--|---|
| Ampara - 11 | <ul style="list-style-type: none"> • Thirukkovil • Uhana | Trincomalee - 09 |
| <ul style="list-style-type: none"> • Akkaraipattu • Ampara • Dehiattakandiya • Kalmunai • Karaithivu • Ninthavur • Pottuvil • Samanthurai • Thandavenvely | Batticaloa - 05 | <ul style="list-style-type: none"> • Kantale • Kinniya • Marathamunai • Mullipathana • Muttur • Trinco Metro • Serunuwara • Trincomalee • Uppuveli |
| | <ul style="list-style-type: none"> • Batticaloa • Eravur • Valachchenai • Kaluwanchikudy • Kattankudy | |

NORTHERN PROVINCE - 21

- | | | |
|---|--|--|
| Jaffna - 12 | <ul style="list-style-type: none"> • Point Pedro • Thirunelvely | Mullaitivu - 02 |
| <ul style="list-style-type: none"> • Atchchuveli • Chankanai • Chavakachcheri • Chunnakam • Jaffna • Jaffna Metro • Kaithady • Kodikamam • Manipay • Nelliady | Kilinochchi - 02 | <ul style="list-style-type: none"> • Mullaitivu • Mulliyawalai |
| | <ul style="list-style-type: none"> • Kilinochchi North • Kilinochchi South | Vavuniya - 02 |
| | Mannar - 03 | <ul style="list-style-type: none"> • Kurumankadu • Vavuniya |
| | <ul style="list-style-type: none"> • Mannar • Mallavi • Nanattan | |

SOUTHERN PROVINCE - 25

- | | | |
|--|---|--|
| Galle - 09 | Hambantota - 8 | Matara - 08 |
| <ul style="list-style-type: none"> • Ambalangoda • Batapola • Elpitiya • Galle • Hikkaduwa • Karapitiya • Koggala • Pitigala • Yakkalamulla | <ul style="list-style-type: none"> • Ambalantota • Angunakolapelessa • Hambantota • Middeniya • Sooriyawewa • Tangalle • Tissamaharama • Walasmulla | <ul style="list-style-type: none"> • Akuressa • Deniyaya • Devinuwara • Dickwella • Hakmana • Matara • Urubokka • Weligama |

NORTH CENTRAL PROVINCE - 10

- | | |
|--|---|
| Anuradhapura - 07 | Polonnaruwa - 03 |
| <ul style="list-style-type: none"> • Anuradhapura • Anuradhapura Metro • Kekirawa • Medawachchiya • Nochchiyagama • Padavi • Parakramapura • Thambuttegama | <ul style="list-style-type: none"> • Aralaganwila • Medirigiriya • Polonnaruwa |

NORTH WESTERN PROVINCE - 18

- | | | |
|---|--|--|
| Kurunegala - 09 | <ul style="list-style-type: none"> • Wariyapola | <ul style="list-style-type: none"> • Udappuwa • Wennappuwa |
| <ul style="list-style-type: none"> • Alawwa • Galgamuwa • Giriulla • Hettipola • Kuliypitiya • Kurunegala • Kurunegala Metro • Nikaweratiya | Puttalam - 09 | |
| | <ul style="list-style-type: none"> • Anamaduwana • Chilaw • Dankotuwa • Madampe • Marawila • Norochchole • Puttalam | |

SABARAGAMUWA PROVINCE - 11

- | | | |
|---|--|---|
| Kegalle - 04 | Ratnapura - 07 | <ul style="list-style-type: none"> • Ratnapura |
| <ul style="list-style-type: none"> • Mawanella • Kegalle • Pinnawala • Warakapola | <ul style="list-style-type: none"> • Balangoda • Embilipitiya • Godakawela • Kahawatta • Kalawana • Pelmadulla | |

UVA PROVINCE - 12

- | | |
|--|--|
| Badulla - 06 | Monaragala - 06 |
| <ul style="list-style-type: none"> • Badulla • Bandarawela • Haputale • Mahiyanganaya • Passara • Welimada | <ul style="list-style-type: none"> • Buttala • Bibile • Kataragama • Monaragala • Siyambalanduwa • Wellawaya |

WESTERN PROVINCE - 103**Colombo - 65**

- Aluthkade
- Asiri Surgical Hospital (Pay Office)
- Athurugiriya
- Avissawella
- Bambalapitiya
- Boralesgamuwa
- Borella
- Cinnamon Gardens
- City Office
- Dehiwela
- Dematagoda
- Grandpass
- Greenpath
- Hanwella
- 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)
- Lanka Hospital PLC (Pay Office)
- Kirindiwela
- Kochchikade
- Marandagahamula
- Minuwangoda
- Mirigama
- Negombo
- Negombo Metro
- Nittambuwa
- Pamunugama
- Pugoda
- Ragama
- Seeduwa
- Sri Lankan Airlines (Pay Office)
- Veyangoda
- Wattala
- Weliweriya
- Yakkala

Gampaha - 29

- Airport Departure Counter (Pay Office)
- Biyagama
- Delgoda
- Divulapitiya
- Ekala
- Gampaha
- Ganemulla
- Hendala
- Ja-Ela
- Kadawatha
- Kandana
- Katunayake

Kalutara - 09

- Aluthgama
- Bandaragama
- Beruwala
- Horana
- Ingiriya
- Kalutara
- Mathugama
- Panadura
- Wadduwa

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 - HBLILKX

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. (changed)

BOARD OF DIRECTORS

Mr Dinesh Weerakkody
(Chairman)

Mr Jonathan Alles
(Managing Director / CEO)

Ms M A R C Cooray

Dr L R Karunaratne

Mr Sujeewa Mudalige

Mr R S Captain
(Alternate Director - Mr P R Saldin)

Mr Amal Cabraal

Mr Palitha Pelpola

Mr D Soosaipillai

Mr A N de Silva

Mr Damien Fernando

Mr Madu Ratnayake

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)

Mr Amal Cabraal

Mr A N de Silva

Mr Rusi Captain

Mr D Soosaipillai

Mr Damien Fernando

NOMINATION COMMITTEE

Mr Dinesh Weerakkody (Chairman)

Ms M A R C Cooray

Mr R S Captain

Mr Palitha Pelpola

HR & REMUNERATION COMMITTEE

Mr Dinesh Weerakkody (Chairman)

Mr Sujeewa Mudalige

Mr Amal Cabraal

Dr Rohan Karunaratne

BOARD INTEGRATED RISK MANAGEMENT COMMITTEE

Ms M A R C Cooray (Chairperson)

Mr D Soosaipillai

Mr Madu Ratnayake

Mr Jonathan Alles
- Managing Director/CEO

Mr Damith Pallewatte
- Chief Risk Officer/ AGM (Risk) / Chief
Information Security 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 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,
Colombo 10, Sri Lanka.

Telephone : +94 11 2661178

Fax : +94 11 2662815

e-mail : investor.relations@hnb.lk

Notice of Meeting

Notice is hereby given that the Fiftieth (50th) Annual General Meeting of Hatton National Bank PLC (the "Bank") is convened on Friday, the Twenty Ninth (29th) day of March 2019 at the Auditorium on Level 22 of "HNB Towers" at No. 479, T.B. Jayah Mawatha, Colombo 10, at 11.00 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 2018 and the Auditor's Report thereon.
- ii. To declare a final dividend as recommended by the Board of Directors, 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 3,448,554,123/- be paid on the issued and fully paid ordinary voting shares and ordinary non-voting shares of the Bank for the financial year ended 31st December 2018 based on the issued ordinary voting shares and ordinary non-voting shares as at February 21st, 2019;
- (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 fourteen per centum (14%).
- (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 20th, 2019 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 pursuant to any changes to the applicable law:
 - i. By way of cash distribution:
 - A cash distribution (A) a sum of Rs 1,384,079,368/- be made to the holders of ordinary voting shares and (B) a sum of Rs 340,197,693.50 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 shares (less Withholding Tax).
 - ii. By way of the allotment of and issue of new shares:
 - A. For voting shares:

A sum of Rs 1,384,079,368/- (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 5,892,615 ordinary voting shares computed on the basis of one (1) ordinary voting share for every 67.1096360444 ordinary voting shares currently in issue (which computation is based on a valuation of Rs. 202/- per each ordinary voting share).
 - B. For non-voting shares:

A sum of Rs 340,197,693.50 (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 1,863,503 ordinary non-voting shares computed on the basis of one (1) ordinary non-voting share for every 52.1594765342 non-voting shares currently in issue (which computation is based on a valuation of Rs 157/- per each ordinary non-voting share).
- (e) THAT the shares arising from the aggregation of the residual fractions consequent to the scrip dividend be issued to and disposed of in the market by the trustees to be nominated by the Board of Directors and the proceeds to be distributed for charitable purposes as may be approved by the Board of Directors.
- (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.

Notice of Meeting

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 A SCRIP DIVIDEND

IT IS HEREBY RESOLVED THAT the issue by the Bank of (a) 5,892,615 ordinary voting shares to the holders of ordinary voting shares on the basis of one (1) ordinary voting share for every 67.1096360444 ordinary voting shares currently in issue and (b) 1,863,503 ordinary non-voting shares to the holders of ordinary non-voting shares on the basis of one (1) ordinary non-voting share for every 52.1594765342 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 pursuant to any changes to the applicable law) with the shares arising from the aggregation of the residual fractions consequent to the scrip dividend being issued to and disposed of in the market by the trustees to be nominated by the Board of Directors and the proceeds from such disposal being distributed to charitable purposes, be and is hereby approved.

- iii. To re-elect Lokuwithanage Rohan Karunaratne, 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 Rusi Sohli 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 Appu Hennadige Don Anthony Nilanthe de Silva 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-elect Mr Lintotage Udaya Damien Fernando as a Director of the Bank in terms of Article 36 of the Articles of Association of the Bank.
- vii. To re-elect Mr Wanniarachchi Mudiyanseelage Madura Duminda Ratnayake, as a Director of the Bank in terms of Article 36 of the Articles of Association of the Bank.
- viii. 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.
- ix. To authorize the Directors to determine payments for the year 2019 for charitable and other purposes.
- x. To consider and amend Articles 34 and 43(i)(a) of the Articles of Association of the Bank, (if thought fit) but subject to the approval by the Central Bank of Sri Lanka, by adopting the special resolutions as given below:

Special Resolution (a)

That Article 34(ii) and (iii) of the Articles of Association be amended by replacing same with the following Articles:

"34(ii) Subject to the provisions of the Statutes, one-third (1/3rd) of the Directors for the time being or, if their number is not a multiple of three (3), the number nearest to, but not greater than one-third (1/3rd), shall retire from office at each annual general meeting. A Director retiring at a meeting shall retain office until the close of the meeting including any adjournment thereof. Provided however that a Director who has not completed three (3) years in office from the date of his election or appointment at a general meeting shall not be required to retire from office by rotation in terms of this Article 34.

(iii) The Directors who retire at each annual general meeting shall as far as practicable be those who have been longest in office since their last election or appointment at a general meeting, but (i) as between persons who were last elected or appointed as Directors at the same general meeting, the Directors who retire shall be those who have been longest in office continuously since they were originally appointed as Directors (either by an ordinary resolution at a general meeting or by the Board in terms of Article 36) and (ii) as between persons who were originally appointed as Directors on the same day as aforesaid, the Directors who retire shall, unless they otherwise agree among themselves, be determined by lot. A retiring Director shall be eligible for re-election".

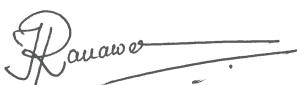
Special Resolution (b)

That Article 43(i)(a) of the Articles of Association be amended by replacing same with the following Article:

43 (i) The Board may approve;

- (a) the payment of any remuneration or provision of any other benefits by the Company to a Non-Executive Director for services as a Non-Executive Director or for services rendered to the Company in any other capacity;

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.
20th February 2019

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.

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**

1. 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.
2. 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.
3. 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.
4. 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.
5. 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.
6. If a poll is taken, votes shall be counted according to the votes attached to the shares of each shareholder present and voting.
7. 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.
8. 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

Dinesh Stephen Weerakkody or failing him/her, or failing him, Antonio Jonathan Alles or failing him, Lokuwithanage Rohan Karunaratne or failing him, Don Tiburtius Sujeeva Handapangoda Mudalige or failing him, 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 or failing him, Lintotage Udaya Damien Fernando or failing him Wanniarachchi Mudiyanseleage Madura Duminda Ratnayake as *my/our proxy, to attend, vote and speak on *my/our behalf represent *me/us at the Fiftieth (50th) 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 Twenty Ninth (29th) day of March, 2019 at 11.00 in the forenoon and at any adjournment thereof.

*I/we the undersigned hereby authorize *my/our proxy to vote on *my/our behalf in accordance with the preference** indicated below:

(i)	To declare the recommended dividend of Rs. 7/- per share as the final dividend for 2018 and	In favour	<input type="checkbox"/>
		Against	<input type="checkbox"/>
(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 a scrip dividend	In favour	<input type="checkbox"/>
		Against	<input type="checkbox"/>
(ii)	To re-elect Lokuwithanage Rohan Karunaratne as a Director of the Bank	In favour	<input type="checkbox"/>
		Against	<input type="checkbox"/>
(iii)	To re-elect Mr. Rusi Sohli Captain as a Director of the Bank	In favour	<input type="checkbox"/>
		Against	<input type="checkbox"/>
(iv)	To re-elect Mr. Appu Hennadige Don Anthony Nilanth de Silva as a Director of the Bank	In favour	<input type="checkbox"/>
		Against	<input type="checkbox"/>
(v)	To re-elect Mr. Lintotage Udaya Damien Fernando as a Director of the Bank	In favour	<input type="checkbox"/>
		Against	<input type="checkbox"/>
(vi)	To re-elect Mr. Wanniarachchi Mudiyanseleage Madura Duminda Ratnayake as a Director of the Bank	In favour	<input type="checkbox"/>
		Against	<input type="checkbox"/>
(vii)	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"/>
(viii)	To authorize the Directors to determine payments for charitable and other purposes	In favour	<input type="checkbox"/>
		Against	<input type="checkbox"/>
(ix)	(a) To adopt Special Resolution (a) - amendment to Article 34 (ii) and (iii) of the Articles of Association of the Bank	In favour	<input type="checkbox"/>
		Against	<input type="checkbox"/>
	(b) To adopt Special Resolution (b) - amendment to Article 43 (i) (a) of the Articles of Association of the Bank	In favour	<input type="checkbox"/>
		Against	<input type="checkbox"/>

* Delete inappropriate words

** Mark your preference with "✓" or "X"

Signed this day 2019.

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) :

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, Dinesh Stephen Weerakkody or failing him/her, or failing him, Antonio Jonathan Alles or failing him, Lokuwithanage Rohan Karunaratne or failing him, Don Tiburtius Sujeewa Handapangoda Mudalige or failing him, 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 or failing him, Lintotage Udaya Damien Fernando or failing him Wanniarachchi Mudiyanseelage Madura Duminda Ratnayake as *my/our proxy, to attend, vote and speak on *my/our behalf represent *me/us at the Fiftieth (50th) 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 Twenty Ninth (29th) day of March, 2019 at 11.00 in the forenoon and at any adjournment thereof.

* Delete inappropriate words

Signed this day 2019.

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.

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, Colombo 10.
 Sri Lanka
 Email : investor.relations@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

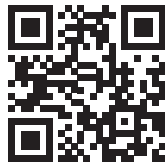
Please tick "✓" the appropriate box

	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"/>

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